

Farm Milk Prices Have No Correlation to Cheese Inventories

If the traditional yield of ten pounds of cheese for every hundredweight of milk were still the norm, approximately 28% more milk would be needed to produce the present cheese production volume.

by John Bunting

Innumerable times the usual “experts” have assured dairy producers, when farm milk prices take a nose-dive, that the decline is, “all about supply/demand ... and that’s that.” Usually some piece of “micro data” – like a monthly USDA milk production report — or the discussion-ending wisdom that “milk production is up in New Zealand” – is trotted out to justify the farm milk price decline.

When accurate, one source of data can generally be said to approximate supply and demand: USDA’s monthly “Cold Storage” report. Within that report USDA lists month’s-ending cheese stocks, including total cheese stocks. The cheese inventory data are key. The “Cold Storage” data also lists monthly butter inventories, but we take that butter data a little less seriously, since some items included in that total are NOT butter, but milk fat in alternative forms of storage that likely would not end up on the Christmas dinner table.

Of course, readers with sharp memories will point out that even USDA’s “Cold Storage” data have its pitfalls. Several times in recent years, inventory figures have been adjusted, after the fact, to account for some failed reporting or accounting error. More often than not, major adjustments to USDA’s “Cold Storage” data find big inventory *increases* during times when dairy commodity prices are moving up fast. Predictably, such new-found inventories knock down “the market.” When repeated too often, that act gets old fast.

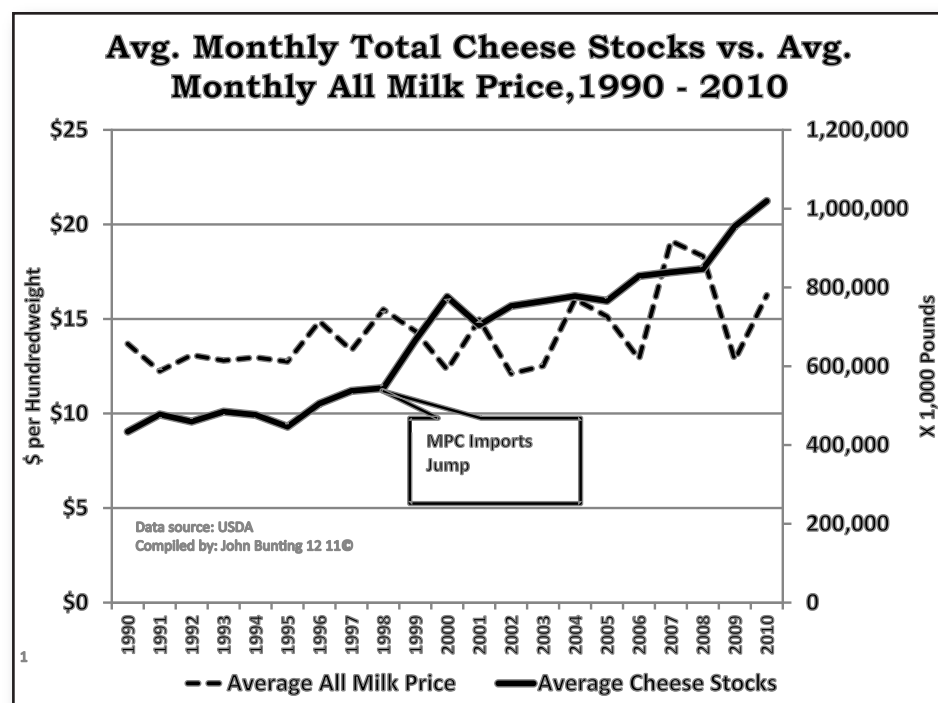
A cheese-based dairy pricing system seems logical. Nearly half of all U.S. farm milk output ends up in the cheese vat. Cheddar has been historically used as our pricing standard, even though “Mozzarella” cheese output now tops Cheddar volume each month. We put quote marks around the word “Mozzarella” because surprisingly little of the product that USDA reports as “Mozzarella” is actually Mozzarella – in full compliance with FDA’s standards of identity for that cheese. A high percentage of total U.S. “Mozzarella” is actually a dumbed-down, second cousin of “Mozz” – so-called “Pizza Cheese.” [Note: Our friends at Leprino Foods make primarily “Pizza Cheese” – so full of water and salt that printed instructions on the boxes of Leprino’s frozen Pizza Cheese have directed Pizza Hut employees to not use the “stuff” (for lack of a better descriptor) if it’s been thawed more than seven days. What kind of “REAL®” cheese starts rotting after seven days in the refrigerator?]

