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A Northeast Dairy Compact Post Mortem

by

Ronald W. Cotterill

Food Marketing Policy Center
University of Connecticut

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Tel (860) 486-1927
Fax (860) 486-2461

email: *fmpc@uconn.edu*
http://www.are.uconn.edu/fmktc.html

Food Marketing Policy Center, Department of Agricultural and Resource Economics, University of Connecticut, 1376 Storrs Road, Unit 4021, Storrs, CT 06269-4021

A Northeast Dairy Compact Post Mortem

Presented at New York State Assembly
Agriculture Committee Roundtable Discussion
SUNY-Morrisville
Morrisville, New York

October 28, 2002

by

Ronald W. Cotterill, Director
Food Marketing Policy Center
Department of Agricultural and Resource Economics
University of Connecticut
Storrs, CT 06269-4021

Tel: (860) 486-2742
Fax: (860) 486-2461
Email: Ronald.Cotterill@uconn.edu

Website: http://www.are.uconn.edu/fmktc.html

A Northeast Dairy Compact Post Mortem

Executive Summary

- Raw fluid milk prices have tanked since the end of the Northeast Dairy Compact.
- Since the end of the Northeast Dairy Compact, retail fluid milk prices and raw milk-retail margins in Boston are consistent with the harvest of huge profit gains by market channel firms.
- Bailey's bogus model of the farm-retail price relationship self destructs in the post-Compact period to the advantage of processors and retailers.
- The Suiza/Dean Foods stock price continues to skyrocket as the overall stock market tanks.

Text

This briefing paper presents some facts that pertain to the overall performance of the milk-marketing channel in New England. It updates information provided in earlier papers that focused upon dairy pricing during and immediately prior to the Compact era. (Cotterill, 2001a, b, Cotterill and Franklin, 2001a, b, c).Those papers are available on our website **www.are.uconn.edu/fmktc.html**. Click on "Northeast Dairy Compact" to locate them.

Figure 1 updates price series in these prior papers. It uses the Order One Market Administrator's retail price series for Boston and the Compact or Class 1 announced raw fluid milk price series to track monthly and retail and "farm" prices from January 1996 to October 2002. The two vertical lines identify the advent and end of the Northeast Dairy Compact. Note that the farm price dropped dramatically soon after

the end of the Compact and has trended down to less than $1.15 per gallon in October 2002.

In contrast, Boston retail prices remain essentially constant throughout 2002 at approximately $3.00 per gallon. Consequently, margins for processors and retailers have increased. Please see Figure 2 and Table 2.

Ken Bailey, Pennsylvania State University, offered a model of the farm retail price relationship (Bailey 2000, 2001) that was quickly adopted by the International Dairy Foods Association and widely quoted in the *Wall Street Journal* and elsewhere. It falsely claims that the Compact elevated retail prices 14 or 20 cents per gallon. Please see Attachment A for further explanation. Also see Cotterill (2001a) and especially Cotterill (2002) for an in depth analysis of this model's shortcomings. At the end of the second paper, I have appended Bailey's and others responses to my comparative review of four Compact pricing studies.

Basically Bailey uses a proportional markup model to predict the retail price from the farm price. The average markup for several periods of data such as 1996-2002 is:

$$\frac{P_{retail}}{P_{farm}} = m$$

One can, according to Bailey, predict the change in retail prices from the change in farm prices with the following equation:

Change in retail price = m times the change in farm price

Bailey uses the model and his estimates of "m," that were at or above 1.7, to inflate the impact of the Compact on retail prices.

Recent pricing conduct in Boston clearly demonstrates the lack of reality with this approach. Looking at Table 1 and Figure 1, one can see that the farm price peaked at

$1.65 per gallon in October 2001. Since then the farm price has dropped to $1.15 per gallon in October 2002. Using Bailey's model with m at 1.7 (his lowest value for m) one predicts that the retail price should be 1.7 x 50 = 85 cents lower in October 2002 than it was in October 2001. In fact the retail price was $3.08 per gallon in October 2001 and $2.97 per gallon in October 2002. Retail price dropped only 11 cents. Bailey's model is bogus. It does not explain observed price conduct. It didn't work during the Compact period to the advantage of the firms in the anti-compact lobby; and, it does not work in the post-Compact period, surprise of surprises, to the advantage of the firms in the anti-Compact lobby.

