

## **Why Are Consumer Prices for Milk and Dairy Products Rising? Surprise – Not Because of Corn Prices:**

A recent barrage of media coverage has pointed the finger at rising ethanol production as the sole cause of higher prices for milk, cheese and other dairy products, including Domino's pizza. Moreover, food industry spokespeople and others have sought to blame ethanol as the primary culprit for rising food prices as a whole. A closer look at the issue, however, reveals a much different story.

### **Why are Milk Prices on the Rise?**

#### **It's as easy as $1 + 2 = 3$**

A basic evaluation of milk prices reveals that traditional market forces are far more important in understanding rising consumer milk prices than the price of corn. In the June 27 edition of the *Sacramento Bee*, four dairy industry experts explain the real reason why consumers are paying more for a gallon of milk.

The price of milk in California and across the country is set by a formula under regional Milk Marketing Orders. As these experts point out, the main component in this formula, particularly in California, is market conditions (supply and demand) surrounding some basic dairy products.

“...officials plug in the market prices for the four globally traded dairy commodities -- butterfat, dry milk powder, whey powder (a byproduct of cheese-making) and cheddar cheese -- and churn out the price that bottlers must pay farmers for their milk.

The prices of two of these commodities -- milk powder and whey -- are very high right now, thanks to a supply shortfall driven by a variety of global trends, including dairy policies in Europe, a long-term drought in Australia, growing demand for milk powder in Asia and the rapid growth of cheese consumption in the United States. Those trends have raised the base price of milk paid to California dairy farmers” (*Sacramento Bee*, 6/27/07).

#### **It's Not Because of Feed Costs**

Moreover, the panel recognized that higher corn prices are having little effect on consumer prices or dairy producers.

“Corn is a staple feed on large dairy farms, and it is about 35 percent more expensive this year than last, largely due to the demand from new ethanol plants.

**But feed costs are not part of the formula that determines the price of milk, so there's no direct way for dairy farmers to pass on their costs to bottlers and consumers.**

However, if farmers collectively reduce the size of the national dairy herd in response to high feed costs, there'd be less milk to go around, which would tend to raise prices.

But that hasn't happened yet. Milk production in California rose 3.4 percent last year -- and now milk prices are so high that farmers are willing to pay premium prices for cows to expand their herds and cash in on the boom” (*Sacramento Bee*, 6/27/07).

The panel of experts for the *Bee* article included:

Roger Hoskin, a dairy economist at the U.S. Department of Agriculture's Economic Research Service

Leslie Butler, a dairy economist at the University of California, Davis  
Joel Karlin, a market analyst at San Joaquin Valley feed giant Western Milling  
Kelly Krug, director of milk marketing services for the California Department of Food and Agriculture

## **The Big Impact of Processing, Packaging and Transportation**

According to a 2001 Government Accountability Office report entitled “Fluid Milk: Farm and Retail Prices and the Factors That Influence Them”, processing, packaging and distribution have a huge impact on the price of milk.

The report states, “...**at the wholesale level, the costs of pasteurization, packaging, and transportation, have a major influence on milk prices, and for some retailers the pricing strategies used by other retailers may have a significant influence on the prices that consumers pay for milk at the retail level.**”

Indeed, the processing, packaging and shipping of food products is a significant part of the price of dairy and other food products. It should come as no surprise, then, that the rise in petroleum prices and gasoline prices is followed closely by a rise in food prices since petroleum is a key energy input in all the stages required to bring food from the field to the aisle.

## **The High Cost of Gasoline**

According to an analysis of food, energy and corn prices conducted by John Urbanchuk of LECG, LLC, “**rising energy prices had a more significant impact on food prices than did corn.**” In fact, rising energy prices have twice the impact on the Consumer Price Index (CPI) for food than does the price of corn, according to the report.

Urbanchuk’s study states, “Increasing petroleum prices have about twice the impact on consumer food prices as equivalent increases in corn prices. A 33 percent increase in crude oil prices – the equivalent of \$1.00 per gallon over current levels of retail gasoline prices – would increase retail food prices measured by the CPI for food by 0.6 to 0.9 percent. An equivalent increase in corn prices – about \$1.00 per bushel over current levels – would increase consumer food prices only 0.3 percent.”

## **More information:**

A copy of the *Sacramento Bee* story can be found at [www.sacbee.com/103/v-print/story/243593.html](http://www.sacbee.com/103/v-print/story/243593.html).

A copy of Urbanchuk’s report can be found [www.ethanolrfa.org](http://www.ethanolrfa.org).

A copy of the GAO report can be found at [www.gao.gov/new.items/d01730t.pdf](http://www.gao.gov/new.items/d01730t.pdf).

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