

Southwest FMMO “Mailbox Prices” Way Below Uniform Prices

by John Bunting

“The world is full of obvious things which nobody by any chance ever observes.”

—Sherlock Holmes

Milk production has been growing dramatically within Southwest Federal Order 126, a federal milk marketing order which includes New Mexico, Texas and a small portion of southern Colorado. But producers’ relative prices in that marketing region suffer from huge milk marketing deductions.

Take Texas for example. Between January 2004 - September 2008, Texas dairy cattle numbers increased by nearly 22%. Texas milk production went from 526 million pounds, in January 2004 to 685 million pounds in September, 2008. Not only are Texas and New Mexico attracting growing numbers of dairy cows but in recent years big new cheese plants have been built in the Southwest.

Southwest Cheese Co. in Clovis, New Mexico is one of the largest block cheese processors in the world. Now Hilmar Cheese of California has built a huge new plant in the Texas Panhandle near Dalhart, Texas.

The location for both Southwest Cheese and Hilmar Cheese can be shown on Google maps. Southwest and Hilmar both produce generic block cheddar. Their customer base is the “cut and wrap” cheese sector. The “cut and wrap” operations are located mostly in the upper Midwest. By moving their operations near milk supplies situated above the Ogallala Aquifer, also known as the High Plains Aquifer, the companies are over 1,000 miles closer to their customers, compared to California cheese plants.

A word should be mentioned about our economic system, which allows entities to ignore long-term consequences. The U.S. Geological Services estimates that total groundwater storage in the Ogallala Aquifer was about 2,925 million acre feet in 2005. This is a decline of about 253 million acre feet, roughly 9%, since substantial groundwater irrigation development began, in the 1950s.

Increased competition doesn’t spur net prices

Logically, anyone might think with two huge cheese plants competing for milk, the mailbox milk price in Order 126 would reflect a healthy bonus over the “Statistical Uniform” farm milk price.

In fact nothing could be further from the truth as seen in chart 1.

As a matter of fact, the average difference is \$1.55 per hundredweight. Some of the difference can be explained by the fact that the “Statistical Uniform” blend price is based in Dallas. But, the Southwest FMMO mailbox price tells a bigger story: increased, high cost of marketing taken from producers’ milk checks.

As mentioned earlier, the block cheese from Southwest and Hilmar tend to go to cut and wrap operations mainly in the upper Midwest. Therefore, a comparison of recent mailbox prices (in \$/cwt) between those two regions is informative as seen in chart 2.

Dairy producers know that their production costs rose for each month during the first half of 2008, at the same time mailbox prices were generally declining.

The reason the Wisconsin mailbox price is so much higher than the Order 126 mailbox price is quite simple. In Wisconsin there is considerably more competition for farm milk. The additional milk being produced Order 126 is primarily the result of expansions driven by past real estate values and the IRS tax code 1031. IRS tax code 1031 allows what would be treated as gains and taxed, to go untaxed if the party invests in a like business in a short amount of time. Resale of California real estate has boosted Southwest milk growth.

One can notice, the Wisconsin mailbox price is not declining anywhere as nearly as rapidly as the Order 126 mailbox price. As a matter of fact, by June, 2008 the difference is huge: \$2.76 per hundredweight.

Since cheese yield by weight is almost 10% of the raw milk, the huge cheese plants in Order 126 have about 25 cents per pound advantage over Wisconsin cheese processors. Therefore, the cheese from the two plans can be delivered to “cut and

wrap” operations for less than the CME block cheddar price. One saving grace for Wisconsin cheese plants is the evolution of more specialized cheeses.

Clearly this situation cannot continue

The dairies in Order 126, particularly those dairies who were there before expansions began in a serious manner, are taking a huge financial hit. However, in the long run, this gaming of the system by cooperatives in the Southwest paying less than

federal order minimum cannot and should not be allowed to continue with a Capper-Volstead Act co-op antitrust exemption. Certainly, this is a serious violation of antitrust regulations.

But, if one were to look at the long, long picture, the consecutive destruction of one dairy region after another is not in the public’s interest.