Shifting to the issue of processor profit performance, as measured by stock price appreciation, one also finds that the post-Compact gains for Suiza/Dean Foods are diametrically opposite to the income losses of dairy farmers. On August 1, 2001 Speaker of the House, Dennis Hastert, held a members only closed door meeting on the Northeast Dairy Compact. Four economists addressed this meeting: Andrew Novakovic, Cornell University; Robert Wellington, Agrimark; and Robert Yonkers, International Dairy Foods Association. Mr. Yonkers was the first to address the group of more than 25 members of Congress, and opened by stating that "Wall Street has not looked favorably on the dairy processing industry, the stock price performance of dairy processors is lackluster…we are a competitive business." At that time I declared that he was wrong and challenged him to provide data that substantiates his claim. No data or response was provided.

On December 6, 2001, I sent the letter that is provided here as Attachment B to member of Congress as well as Mr. Yonkers and the other economists. It contains

one, two, and five year stock price performance charts for Suiza and Dean Foods. During 2001 Suiza's stock price surged up 40%, and Deans was up 60% while the S&P 500 index dropped 15 percent.

This paper contains an update for 2002. The merged company of Suiza and Dean (effective December 21, 2001, see Attachment C) now called Dean Foods amounts for as much as 35 percent of fluid milk processing in the U.S. and 85 to 90 percent of processing in the Boston Providence market area. Chart 1 indicates that, as of October 24, 2002, Dean Foods is up over 20% over the prior 12 months while the S&P index has dropped approximately 20 percent over that same 12-month period. Chart I also provides graphs of 2-year performance (Dean up over 50%, S&P down nearly 50%) and 5 year performance (Dean up 50%, S&P down 5 to 10%).

In conclusion, pricing in the Boston milk marketing channel has continued to be noncompetitive since the end of the Dairy Compact. The only way to temper this point is to submit that other processing and retailing costs related to the distribution of milk exploded and sustained observed retail prices at $3.00/gallon. We invite the processors and retailers to make their costs and margins public to refute our conclusion. One processor-retailer, Midland Farms, is selling different blends of milk at $1.49 and $1.79 per gallon in the Boston Providence market area. (See Boston Globe, and Milkweed articles provided in Attachment D). An Aldi store in Ithaca, New York, is currently selling skim milk at $1.79/gallon. Milk pricing in New York and New England remains an issue.

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Mohl, Bruce. Amid Talk of High Milk Costs, Low Price Sets off State's Alarm. *The Boston Globe*, Wednesday, October 9, 2002, page C6.

Table 1: Boston Retail Milk Prices and Raw Fluid Milk Prices: January 1996 - October 2002

