# Origin of Livestock Final Rule

In response to a question on the E. O. 12866 Conference Call on February 3rd , 2022, I am supplying data on the economic inequity for operations that are transitioning to organic.

The lack of one standard that is implemented universally caused a dramatic change in the supply side of the organic dairy market. In response to an increased demand for organic milk at the retail level in 2015, the two national brands increased the number of farms supplying organic milk. Some operations used the loophole in the transition requirements to increase their herds rapidly. The result was a national surplus of organic milk. This has caused economic harm to organic dairy producers bottom line who had expected a slow growth in cow numbers in line with the three year requirements of replacement organic cows which are organic from the last third of gestation.
Presented by Ed Maltby, NODPA 2/3/2022

**Economic Inequity for Operations that are Transitioning to Organic**
For some conventional dairy operations that are transitioning to organic production, their certifier is currently restricting the transition to one, already-established, distinct conventional herd with a clearly defined start and finish time for the transition. After that, they have to rear or purchase animals which are organic from the last third of gestation, which involves increased cost of feeding animals, both with the use of land which could graze milking animals and the purchase or raising of higher priced organic feed. In July 2013, the USDA Office of Inspector General (OIG) published an audit report on organic milk operations stating that certifying agents were interpreting the origin of livestock requirements differently.[1] Other certifiers are allowing operations to form a new herd from purchased, conventional animals and take one year to transition that initial number of animals. Then, they can add conventional animals transitioned for just one year to suit the supply side demands of the market, or transition more non-organic animals at a different time, or rear organically born calves on conventional feed and then transition them into the original transitioned herd, as well as other combinations of conditions now being accepted by certifiers.

All these many different ways of transitioning, other than the first one described, are less expensive in feed, health care, and land use costs, allowing staggered capital investment to reduce the cost of debt service and reduced operational costs and give the operations greater flexibility to respond more quickly to supply demand. Organic dairy farms that are raising all of their youngstock organically are at severe economic disadvantage because it is much more expensive to feed calves organic milk than conventional milk replacer or conventional milk (organic milk pay price is usually double that of the conventional pay price). It is more costly to feed the youngstock certified organic feeds during the first year of life rather than conventionally grown feeds, and they cannot respond as quickly to an increase in supply demand. Being able to raise the conventional youngstock with the whole arsenal of antibiotics, drugs, parasiticides,

[1] The July 2013 Office of Inspector General (OIG) audit report on organic milk operations may be accessed at the following website: http://www.usda.gov/oig/webdocs/01601-0002-32.pdf

ionophores and other growth promoters, etc., allowed in the conventional production, creates a very uneven playing field. At an operation level, the higher cost to raise animals organically puts operations that are abiding by the last third of gestation regulation at a significant economic disadvantage compared to those operations making use of the continuous transition loophole. The cost of raising replacement animals is highly sensitive to changes in feed costs, as well as geographic and operation-level variations in costs of production.[2]

**Changing demand for organic dairy products**

Organic milk has been the gateway point for customers moving towards organic purchases, and its growth was at 8-10% until 2012, with the exception of the downturn in the U.S. economy which started in late 2007 when organic milk sales actually declined 4% between 2008 and 2009. Sales rebounded quickly with supply exceeding demand, and from there it has varied year by year but declining to zero growth in retail organic sales by 2017.

