Milk Pricing in the United States. By Alden C. Manchester and Don P. Blayney. Market and Trade Economics Division, Economic Research Service, U.S. Department of Agriculture. Agriculture Information Bulletin No. 761.

Abstract

This report provides a primer on the complex pricing system that has evolved in the United States to deal with milk production, its assembly (collection), and its distribution to alternative users. All the various government and private institutions making up the system are expected to work together to ensure that the public gets the milk it wants, while dairy farmers get the economic returns needed to provide the milk. The major institutions are the Federal milk price support program and milk marketing orders, the Northeast Interstate Dairy Compact, State regulations, dairy cooperatives, and milk and dairy product futures and options markets. Our goal is to provide a primer on milk pricing that can serve as a steppingstone to other, more detailed works for those so inclined.

Keywords: Dairy, milk pricing.

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Summary

Over the past 125 years, a complex pricing system has evolved to deal with the problems of milk production, assembly, and distribution. The various government and private institutions making up the system are designed to work together to ensure that the public gets the milk it wants, while dairy farmers get the economic returns needed to provide the milk. The very complexity of the system, however, has baffled many and led to numerous misconceptions.

Economic theory posits that the milk pricing system must balance the supply of milk with the demand for milk. The physical uniqueness of milk complicates many of the pricing arrangements that are available for other products or commodities. The complex mix of public and private pricing institutions has arisen as producers, processors, milk marketers, and consumers have grappled with that uniqueness.

The pricing of milk in the United States involves a wide variety of pricing regulations based on public policy decisions. Some of these regulations include milk price supports, Federal milk marketing orders, import restrictions, export subsidies, domestic and international food aid programs, State-level milk marketing programs, and a multi-State milk pricing organization. Nongovernment pricing institutions are also important—the dairy cooperative being a major example. As the dairy industry has become less regulated in recent years, the use of futures markets has engendered considerable interest. In almost all cases, the major intent of public pricing policies is to somehow influence producer (farm) milk prices.

For some 50 years, price supports have been the backbone of the pricing system for milk and dairy products. The support price underpinned the entire price structure for bulk milk sold by farmers either directly to processors or through cooperatives. USDA's Commodity Credit Corporation (CCC) stood ready to buy as much butter, nonfat dry milk, and Cheddar cheese as manufacturers wanted to sell at specified support purchase prices. These prices were calculated to return at least the announced milk support price to the farmer. Until the 1996 Farm Act, interest in developing alternatives to the support purchase program was minimal or nonexistent.

Federal milk marketing orders are concerned primarily with the orderly marketing of raw fluid-grade milk from the producer to the processor. Legal and technical language makes them complex. Underlying the entire pricing system is the linkage between prices for various milk classes and the wholesale prices of manufactured dairy products. The 1996 Farm Act required that the Federal milk marketing order system be reformed.

The 1996 Farm Act offered a concept that had been under discussion in the Northeast for many years—an interstate compact for dairy market regulation. The proponents of the compact argued, successfully, that regulatory authority over the dairy marketplace in the New England States (Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut) needed to be restored to the six States, acting together. The compact has proven to be a lightning rod for regional conflict in the industry.

The authority to regulate intrastate milk markets was denied to the Federal Government in court decisions early in the New Deal period. These court decisions led the States to make efforts to assist dairy farmers suffering economic hardships at the time by implementing State milk controls. State regulations are important from a national perspective because the States that control milk prices tend to be major milk producers—California and Pennsylvania, for example. State milk pricing is much less prevalent today than in earlier years.

Not all of the pricing institutions for milk are based on public policy decisions. The roles of the dairy cooperatives in both regulated and unregulated milk markets have changed. Cooperatives still represent member interests in the rule-making processes of Federal- and State-regulated markets, which can include minimum price issues. But other roles have become more prominent and claimed more of the public's attention. In many cases, the cooperatives have assumed operation of a complete procurement and distribution system for milk. Assembling milk from the farm, routing raw milk where it is needed, managing or coordinating movements of processed or manufactured products, and managing surplus milk, defined for our purposes as supplies above fluid requirements, are all parts of the system. Taken together, these activities are called "balancing."

The advent of futures and options contracts for Cheddar cheese, butter, nonfat dry milk, and raw fluid milk was seen by some as the prelude to a new era in milk pricing. Were they to be widely used, futures and options contracts could manage price instability. As the role of the price support program has been reduced, milk price volatility has increased. As long as there is price volatility in cash markets for milk and dairy products, the dairy industry will continue to evaluate futures and options contracts for price risk management.