	1 Boston Class I		2 Compact Over Order		3 Class I & Compact	4 Boston Retail Price	5 Boston Coop Class I Price		
	Per Cwt.	Per Gallon	Per Cwt.	Per Gallon	Per Gallon	Per Gallon	Per Cwt.	Per Gallon	Pay Per Gallon
Jan'96	16.11	1.39			1.39	2.37	16.84	1.45	1.45
Feb	16.15	1.39			1.39	2.38	16.88	1.45	1.45
Mar	15.97	1.37			1.37	2.41	16.70	1.44	1.44
Apr	15.83	1.36			1.36	2.40	16.56	1.42	1.42
May	15.94	1.37			1.37	2.39	16.67	1.43	1.43
Jun	16.33	1.40			1.40	2.41	17.06	1.47	1.47
Jul	17.01	1.46			1.46	2.43	17.74	1.53	1.53
Aug	17.16	1.48			1.48	2.38	17.89	1.54	1.54
Sep	17.73	1.52			1.52	2.39	18.46	1.59	1.59
Oct	18.18	1.56			1.56	2.43	18.91	1.63	1.63
Nov	18.61	1.60			1.60	2.45	19.34	1.66	1.66
Dec	17.37	1.49			1.49	2.41	18.50	1.59	1.59
Jan'97	14.85	1.28			1.28	2.42	15.98	1.37	1.37
Feb	14.58	1.25			1.25	2.45	15.71	1.35	1.35
Mar	15.18	1.31			1.31	2.45	16.31	1.40	1.40
Apr	15.70	1.35			1.35	2.45	16.56	1.42	1.42
May	15.73	1.35			1.35	2.45	16.67	1.43	1.43
Jun	14.68	1.26			1.26	2.44	15.81	1.36	1.36
Jul	13.94	1.20	3.00	0.26	1.46	2.64	15.07	1.30	1.46
Aug	13.98	1.20	2.96	0.25	1.46	2.63	14.91	1.28	1.46
Sep	14.10	1.21	2.84	0.24	1.46	2.63	14.78	1.27	1.46
Oct	15.31	1.32	1.63	0.14	1.46	2.62	15.94	1.37	1.46
Nov	16.03	1.38	0.91	0.08	1.46	2.63	16.66	1.43	1.46
Dec	16.07	1.38	0.87	0.07	1.46	2.63	16.70	1.44	1.46
Jan'98	16.20	1.39	0.74	0.06	1.46	2.60	16.83	1.45	1.46
Feb	16.53	1.42	0.41	0.04	1.46	2.59	17.16	1.48	1.48
Mar	16.49	1.42	0.45	0.04	1.46	2.60	17.12	1.47	1.47
Apr	16.56	1.42	0.38	0.03	1.46	2.60	17.04	1.47	1.47
May	16.05	1.38	0.89	0.08	1.46	2.60	16.53	1.42	1.46
Jun	15.25	1.31	1.69	0.15	1.46	2.54	15.73	1.35	1.46
Jul	14.12	1.21	2.82	0.24	1.46	2.55	14.60	1.26	1.46
Aug	16.34	1.41	0.60	0.05	1.46	2.57	16.82	1.45	1.46
Sept	18.01	1.55	0.00	0.00	1.55	2.58	18.49	1.59	1.59
Oct	18.23	1.57	0.00	0.00	1.57	2.58	18.71	1.61	1.61
Nov	18.34	1.58	0.00	0.00	1.58	2.58	18.82	1.62	1.62
Dec	19.28	1.66	0.00	0.00	1.66	2.71	19.76	1.70	1.70
Jan'99	20.08	1.73	0.00	0.00	1.73	2.89	20.56	1.77	1.77
Feb	20.58	1.77	0.00	0.00	1.77	2.89	21.06	1.81	1.81
Mar	19.51	1.68	0.00	0.00	1.68	2.81	19.99	1.72	1.72
Apr	13.51	1.16	3.43	0.29	1.46	2.67	13.99	1.20	1.46
May	14.86	1.28	2.08	0.18	1.46	2.72	15.34	1.32	1.46
June	15.05	1.29	1.89	0.16	1.46	2.72	15.53	1.34	1.46
July	14.50	1.25	2.44	0.21	1.46	2.72	14.98	1.29	1.46
August	14.66	1.26	2.28	0.20	1.46	2.64	15.14	1.30	1.46
Sept	16.83	1.45	0.11	0.01	1.46	2.66	17.31	1.49	1.49
Oct	19.03	1.64	0.00	0.00	1.64	2.91	19.51	1.68	1.68
Nov	19.50	1.68	0.00	0.00	1.68	2.89	19.98	1.72	1.72
Dec	14.73	1.27	2.21	0.19	1.46	2.83	15.21	1.31	1.46

(continues)