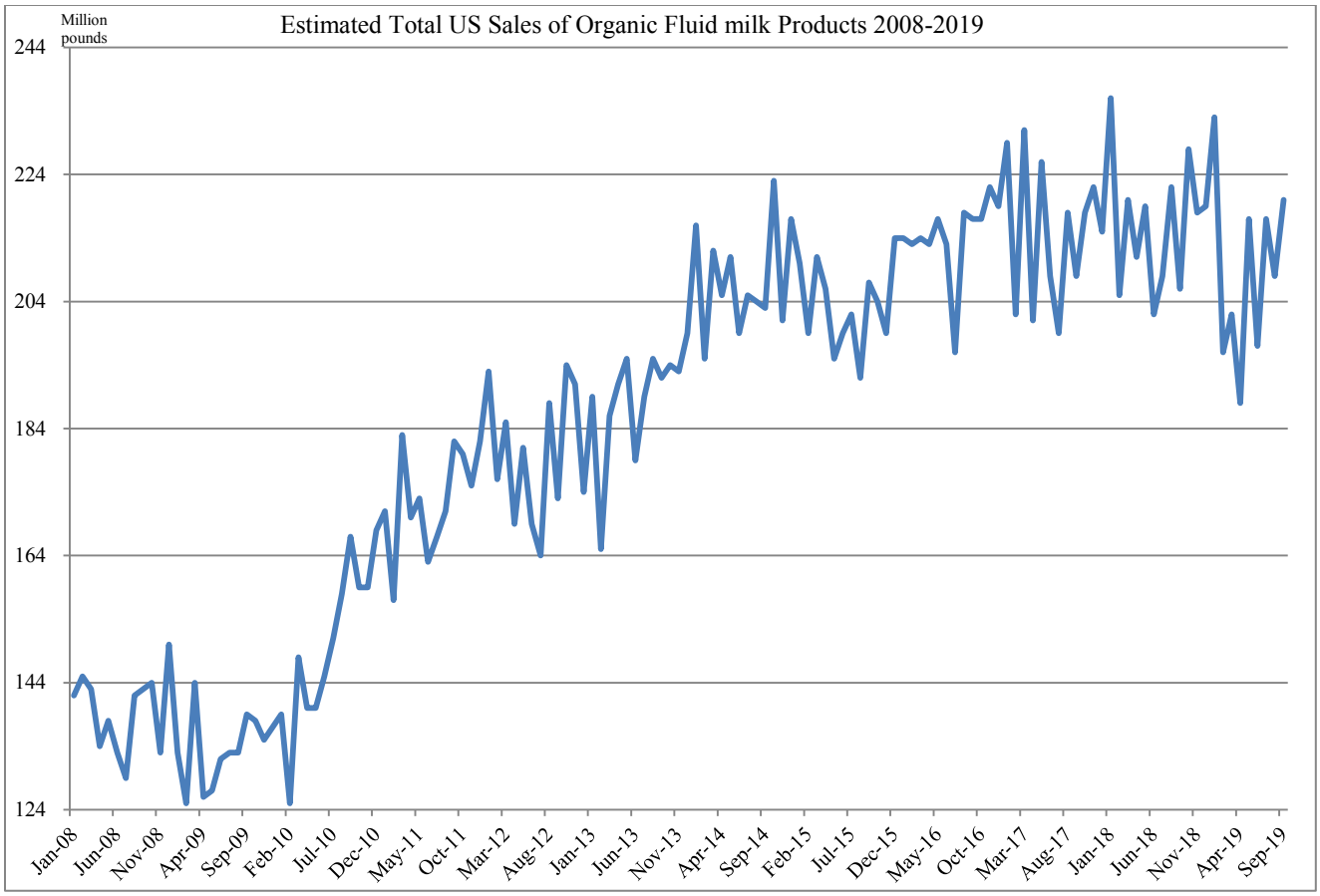
USDA AMS does publish retail sales data of organic milk which make up approximately 75% of organic milk that is consumed as fluid milk[3]. USDA AMS reported sales of retail fluid organic milk in 2008 at 1,676 million lbs.; in 2012 it was 2,157 million lbs.; in 2017 total retail sales was 2,577 million lbs. and in 2018 sales plateaued at 2,594 million lbs., as whole milk sales balanced the drop in fat-free milk. This shows a slowing growth of retail sales, from roughly 8%, annually, to less than 1%. In the last 4 years, whole milk sales have been growing at an average of 5% year over year and fat-free milk retail sales are not increasing and even declining, as we see consumers' choices of many different nut and cereal milks growing, and value added organic milk products sales dropping.

**Retail sales of organic fluid milk using USDA AMS data -2008-2018**

| Year | Fluid milk sales (million pounds) | % Change year to year | Whole Milk retail sales | Low Fat products retail sales |
|---|---|---|---|---|
| 2008 | 1,676 | | | |
| 2009 | 1,602 | -4.60% | | |
| 2010 | 1,799 | 11.00% | | |
| 2011 | 2,074 | 13.30% | | |
| 2012 | 2,157 | 3.80% | | |
| 2013 | 2,267 | 4.90% | 617 | 1,650 |
| 2014 | 2,491 | 9.00% | 742 | 1,702 |
| 2015 | 2,438 | -2.20% | 881 | 1,614 |
| 2016 | 2,573 | 5.20% | 951 | 1,624 |
| 2017 | 2,577 | 0.20% | 1,012 | 1,564 |
| 2018 | 2,594 | 0.70% | 1,062 | 1,523 |

[2] National Organic Coalition comments 12/2/2019 on the Origin of Livestock proposed Rule (Docket Number AMS-NOP-11-0009-1572)

