

## Land O'Lakes Explains New Pricing System

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the United States. Farmers in the old federal orders 1, 2, and 4 are now all included in Order 1.

"The original order system related to local class I markets," explained Schad. "But now milk travels much longer distances. The new orders reflect regional milk markets."

42 percent of the milk produced in Federal Order 1 goes toward Class I milk, which is processed as fluid milk. 30 percent goes to Class III, which is used to make cheese, while 18 percent goes for Class II or soft products, like yogurt or sour cream. And 10 percent is marketed as Class IV, which is used for butter and powder.

Under the new milk pricing system, the blend price for Federal Order 1 is a weighted average of all four classes. It is basically formulated by taking the Class I milk price multiplied by .42, the Class II price by .18, the Class III price by .3, and the Class IV price by .1, and then adding the four totals together.

According to Schad, the new

system benefits the farmer because the Class I price is based on the higher of either Class III or Class IV.

"In January, the Class IV price was \$1 higher than the Class III price, so bottlers paid a dollar more per hundredweight," said Schad. "That added about 40 cents to farmers' blend price."

The new system also establishes "multiple component pricing" in which the farmer's price is based on three different components found in the milk -- true protein, other solids, and butterfat. This "multiple component pricing" takes into account what the processors want most from the milk.

"Cheese makers want the protein from milk," said Schad. "So they'll pay more for it, while Class IV users want butterfat, protein, and solids."

The farmer's milk check will list pounds produced for each of the three components. That poundage will be multiplied by the unit price the processor is paying for that component, and then the three values will be

added together to get the Class III price that farmer receives for his milk.

For example, if a hundredweight of milk tests for 3.1 percent protein, 5.6 percent other solids, and 3.5 percent butterfat and if processors are paying \$2.12 per pound of protein, \$.049 per pound of other solids, and \$.86 per pound of butterfat, the Class III price for that farmer would be \$9.8564 per hundredweight.

The Class III price is then converted to the blend price by accounting for the Class I, II, and IV milk price at the market. This conversion is called the Producer Price Differential, and it equals the pooled difference between Class III and the other classes.

This is where it gets tricky -- the Producer Price Differential is announced in Boston, Ms., but the Boston price only works for farmers who are shipping their milk into Boston. Most farmers around here don't send their milk to Boston, so their blend price also takes into account a Location Adjustment.

The location adjustment basically equates the Producer Price Differential to where the farmer's milk is delivered. For example, milk shipped into the Carlisle, Harrisburg, and Hershey area would have a location adjustment of -\$0.45. That means that 45 cents would be deducted from the PPD price announced in Boston for farmers shipping their milk to Carlisle.

According to Schad, the handler or cooperative will have a choice of either showing the lo-

cation adjustment on a farmer's milk check or automatically deducting it from the PPD price. Land O'Lakes will have a line item on the check with the location adjustment listed.

"The bottom line of the new pricing system will benefit farmers who are making what the processors want," said Schad.

"Farmers will now be paid the most for protein, which is used to make cheese." In the past, farmers producing high amounts of butterfat profited the most.

## Order No. 4 Weighted Price \$12.47 For December

ALEXANDRIA, Va.--The December 1999 weighted average milk price announced for the Middle Atlantic Marketing Area is \$12.47 per hundredweight.

The weighted average differential price was \$2.76 per hundredweight and the producer nonfat milk solids (NFMS) price was 73 cents per pound. The weighted average price was down \$3.25 from November and

was \$4.88 lower than a year earlier. The producer NFMS price was down 67 cents from last December.

The nonfat milk solids price, applicable to handler payments, was \$.7407 per pound for the month, down 66.92 cents from last year. The gross value of December producer milk, adjusted to 3.5 percent butterfat was \$72.5 million, compared to \$92.3 million a year ago.

Producer receipts totaled 586.9 million pounds during December, an increase of 51.7 million pounds from last December and the average daily delivery of 3,749 pounds per producer increased 155 pounds or 4.3 percent from a year earlier. A total of 5,050 producers supplied Order 4 handlers during the month, an increase of 246 from a year ago.

Class I producer milk totaled 253.0 million pounds and was up 19.7 million pounds, or 8.4 percent, from last December. Class I milk accounted for 43.11 percent of total producer receipts during the month, compared with 43.60 percent in December 1998.

The average NFMS test of producer milk was 8.73 percent, down from 8.76 percent the previous year. The average butterfat test of producer milk was 3.83 percent, up from 3.80 percent last December.

Middle Atlantic Order pool handlers reported Class I in-area milk sales of 199.6 million pounds during December, an increase of 3.6 percent from a year earlier, after adjustment to eliminate variation due to calendar composition.