Table 1: *(continued)*

	1 Boston Class I		2 Compact Over Order		3 Class I & Compact	4 Boston Retail Price	5 Boston Coop Class I Price		
	Per Cwt.	Per Gallon	Per Cwt.	Per Gallon	Per Gallon	Per Gallon	Per Cwt.	Per Gallon	Pay Per Gallon
Jan'00	14.15	1.22	2.79	0.24	1.46	2.92	14.63	1.26	1.46
Feb	13.96	1.20	2.98	0.26	1.46	2.85	14.44	1.24	1.46
Mar	14.09	1.21	2.85	0.25	1.46	2.83	14.57	1.25	1.46
Apr	14.18	1.22	2.76	0.24	1.46	2.81	14.66	1.26	1.46
May	14.73	1.27	2.21	0.19	1.46	2.84	15.21	1.31	1.46
Jun	14.95	1.29	1.99	0.17	1.46	2.83	15.43	1.33	1.46
Jul	15.71	1.35	1.23	0.11	1.46	2.82	16.19	1.39	1.46
August	15.20	1.31	1.74	0.15	1.46	2.85	15.68	1.35	1.46
Sept	15.09	1.30	1.85	0.16	1.46	2.82	15.57	1.34	1.46
Oct	15.14	1.30	1.80	0.16	1.46	2.82	15.62	1.34	1.46
Nov	15.07	1.30	1.87	0.16	1.46	2.87	15.55	1.34	1.46
Dec	15.38	1.32	1.56	0.14	1.46	2.88	15.86	1.36	1.46
Jan'01	17.24	1.48	0.00	0.00	1.48	2.90	17.72	1.52	1.52
Feb	15.19	1.31	1.75	0.15	1.46	2.92	15.67	1.35	1.46
Mar	15.90	1.37	1.04	0.09	1.46	2.90	16.38	1.41	1.46
Apr	16.69	1.44	0.25	0.02	1.46	2.94	17.17	1.48	1.48
May	17.46	1.50	0.00	0.00	1.50	2.95	17.94	1.54	1.54
Jun	18.24	1.57	0.00	0.00	1.57	2.98	19.14	1.65	1.65
Jul	18.59	1.60	0.00	0.00	1.60	3.01	19.49	1.68	1.68
August	18.65	1.60	0.00	0.00	1.60	3.02	20.25	1.74	1.74
Sept	18.81	1.62	0.00	0.00	1.62	3.08	20.41	1.76	1.76
Oct	19.18	1.65			1.65	3.08	20.78	1.79	1.79
Nov	19.01	1.63			1.63	3.08	20.61	1.77	1.77
Dec	15.23	1.31			1.31	2.99	16.83	1.45	1.45
Jan'02	15.21	1.31			1.31	2.99	16.81	1.45	1.45
Feb	15.20	1.31			1.31	2.98	16.80	1.44	1.44
Mar	14.87	1.28			1.28	2.99	16.47	1.42	1.42
Apr	14.72	1.27			1.27	2.99	16.32	1.40	1.40
May	14.51	1.25			1.25	2.99	16.11	1.39	1.39
Jun	14.28	1.23			1.23	2.99	15.88	1.37	1.37
Jul	13.87	1.19			1.19	2.99	15.47	1.33	1.33
August	13.73	1.18			1.18	2.97	15.13	1.30	1.30
Sept	13.71	1.18			1.18	2.97	15.11	1.30	1.30
Oct	13.40	1.15			1.15	2.97	14.80	1.27	1.27