[3] Ye Su, Scott Brown, Michael Cook, Stability in Organic Milk Farm Prices: A Comparative Study, No. 150735, 2013 Annual Meeting, August 4-6, 2013, Washington, D.C., Agricultural and Applied Economics Association at 7 (June 3, 2013), http://ageconsearch.umn.edu/bitstream/150735/2/Stability%20in%20Organic%20Milk%20Farm%20Prices%20A%20Comparative%20Stud%20AAEA%203180.pdf




Together, Organic Valley (CROPP Cooperative) and Horizon Organic (Danone NA) control about 84% of the organic milk supply.[4] In March 2015, CROPP Cooperative raised its pay price to reflect an increase in costs of production and "a surge in market demand."[5] In 2016, the twelve month average mailbox pay price was $35.68 per hundred pounds (CROPP Cooperative); in May 2017 it had dropped to $30.10, which included the ending of the $2.00 market adjustment premium (MAP), the initiation of a quota, and the start of an inventory management deduction of $1.00. In 2018, the twelve month average mailbox pay price was $29.52. In less than two years, the deficit in supply was replaced by a significant surplus that resulted in a quota being imposed and a 25% reduction in pay price. While sales were at the monthly highest level because of an increase in organic whole milk sales, growth of sales in non-fat organic dairy products were dropping at a rate of 4% annually; the retail price was consistent while the average pay price to producers was plummeting.

[4] Ye Su, Scott Brown, Michael Cook, Stability in Organic Milk Farm Prices: A Comparative Study, No. 150735, 2013 Annual Meeting, August 4-6, 2013, Washington, D.C., Agricultural and Applied Economics Association at 21 (June 3, 2013), http://ageconsearch.umn.edu/bitstream/150735/2/Stability%20in%20Organic%20Milk%20Farm%20Prices%20A%20Comparative%20Stud%20AAEA%203180.pdf.

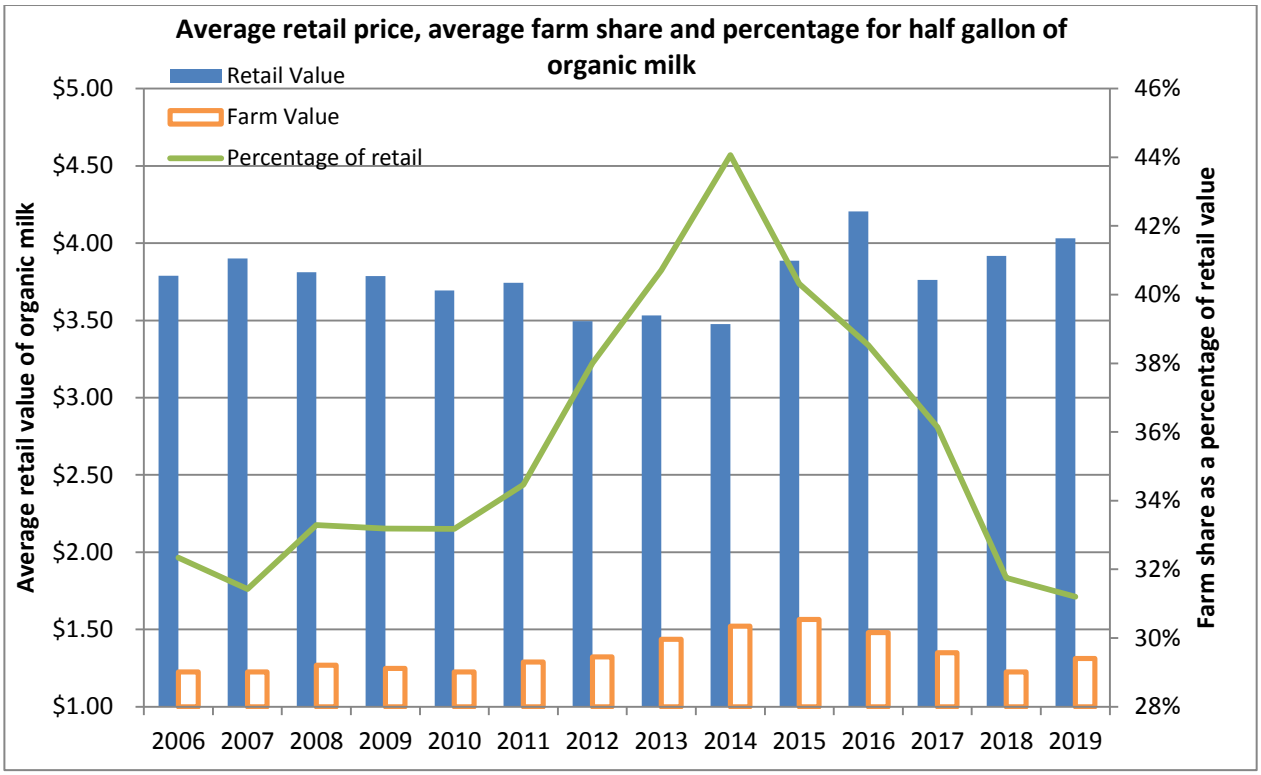
[5] Letter from CROPP Cooperative November 2014