Point is, in this digression, is that Mozzarella would not work as a pricing standard because most of the stuff dubbed “Mozzarella” conforms to no established federal Standard of Identity. Fact of life.

Cheese inventories & milk prices: no correlation

For the above reasons, dairy farmers’ milk output is primarily priced using the basis of Cheddar cheese cash markets traded daily at the Chicago Mercantile Exchange (CME). The relationship between CME block Cheddar price and farm milk is a near-perfect correlation. The way milk pricing works – milk produced on dairy farms (supply) is converted to a product. The product is then put in “storage.” When sold (demand), that cheese is removed from storage (and the volume is subtracted from the warehouse inventory data supplied to USDA for the “Cold Storage” report).

Farm milk is priced from cheese and dairy farmers are told CME Cheddar cash market prices accurately represent “the market” supply and demand for our single-biggest general commodity. Therefore, we should expect a strong, positive statistical correlation between the “Cold Storage” for cheese and dairy producers’ “All Milk Price” (another statistic that USDA calculates each month). At this point, we must exorcise any remaining faithful believers in dairy’s so-called, “Free Market system.” No statistical correlation between monthly totals of cheese stocks reported in USDA’s monthly “Cold Storage” data and milk prices received by dairy producers.



From approximately the beginning of trading of Class III milk futures at the CME in the late 1990s, cash market price volatility has INCREASED.

Excuses are given for the volatility (dramatic ups and downs) – such as the “Globalization” of dairy trade. CME and a small army of consulting firms promote milk futures as a “risk management tool.” Of course, if no risk existed, then there would be no need for such a tool.

But over the years, dairy has observed how at least one major dairy firm – Dairy Farmers of America (DFA) – illegally manipulated CME futures by various antics in the cash trading pits. So the system is suspect. And CME’s directors took no action against DFA’s illegal deeds ... perhaps because DFA’s floor trader at that time was a CME director and headed the committee that oversaw trading irregularities. Bottom line: various studies have concluded milk futures trading, in net, has reduced farm milk prices.

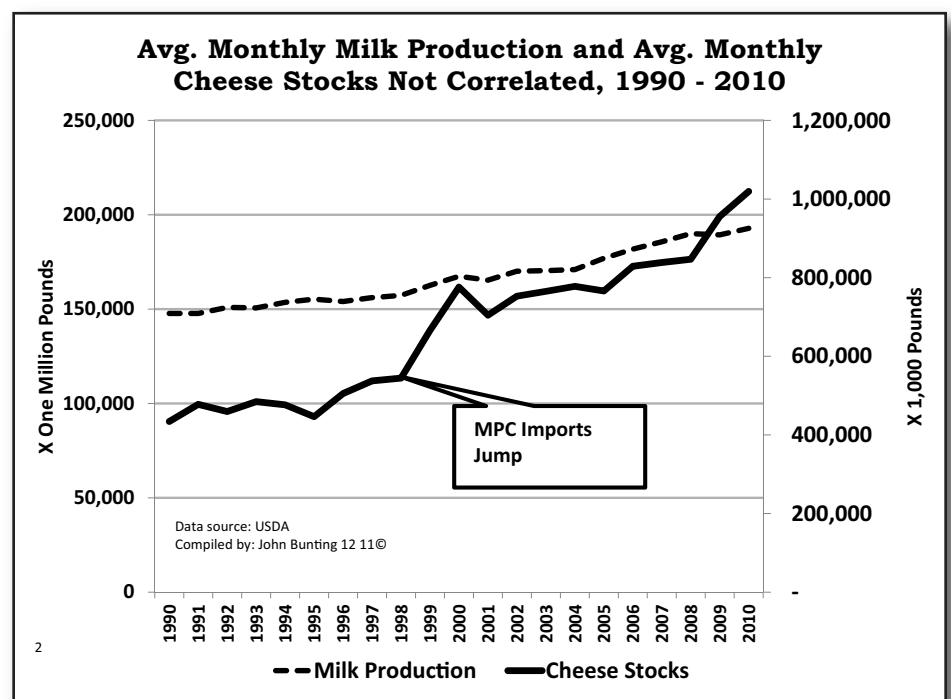
For an extremely long period of time, U.S. farm milk production has very closely followed our nation’s population growth. The correlation between the two factors is amazingly near-perfect: 0.98702. (1.00 would be a perfect correlation.) Over time, from an honest supply-demand basis, there is no fundamental reason for all the volatility in farm milk prices. More people are dining upon more dairy products. (See chart, page 1 this issue.)

