STRATIFIED FARM MILK PRICING

INTRODUCTION

Supply and demand does work in the dairy industry to determine and move both farm milk and dairy product prices. While farmers and dairy product companies have worked to influence national and international demand for U.S. dairy, activities on the supply side have been far less aggressive. Some dairy cooperatives have used supply management programs to reduce local supplies of milk when plant capacities and/or dairy/beverage milk sales were declining. However, there were no recent direct price related intentions to reduce aggregate supplies of milk nationally to impact farm milk prices.

Managing aggregate U.S. milk production through farm level actions and incentives have been tried in the past but have had little success. Such actions are usually very difficult to implement, complex to administer, and controversial among dairy farmers and dairy organizations.

The key to developing a comprehensive national farm milk supply management program is to coordinate farm level incentives to change milk production with national incentives to do likewise. Currently, there is a disconnect between the pricing signals sent by national supply and demand conditions and those at the farm level. When prices fall, markets usually need less product. If supplies contract, prices then rise. However, as farm milk prices fall, individual farmers often have a strong incentive to increase production to maintain cash flow. While this may be the correct decision for an individual dairy operation, it further aggravates the price dilemma. A program is needed that will provide the appropriate signals at both the aggregate national and individual farm levels.

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When first challenged to develop a comprehensive supply management plan, the Federal Order concept of classified pricing was considered as a possible template. This pricing system takes essentially the same farm milk and prices it at four different levels according to its use or "classification." Milk used for beverage products are priced at the highest, Class I level, while three uses of milk (Class II for soft products like yogurt, cottage cheese and ice cream; Class III for most cheese and whey products; and Class IV for butter and nonfat dry milk) have lower price levels and values. This pricing system has been in effect for 80 years and has weathered many changes in markets, technology and price relationships.

Could dairy farmers be paid based on different basic pricing levels? This might be attractive to dairy farmers throughout the nation who could be paid $20.00 per hundredweight for milk immediately. However, they could only receive that price on limited volumes of that milk. For example, in February 2018, the U.S. all-milk price was $15.30 per hundredweight. If there were three stratifications for the value of milk, 60% of the milk could receive a price of $20.00 per hundredweight, 2% could receive a $2.00 price, and the balance would receive a residual price of $8.69. If dairy farmers around the country were to reduce production by 2%, the all-milk price would rise significantly, and the residual price would climb. If the market price reached $20, the residual price would also be $20. At that point, all prices would rise to the higher market price.

The problem with this pricing scheme is its complexity. It would take significant amounts of time and information to calculate the residual price on a farm by farm basis. While it might be doable in a single, relatively higher value Federal Order like the Northeast Milk Marketing Order, it would be more difficult in other Orders. This is particularly so if producers switch Orders or move in and out of regulation, like some do seasonally or for other reasons. This would also be extremely difficult to do for Federally unregulated producers which still represent a large share of dairy farms and milk production.

This proposal would likely only work if there was one national Federal Order covering all dairy farms and their production in the continental U.S. This would require Federal legislation. It would be a huge change in the pricing and market structure of the dairy industry which would go far beyond the concept of sending milk pricing incentives and signals to dairy farmers. This action would very likely generate tremendous controversy and diminish any support for doing so.

With that is mind, I have decided not to present this proposal in any detail, but instead provide the above brief description of the concept in case others would like to pursue it.