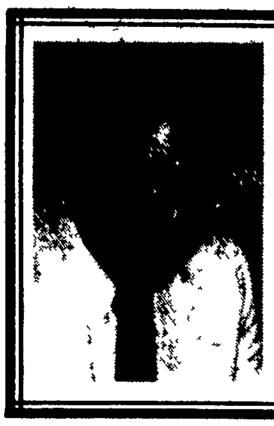

MILK CHECK

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SCRANTON (Lackawanna Co.) — After dropping 38 cents in December, the Minnesota-Wisconsin Price Series took another dip of 39 cents in January, dropping it to $11.71. But that's still $1.55 better than last year and $1.77 above the support price for manufacturing grade milk.

Cheese prices dropped another five cents but most of that came the first two weeks of January and have held pretty steady since then.

Cheese inventories are considerably lower than a year ago and even though sales are not great, present prices may hold until the normal inventory building starts with the spring flush.

Support prices on butter and powder were tilted again by the Commodity Credit Corporation to favor powder.

Butter prices were dropped 11 cents to 87 cents on January 17 and powder prices increased six cents to 91 cents. This dropped market prices of butter to 85 cents in January and had some impact on the M-W price but will be more of a factor in February.

Further drops in the M-W are expected but the worst seems to be behind us.

Cheese and powder prices are expected to stay above their support prices and butter is about as low as it can go.

All of these changes of butter prices in the last few years to stimulate sales have produced a butterfat differential below 10 cents and the last time that happened was in 1976.

It's still pretty much a milk supply problem. There seems to be more than enough in most areas including the Northeast. Without increases in fluid sales, it has become a buyer's market, but so far the market for manufactured dairy products is carrying the load.

However, you're on thin ice and predictions are difficult. If last year's drought is to affect the milk supply it will have to show up soon.

Farm Prices

And so far it hasn't shown up in Federal Order 2 with receipts in January reaching a high not seen since 1986, and average daily deliveries per producer setting a record for the month.

However, the full impact of a 79-cent drop in the M-W in three months hasn't yet been reflected in farm prices so the blend price for January was $12.97 for 3.5 percent milk at the 201-210 mile zone.

That's 37 cents less than December but $1.86 better than last January.

Total milk in F.O. 2 in January was 16 million pounds or two percent more than last year, while Class I sales were the same. It indicates that the supply problem mentioned earlier exists here in the Northeast also.

This sends more milk to manufacturing which lowers dairy product prices that are the basis for your milk prices.

In January, the Class I price at $14.90 was only two cents lower than December and kept your blend price up. This will drop 77 cents to $14.13 by March so you can expect the full impact of the lower M-W by then.

For February, the Class I price will be down 38 cents to $14.52 and the Class II price down 30 cents to $12.20. That makes up 56 percent of the pool.

The Class III price or 44 percent of the pool will change with the M-W for February.

Looking Ahead

With last year's prices starting low and ending high, it's easy to say the first half of 1992 will be better than 1991.

From January to June last year the average F.O. 2 blend price was only $10.95 and we're starting 1992 about $2 higher, so an average of a dollar more for the first half looks pretty safe.

It's the second half of 1992 that's difficult for the forecasters. There have been no signs of reduction in milk supplies because of lower prices. What we lose in cow numbers we make up in production per cow. One producer quits another one expands.

Adding to the forecasting problem are changes in the system already adopted or expected this year.

The New England and Mid Atlantic F.O.s already have a new Class IIIA price for milk used to make butter and powder; producer assessments will be increasing and the M-W may be replaced to calculate the Basic Formula Price.

If all that isn't enough, then try to predict the rate of recovery for the national economy that will certainly affect your milk prices.

Looking Back

Now that 1991 is history, we can look at the prices to see how they measure up to the past.

Last year the M-W started at $10.16 in January and peaked at $12.50 in October. In 1990 it was just the opposite starting at $13.94 in January and dropping to $10.19 in December.

In 1989 the pattern was back to a low in the spring of $10.98 and a high of $14.93 in December.

This is the roller coaster that everyone talks about, but produced by market conditions some of which you may never see in combination again.

However, if you look at yearly averages it may be easier to see from the top of the roller coaster.