**How organic pay price is determined:**

- It is not determined by the costs of production as the differential between the conventional and the organic pay-price does not cover the increase in costs. Research from the University of Vermont shows that a typical break-even for organic milk production in the northeast in 2017 is $36 per hundred pounds not the current pay price of $29.
- It is not determined by the Federal Milk Marketing Order (FMMO) which was established in 1930's. The conventional pay price is determined by Federal regulation through the FMMO that regulates conventional pay price and protects farmers from being exploited by individual contracts. Conventional dairy also has subsidized margin insurance when pay price drops which can be claimed by organic operations but not by using organic costs of production.
- There is no extra cost of manufacturing that needs to be factored into an organic pay price. The cost of handling, processing and marketing organic milk is no more expensive than conventional now that the organic supply has reached a critical mass of approximately 5% of total dairy supply. There are economies of scale for vertically integrated organic dairies that process their own milk and market directly to store brand or private label contracts. There are also challenges to process organic milk when conventional supply is in surplus and there is no spare capacity on the manufacturing side for any surplus of organic milk. Surplus organic milk is sold conventionally usually at the lowest FMMO price, which can be as much as $20 per hundred pounds of milk lower than the organic pay price.
- Pay price is not affected by the retail price or the premium paid by consumers. Retail price is determined by the retailer, depending on their market--whether they use organic milk as a loss leader, whether they have their own store brand, or what margin they need for their dairy case which displays all types of non-bovine milk co-opting the term 'milk' (oat milk, soy milk). The USDA AMS reports that the average retail price for branded organic product from 2006 to 2018 is $3.77 per half gallon with a high of $4.21 in 2016 and a low of $3.48 in 2014. The highest month for sales was January 2018 with 234 million lbs., with an average retail price of $3.88 per half gallon. The organic pay price in 2006 averaged $26 /cwt; in 2014 it averaged $35.6/cwt and in January 2018 it was $30.60/cwt.

**Average retail price for a ½ gallon of organic milk compared to the cost of the milk at the farm to give the percentage share of the retail dollar that the farmer receives**

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Average Retail Value of ½ gallon | $ 3.79 | $ 3.90 | $ 3.81 | $ 3.79 | $ 3.69 | $ 3.74 | $ 3.49 | $ 3.53 | $ 3.48 | $ 3.89 | $ 4.21 | $ 3.76 | $ 3.92 |
| Farm Value of ½ gallon | $ 1.23 | $ 1.23 | $ 1.27 | $ 1.25 | $ 1.23 | $ 1.29 | $ 1.32 | $ 1.44 | $ 1.52 | $ 1.56 | $ 1.48 | $ 1.35 | $ 1.23 |
| Pay price as a percentage of retail | 32% | 31% | 33% | 33% | 33% | 34% | 38% | 41% | 44% | 40% | 39% | 36% | 32% |




The organic pay price is determined by the two national buyers, vertically integrated large dairies, and the conventional price for balancing organic milk when there is over supply. National buyers are CROPP Cooperative and Danone NA, and the major independent supplier is Aurora Dairy. The two major buyers, with their own dedicated pool of milk, dominate the supply-side, buying organic raw milk because monopsony[6] is prevalent in organic dairy. They each have regional pricing depending on geographic location. They also have quality incentives and penalties that are similar but not identical. In many cases a farmer's decision as to whom they sell their milk is determined by the pick-up route or processing plant that is nearest to their farm. Historical data shows that when there is a surplus of organic milk, the pay price drops across the board. It is only when supply is short or there is a new entrant into the supply market that pay price will increase, not when farm operational costs increase. Milk buyers have to bear the increased costs of balancing supply with demand and this affects the pay price in both the conventional and organic market because any surplus has to be sold at a lower price.