Source: Order One Market Administrator and Dairy Market News

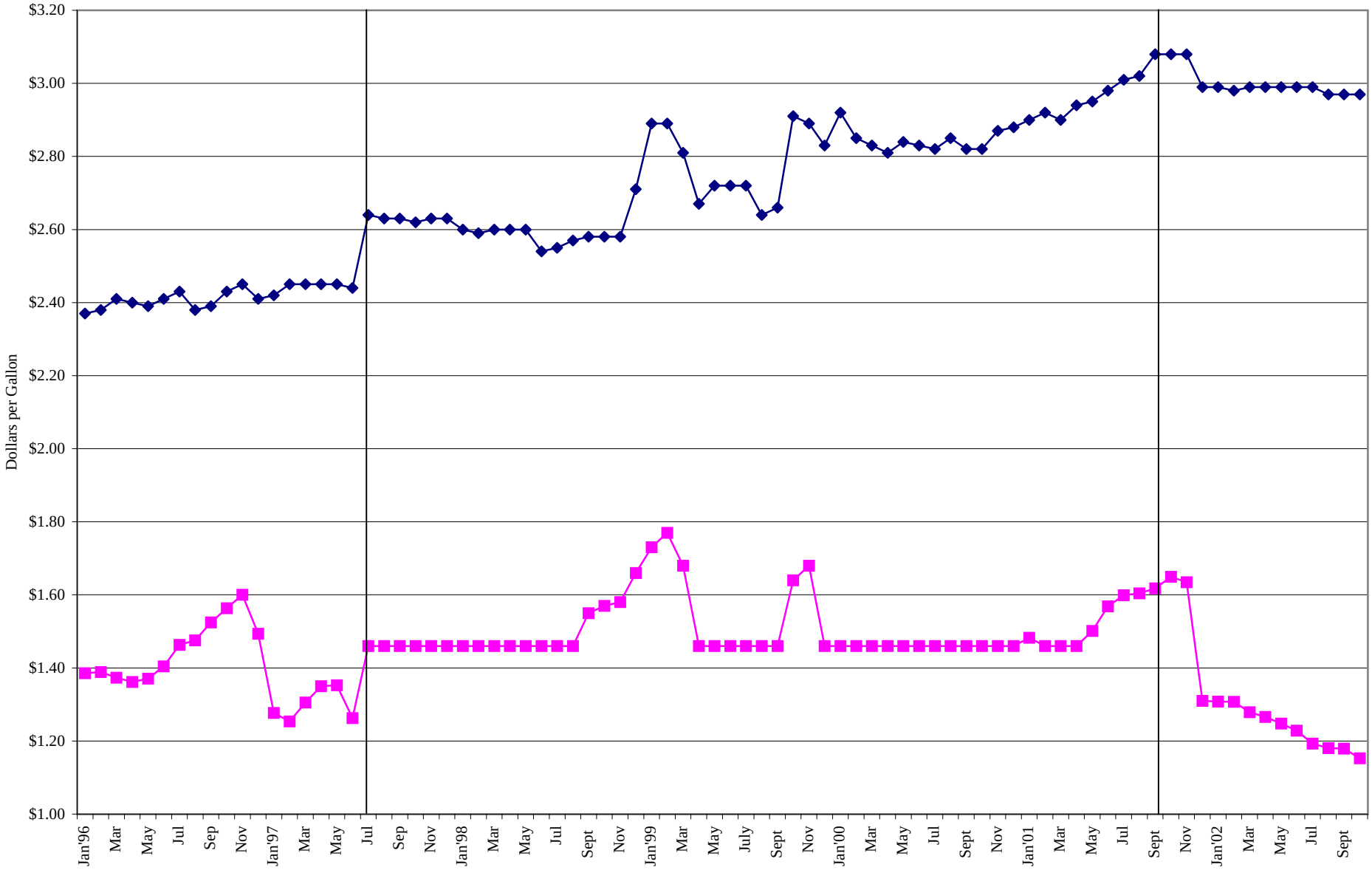
Table 2: Boston Retail to Farm Fluid Marketing Margin: January 1996 - October 2002

	Boston Margin Per Gallon		Boston Margin Per Gallon
Jan'96	0.98	Jan'00	1.46
Feb	0.99	Feb	1.39
Mar	1.04	Mar	1.37
Apr	1.04	Apr	1.35
May	1.02	May	1.38
Jun	1.01	Jun	1.37
Jul	0.97	Jul	1.36
Aug	0.90	August	1.39
Sep	0.87	Sept	1.36
Oct	0.87	Oct	1.36
Nov	0.85	Nov	1.41
Dec	0.92	Dec	1.42
Jan'97	1.14	Jan'01	1.42
Feb	1.20	Feb	1.46
Mar	1.14	Mar	1.44
Apr	1.10	Apr	1.48
May	1.10	May	1.45
Jun	1.18	Jun	1.41
Jul	1.18	Jul	1.41
Aug	1.17	August	1.42
Sep	1.17	Sept	1.46
Oct	1.16	Oct	1.43
Nov	1.17	Nov	1.45
Dec	1.17	Dec	1.68
Jan'98	1.14	Jan'02	1.68
Feb	1.13	Feb	1.67
Mar	1.14	Mar	1.71
Apr	1.14	Apr	1.72
May	1.14	May	1.74
Jun	1.08	Jun	1.76
Jul	1.09	Jul	1.80
Aug	1.11	August	1.79
Sept	1.03	Sept	1.79
Oct	1.01	Oct	1.82
Nov	1.00		
Dec	1.05		
Jan'99	1.16		
Feb	1.12		
Mar	1.13		
Apr	1.21		
May	1.26		
June	1.26		
July	1.26		
August	1.18		
Sept	1.20		
Oct	1.27		
Nov	1.21		
Dec	1.37		

Source: Table 1: Column 4 minus Column 3

Figure 1.