Arrival of Milk Protein Concentrates boosted inventories

One noticeable change in the USDA “Cold Storage” cheese data, relative to farm milk production, commenced in the late 1990s. That single factor was imports of Milk Protein Concentrates (MPCs). As long-term readers of *The Milkweed* know well:

- * MPCs have no standard of identity as an ingredient under rules set forth by the federal Food and Drug Administration (FDA).
- * MPCs are not legal ingredients in standard cheeses, under FDA rules.
- * MPCs have NEVER been approved under FDA’s GRAS food safety rules.

Regardless of any such legalities, over time, hundreds of millions of pounds of MPCs have been added to the cheese vat, and to processed cheese products. And the impact of that additional supply of dairy proteins has meant that more cheeses are counted in inventory – with predictable results upon commodity Cheddar priced ... and farm milk prices! Go into a major supermarket and you can find more than three dozen Kraft Foods products that contain MPC. Years ago, a Kraft Foods patent for making cheese from a recipe that included MPCs went so far as to express the efficiency of not having to locate cheese plants near the sources of milk production, when MPCs were substituted for good, old-fashioned, *legal* U.S. farm milk.



As can be seen in the chart above, massive amounts of MPC imports have been pouring into U.S. cheese vats – causing total cheese in storage to jump, relative to farm milk production. Why did MPC imports increase so dramatically?

Loss of Section 22 Import Quotas in 1995

Until 1995, almost all dairy products imports (butter, cheese, and dry milk) were subject to quantitative import quotas established under Section 22 of the Agricultural Adjustment Act of 1933, as amended. Section 22 quotas were essential tools which prevented imports of dairy products and other agricultural commodities from “materially interfering” with the operations of federal price support programs for those commodities. Dairy products not covered by Section 22 quotas included casein, caseinates, whey, and soft-ripened cow’s milk cheese.

Section 22 dairy import protections came to a screeching halt when the Uruguay Round of the General Agreements on Tariffs and Trade (GATT) was implemented January 1, 1995. The Uruguay Round included an ominous process called “tariffication,” which converted Section 22 quotas on agricultural imports – including dairy products – into much less effective tariff rate quotas (TRQs). The new TRQs were then ratcheted down under a specific timeline enforced by the World Trade Organization, the successor to the GATT. Since MPCs imports were a new type of dairy product that had not been recognized or restricted by Section 22, they were not subject to the new TRQ regime. Casein, another milk protein which has not been produced in the U.S. for many decades, was not subject to Section 22 or the new TRQs because casein – and caseinates, a related import – were technically defined as an industrial chemicals under trade rules.

Where were America’s dairy representatives when Section 22 was lost?

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They were probably drunk, at a casino, or asleep. National Milk Producers Federation President Tom Camerlo (now deceased) and other so-called dairy co-op “leaders” – who participated in the GATT negotiations as senior U.S. government advisors – stood idly by as U.S. dairy farmers’ vital import protections were sold out. Shame! Canadian dairy scientists have shown that cheese made from “filtered” dairy ingredients is quality impaired.

Shortly after the Uruguay Round took effect in 1995, MPC imports were promoted by New Zealand for increasing cheese yields. Those cagey Kiwis waited until conclusion of the Uruguay Round to unleash their “secret weapon” – cheap MPCs – into the U.S. market. Although terms such as functionality were used, the real reason had everything to do with price and therefore, processor profit. Cheaper ingredients (MPCs) yielded more cheese and cheese products (supply).

MPCs and ultrafiltered – sometimes called “liquid MPC” – reduce the need for U.S.-produced raw milk going into the cheese vat. Imported MPCs

simply displace domestic milk. Ultrafiltering milk causes whey proteins to be retained in the cheese instead of drained from cheese.

At times when USDA’s “Cold Storage” data have needed serious “revision” (after the initial reporting) ... the numbers almost always seem to be revised downward. Looking at the spectrum of dairy data, over time, is valuable for dispelling some dairy and cheese pricing myths. As a package, the array of milk-pricing myths ... or better yet, disinformation ... that includes “CME cash Cheddar transactions reflect dairy “supply/demand,” and “New Zealand milk production is up four percent” is all a complex ruse to keep dairy producers’ minds in the dark concerning the overt inequities of our farm milk pricing system.

Such practices and disinformation have continued for so long that the big firms, up the ladder from the farm and cheese plant, are in clear violation of the “First Law of Parasites” – don’t kill the host.