**Inequity in Responding to Supply-Side Demand and Undermining the Pay Price for all Organic Dairies**

For those operations whose certifier does not allow continuous transition of conventional animals, it will take a minimum of three years to have a significant response to a shortage of supply by increasing cow numbers, unless they have sufficient capital available to purchase organically certified milking cows. For

[6] On April 3, 2017, the Antitrust Division of the U.S. Department of Justice announced that it completed its review of Danone S.A.'s acquisition of The WhiteWave Foods Company Inc. ("WhiteWave"). In order to allow the $12.5 billion acquisition to proceed, the Antitrust Division is requiring Danone to divest the Stonyfield Farms business to an independent buyer approved by the U.S. government. https://www.huntonretailindustryblog.com/2017/04/articles/competition-antitrust/doj-completes-review-danonewhitewave-merger-requires-divestitures/

those entities whose certifiers allow continuous transition, they can respond within one year of seeing an increase in demand and pay price. USDA NASS organic census showed an increase in the number of organic dairy cows from 2014 to 2015 was 1,068. The increase in organic cows from 2015 to 2016 was 38,326. This ability to expand rapidly gives those continuous transitioning operations economic advantage to increase profits quickly with a higher pay price. Operations whose certifiers allow continuous transition were able to increase their volume quickly and market their milk directly to store brand and private label contracts, which in 2018 became the number one sellers of retail organic dairy products.

To give an idea of the difference between dairies' sizes in Texas and Wisconsin, a NASS survey showed there were 76 times more organic dairies in Wisconsin than Texas, yet Texas produced 1.3 times more milk. Put another way, the average annual dairy's production in Texas was 80,000,000 pounds, while the average dairy in Wisconsin annually produced 810,000 pounds. The inconsistencies in applying the Origin of Livestock regulations result in economic advantage for those whose certifiers allow for more than a one-time transition as they can respond more quickly to changes in the supply side market. With a supply deficit, they can increase the number of milking cows and heifers quickly while the pay price is high. When the price drops they can sell their less productive milkers to minimize losses in the knowledge that they can buy and transition more animals if the demand changes. ***Consistency in interpretation and enforcement of organic regulations that affect the supply side of the organic market are essential in creating a level playing field and maintaining the integrity of the organic seal***.

**Undermining the Integrity of the Organic Market**

The majority of organic dairies rely on selling their organic milk on the wholesale market and the integrity of that market is tied directly to their pay price. 'No antibiotics' was the top concern of organic dairy consumers in the Natural Marketing Institute survey in 2005 and in all other surveys since then. Once that integrity is undermined, consumers will be unwilling to pay more for organic milk and the only operations able to provide the organic milk are large scale operations that have access to capital. Conventional youngstock being brought onto operations on a continuous basis, as is now practiced, belies the trust of organic dairy consumers who expect that organic milk is coming from animals that have not been treated with antibiotics or other prohibited substances nor fed genetically modified or other prohibited feeds. While rearing organic dairy replacement from the last third of gestation is more expensive than other methods, not doing so will undermine the integrity of the organic seal, directly expose small to mid-size organic dairy operations to a fluctuating pay price below their costs of production and fraudulently market milk as organic that clearly does not meet the expectations of the consumer.

**Undermine the Market for Organic Dairy Replacements**

Currently, there is no established market for organic dairy replacements that are organic from the last third of gestation because of the inconsistent implementation of the Origin of Livestock. Although there are some private sales of both individual animals and herds, there is no national reporting of the value of organically certified dairy animals. Most organic dairy replacements are sold on the conventional market. The fact that the number of organic dairy cows was able to expand by 38,326 in one year illustrates that the increase in organic dairy cows came from the continuous transition of conventional animals, since it takes 24-30 months to increase retention of heifer calves and grow organically certified animals from the last third of gestation. Anecdotally, organic dairy herds average a cull rate of between 20-24% and the USDA NASS data for 2016 shows a total number of organic cows of 267,523 who would produce

133,761 heifer calves every year/lactation (50% male to female). If operations need to retain replacements for their own operations at 25% of heifer calves, potentially there will be 100,000 replacements per year, more than enough to supply all those who want to start or expand their herds to meet existing demand of the marketplace. The inconsistent implementation of the Origin of Livestock brings uncertainty into the market for rearing and selling organic dairy replacements plus deprives established organic dairies of a secondary income stream that compensates for the investment of capital, sweat equity and building fertility in the land.

The Proposed Rule states its intent as, "A stated purpose of the Organic Foods Production Act (OFPA) of 1990 (OFPA) (7 U.S.C. 6501-6522) is to assure consumers that organically produced products meet a consistent and uniform standard (7 U.S.C. 6501). This action (*the Proposed Rule*) would facilitate and improve compliance with and enforcement of the USDA organic regulations (7 CFR part 205) and maintain consumer trust in the consistency of the Organic seal."