Boston
Market Level Retail and Farm Fluid Milk Price
January 1996 - October 2002



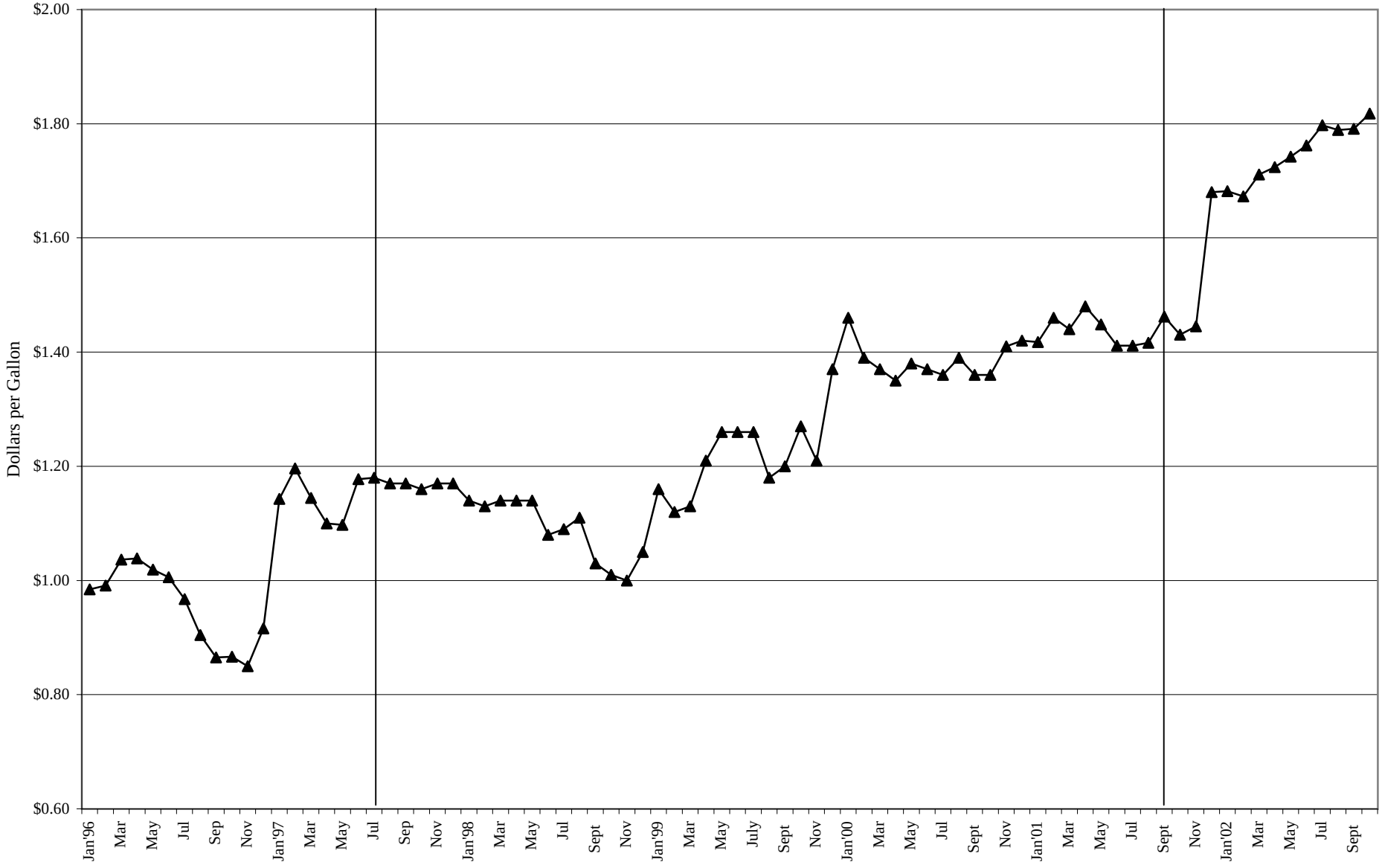
Source: Boston Retail Prices are from Table 1, Column 4
Compact/Class 1 Prices are from Table 1, Column 3

Boston Retail — Compact/Class 1

Vertical lines indicate beginning (7/97)
and end (9/01) of Northeast Dairy Compact.