The public has an interest, and government has a mandate, to provide a regional and resilient food supply system, and that includes dairy.

Chart 1: Avg. Southwest Order 126 Mailbox Price vs. Statistical Uniform Price 2004-2007*

PRICE DATA	2004	2005	2006	2007
Western Texas Mailbox	\$15.19	\$14.05	\$11.94	\$18.28
New Mexico Mailbox	\$14.11	\$13.23	\$11.08	\$17.58
Statistical Uniform (Dallas)	\$16.00	\$15.37	\$13.16	\$19.40
Average Difference Mailbox & Blend	-\$1.35	-\$1.73	-\$1.65	-\$1.47
USDA Costs (Texas)	\$15.02	\$15.15	\$16.38	\$20.05

Data source: USDA

* This statistic represents the simple average of the annual mailbox price for Western Texas and New Mexico.

Chart 2: FMMO Mailbox Farm Price Differences Wisconsin vs. Southwest

PRICE DATA	Jan. '08	Feb. '08	Mar. '08	Apr. '08	May '08	Jun. '08
Wisconsin	\$20.79	\$18.85	\$18.86	\$18.11	\$18.87	\$20.22
Western States	\$19.53	\$17.43	\$16.70	\$17.20	\$16.90	\$17.91
New Mexico	\$18.83	\$16.43	\$15.94	\$16.33	\$16.04	\$17.01
Avg WT & NM	\$19.18	\$16.94	\$16.32	\$16.76	\$16.47	\$17.46
Difference 126 & Wisconsin	\$1.61	\$1.91	\$2.54	\$1.34	\$2.40	\$2.76

Data source: USDA

DFA Members in TX/NM Receive Pay-Back Checks For Money “Lent” to Help Build Southwest Cheese

Pay-back time???

In October and November 2008, DFA members in Texas and New Mexico received large, unexpected checks from their cooperative. These checks represented funds paid back to the regional milk marketing agency – the Greater Southwest Agency – for “loans” to Southwest Cheese (Clovis, New Mexico) from 2003 through 2007. The checks total in the thousands of dollars.

When Southwest Cheese was being planned, local dairy cooperatives agreed to reduce raw milk prices to that plant by a dime per cwt., to help fund construction. Now payback time has come. A dime per cwt. on years’ of milk marketings adds up to a lot of money.

DFA members have started seeing these checks. Sources in Texas report that members of other dairy cooperatives that belong to the Greater Southwest Agency are still awaiting details from their organizations.

As usual, DFA manages to stir the pot ... even when it’s paying back dairy farmers’ money. The pay-backs are based on recent months’ milk production to current members. No money is being paid to former DFA producers, who may have left the co-op (or exited milk production) since 2003. A few “retired” members are wondering where their money went.

Massive tax write-offs, also

The letters bearing “surprise” checks to DFA members also bore witness to massive losses at

Southwest Cheese since the plant started operating. An amount equal to more than twice the dime per cwt. paid back has been reduced from DFA members’ “pay-back checks” as tax write-offs on operating losses at Southwest Cheese.

Many of the regional dairy cooperatives were minority investors in Southwest Cheese. A letter received by DFA members – dated November 5, 2008 – stated, in part:

“The amount of this DFA Advantage check has been determined by adding the amount deducted from marketing proceeds for each Southwest Area member and reducing that amount by Southwest Area members’ proportionate share of SWC tax losses since inception through the tax year ending December 31, 2007.”

If dairy cooperatives owned a percentage of Southwest Cheese, and the payback of ten cents per cwt. to DFA members equaled less than a third of the combined “pay-back” and tax write-off at Southwest Cheese for its years of operations through 2007, then Southwest Cheese has lost a big chunk of money in its operations. Southwest Cheese’s major owner, and operator, is the Irish firm Glanbia.

The November 5, 2008 letter from DFA to its members who received the surprise “pay-back” checks closed with the following note:

“We are pleased with the achievements that SWC has made in such a short time and look forward to positive returns from their operations in the future.”