## Farmers Can

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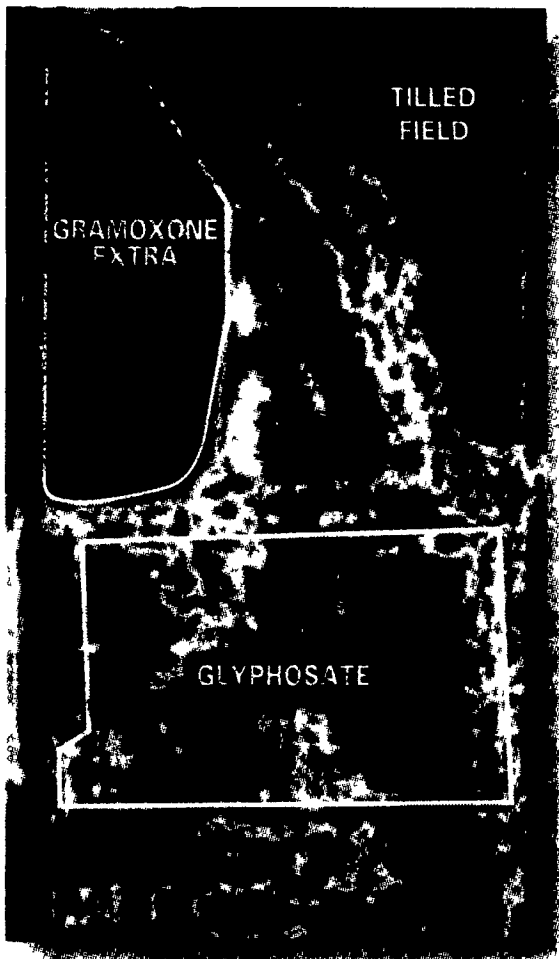
Understand the information on your milk check. Bailey does recommend that farmers take more interest in understanding how their milk price is formulated. "Everyone producing milk in Pennsylvania has to understand how the milk price is determined," he said.

"When the price is announced by the market administrator, farmers should be able to look at their milk check and determine if it falls in line with the price that was announced. If it doesn't, they need to ask questions to their cooperative or dairy."

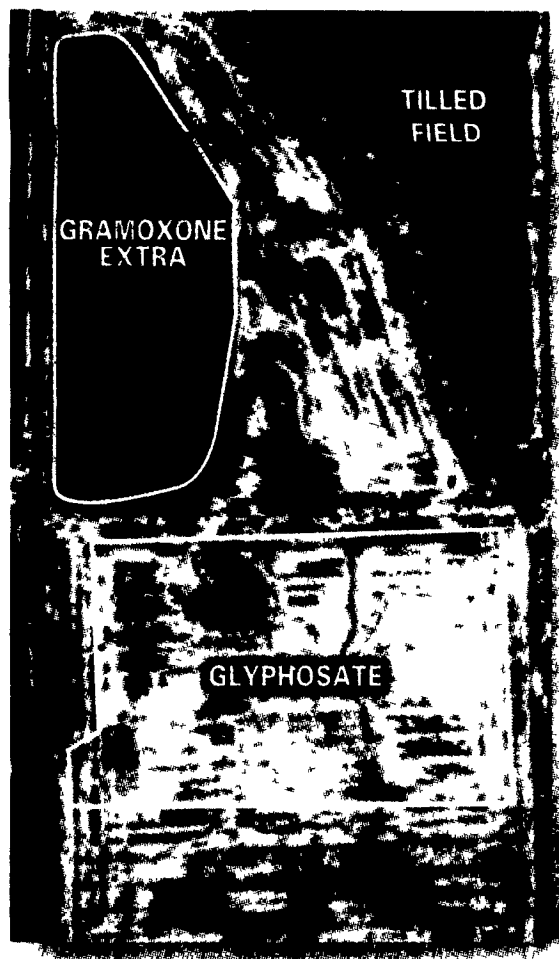
Bailey's web site includes a forecast of the milk prices for the next 12 months, along with an explanation of how the new milk pricing system works. "It's my job to take the milk prices that come out of Washington and explain what they mean," said Bailey.

Farmers who have access to the Internet should visit Bailey's website, [www.aers.psu.edu/dairyoutlook](http://www.aers.psu.edu/dairyoutlook), to utilize the spreadsheets and information available on the site.

Bailey also hopes to provide dairy extension agents with the forecast numbers, spreadsheets, and benchmark tools from the web site so that the agents can share the information with farmers in their counties.



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