Figure 2.

Boston
Retail - Farm Marketing Margin
January 1996 - October 2002

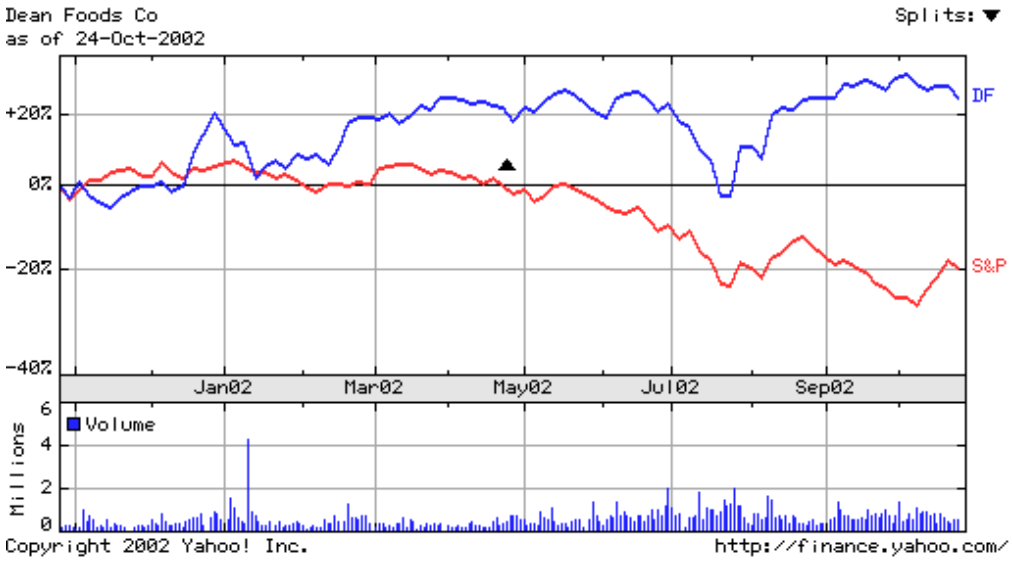


Source: Table 2

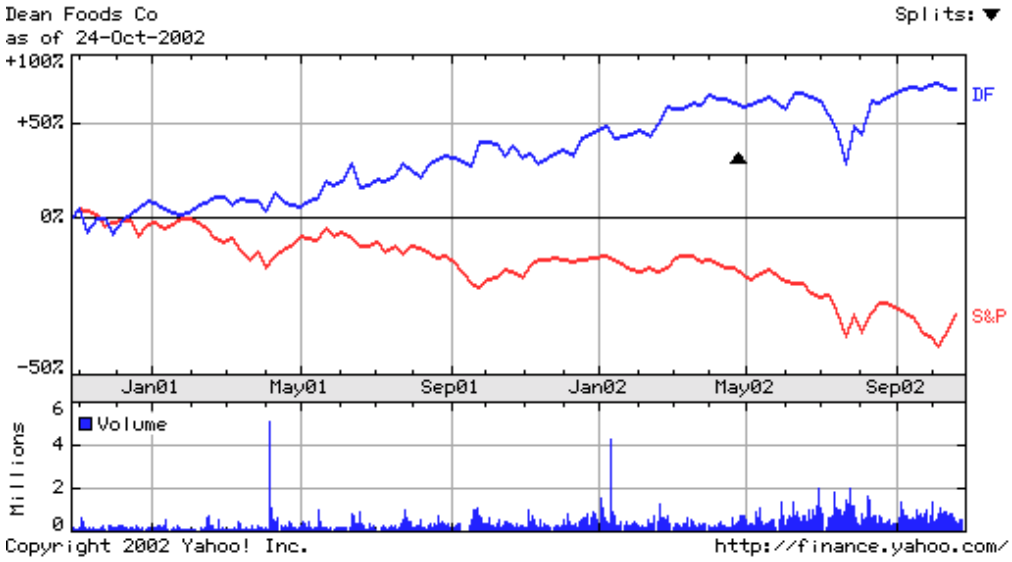
Vertical lines indicate beginning (7/97)
and end (9/01) of Northeast Dairy Compact.