The average M-W last year was $11.05, which seems low compared to $12.21 in 1990 and $12.37 in 1989, but right back to the $11.03 in 1988.

The same pattern shows in your blend price in F.O. 2.

Last year it was $11.80, falling from $13.14 and $13.10 in 1990 and 1989, but right back to the $11.87 you got in 1988.

The point is, there was something very different about 1989 and 1990 that doesn't exist any more.

The reasons were mentioned often in this letter, and many other sources, in 1989, but have largely been ignored. It was a combination of a drought in the upper Midwest which affected the milk supply in Minnesota and Wisconsin — right where your milk prices start.

If the M-W hadn't gone to $11.93 in December 1989, or if the drought had been any where else, you may not have seen the impact.

Adding to the short milk supply was a drop in worldwide stocks of powder produced partly by cuts in production quotas for European common market dairymen.

Powder prices in world trade went so high we cleaned out our own surplus stocks and powder was hard to find here at any price.

In the meantime, we had given away all of our surplus butter and cheese in give-away programs at home. This means there were no CCC stocks to put on the market to keep a lid on prices so they went as high as the market would allow.

Butter prices were over $1.35 and cheese reached $1.60 a pound.

That's all behind us now and what should be considered more normal market conditions have returned.

That roller coaster ride is now referred to as price volatility which is not new to the dairy industry. We just hit higher peaks and lower valleys than ever before.

We'll always have seasonal changes in milk supply and certainly the weather will be a factor, but the same pricing system that gave you the low prices in January 1991 was the same system that gave you the high prices of December 1989, but it was the outside forces that made the difference.

Now, if you're looking for the prices of 1989, you'll have to get them on your own and without much government money. It sounds like a job for cooperatives or a super co-op.

IRS Gives Farm Preservation Flexibility

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Editor's Note: The author is a tax attorney practicing in Lancaster and is the solicitor for the Lancaster County Agricultural Preserve Board. In addition, he farms with his father in Chester County.

LANCASTER (Lancaster Co.) — The combination of last year's drought and depressed milk prices has increased interest in the state's Agricultural Conservation Easement purchase program under which farm owners can sell their development rights to the commonwealth and/or county government for cash.

In effect, the landowner is cashing out on part of his farm capital investment by permanently restricting the use of his land to agriculture. The receipt of the easement proceeds by the landowner triggers a taxable event for federal and state tax purposes.

Until now, a landowner receiving cash for his easement likely had a tax bill to the state and federal governments to go along with it.

A recent private letter ruling by the Internal Revenue Service permits the use of a tax-deferred exchange with a farm owner participates in the state Agricultural Conservation Easement program and conveys development rights to the commonwealth and/or county.

Under the ruling, the IRS has decided that an Agricultural Conservation Easement, as defined in Pennsylvania's Agricultural Area Security Law, is an interest in real property that is "likekind" to an unencumbered fee simple interest in another farm for purposes of tax-deferred exchanges under section 1031 of the Internal Revenue Code.

Although a private letter ruling issued by the Internal Revenue Service can be relied upon only by the taxpayer who requested it, the issuance of the ruling is helpful because a farmer contemplating an exchange utilizing the value of his development rights can be reasonably certain that a similar ruling can be obtained on his behalf.

For the farm owner who desires to expand his operation but is reluctant to increase his debt load to buy more farm ground, the ruling means that he can, in effect, trade his development rights for another farm and defer recognition of gain that might occur if he simply sold the development rights for cash.

If the farm owner holds the replacement farm at death, his heirs receive a "stepped-up basis" in the farm and the income tax which has been deferred as a result of the exchange is avoided entirely.

Pennsylvania's Tax Code does not recognize tax-deferred exchanges. This means that the exchange, although tax-deferred for federal tax purposes, will be taxable for state tax purposes even if there is a full exchange with no cash received by the landowner.

The landowner need not use all of the easement proceeds in the exchange, that is, he can defer recognition of gain on part of the easement sale and take some cash away from the transaction. In such a case, the landowner will pay tax on the lesser of the realized gain or the net cash received.

A successful tax-deferred exchange can be accomplished only with careful legal documentation and adherence to all of the constraints imposed by IRS regulations.

In addition, agreements with the state and county may need to be modified to accommodate the requirements for an exchange.