Chart 1: One, Two, and Five Year Stock Price Performance Charts for Dean Foods: Oct. 24, 2002

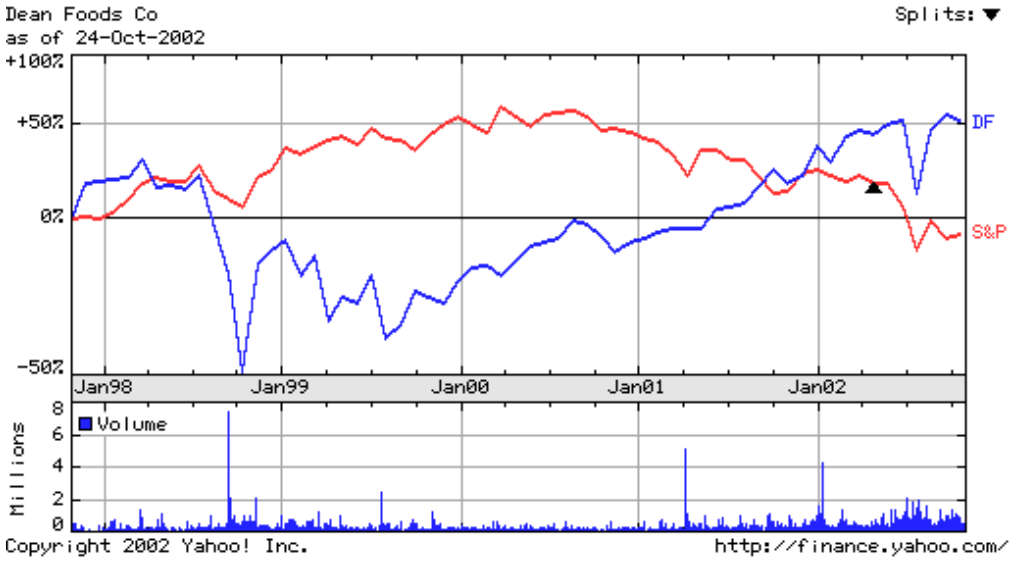
One Year



Two Year



Five Year



Attachment A

Kenneth Bailey's Bogus Consumer Impact
Numbers for the Compact

Attachment B

Letter to Participants in the Speaker of House of Representatives
Meeting on Milk Pricing, August 1, 2001

DATE: December 6, 2001

TO: Participants in the Speaker of House of Representatives
Meeting on Milk Pricing, August 1, 2001

FROM: Ronald W. Cotterill, Director
University of Connecticut, Food Marketing Policy Center

RE: Robert Yonkers' Opening Statement at the August 1, 2001
House Meeting on the Dairy Compact

Mr. Yonkers, the International Dairy Foods Association economist, openly and clearly stated that, "Wall Street has not looked favorably on the dairy processing industry, the stock price performance of dairy processors is lackluster . . . we are a competitive business." At that time I stated that Mr. Yonkers was wrong. The fluid milk business for processors and supermarket retailers is highly profitable in New England and elsewhere. I challenged him to provide the Congress with processor and retailer data on milk profits that would substantiate his claim.

The attached stock price charts for the nation's two largest dairy processors clearly reject Yonkers' characterization of the dairy processing industry's performance on Wall Street. Over the past year Suiza's stock price has increased 40%, and Dean's has increased 60% while the S&P 500 has dropped 15%. The attached two and five year performance charts also reject Yonkers' assertion that these stocks have under performed the market.

RWC/lk
Attachments

Attachment C

Company Information and History on Dean Foods

Attachment D

Newspaper Articles on Midland Farms Milk Pricing