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Marketing Information for Minnesota Dairy Farmers

Federal Milk Marketing Orders

On January 1, 1979, there were 47 federal milk marketing orders in the United States. Through these milk marketing orders, the federal government directly regulates the handling and pricing of about 65 percent of all U.S. produced milk and about 80 percent of all U.S. grade A milk. Much of the remaining milk not regulated by federal orders is priced under state regulation.

The present federal milk marketing order program evolved from a set of marketing regulations first established during the 1930's. Recently, public attention has focused on federal milk marketing orders because of a concern over government involvement and regulation throughout the economy. This fact sheet focuses on major provisions and operations of the program.

MAJOR PROVISIONS OF FEDERAL ORDERS

Two major provisions are:

- Classified milk pricing according to use and
- Pooling or combining all revenue from the sale of regulated milk from which a single uniform price is calculated.

This single uniform (blend) price is, then, the basis of prices paid to grade A dairy farmers.

Classified Pricing

Federal orders require handlers who buy grade A milk from dairy farmers and who distribute it in the specified market order area to pay at least minimum milk prices depending on how the milk is used. In most orders there are three classes of use:

- Class I milk – milk used in fluid milk products such as whole milk, skim milk, low-fat milk, and milk drinks;
- Class II milk – milk used in soft manufactured products such as fluid cream products, cottage cheese, ice cream, and frozen desserts;
- Class III milk – milk used in hard manufactured products such as cheese, butter, dry milk, and nonfat dry milk.

In most federal orders, the price charged handlers for milk used to make Class III products (Class III price) is set equal to the average price that manufacturing plants pay per 100 pounds of grade B milk (f.o.b. plant) in the Minnesota-Wisconsin area. A floor is placed under this price as the government stands ready to purchase dairy products in amounts needed to keep it from falling below the support price.

The price charged handlers for milk used in Class II products (Class II price) is set about 10 cents above the Class III price.

A minimum price to be charged handlers for milk used in Class I products (Class I price) is determined in each federal order. This price is different in each order, while the Class II and Class III prices are about the same in all orders. The minimum Class I price for a given order is determined by adding a designated amount (Class I differential) to the M-W price.

In federal orders east of the Rocky Mountains, the minimum Class I price per 100 pounds of milk is approximately the M-W price plus 90 cents plus 0.15 cents for each mile the specific order area is located from Eau Claire, Wisconsin. For example, the minimum Class I price in the southeastern Florida market order is set $3.15 above the M-W price. (That $3.15 is 90 cents plus 0.15 cents times the approximate 1,500 miles the order is from Eau Claire, Wisconsin.) The minimum Class I prices set in some orders located in the far west are less than those calculated with this formula.

Pooling

A second major provision of federal orders requires that all payments for regulated milk used in different classes be pooled. A uniform price, usually called the blend price, is then calculated for each order and used as a basis for paying grade A dairy farmers associated with the respective order for their milk. An example illustrates the calculation of the blend price and the effect of pooling on milk prices received by farmers.

Assume a situation with two handlers selling milk in a market order area. Table 1 shows (1) the prices the handlers are required to pay for the three use classes of milk, (2) the volume of milk each handler uses in each class, (3) the payment obligation of each handler to the pool, and (4) the market total for the use classes and payment obligations.

Notice that even though the two handlers receive the same amount of milk, their utilization of that milk is different. Handler A used a larger proportion of milk in the higher priced Class I use (80 percent) than did handler B (50 percent). Therefore, the average price paid by handler A was $10.24 per 100 pounds of milk received compared to $10.04 for handler B. If the federal order market uses an *individual handler* type of pool, handler A must pay selling farmers a minimum of $10.24, while handler B's minimum is only $10.04.

Most federal orders use a market-wide type of pool. This means the Class I utilization for the entire market (65 percent in this example) is used for calculating a market-wide uniform (blend) price of $10.14 ($20,285 ÷ 2,000). Individual handlers still pay the table 1 prices; however, handler A pays $10.14 to farmers and 10 cents ($10.14 + $0.10 = $10.24) to a producer's settlement fund operated under the federal milk marketing order. But handler B receives the 10 cents from the producer's settlement fund so, like handler A, B can pay

Table 1. Hypothetical example of pooling under federal milk marketing orders

Use	Price[a]	Handler A		Handler B		Total market	
		Cwt.	Payment	Cwt.	Payment	Cwt.	Payment
Class I	$10.38	800	$8,304	500	$5,190	1,300	$13,494
Class II	9.78	50	489	100	978	500	1,467
Class III	9.68	150	1,452	400	3,872	550	5,324
Total	—	1,000	10,245	1,000	10,044	2,000	20,285
Average price	—	—	10.24	—	10.04	—	10.14

[a]These were the August 1978 Class I, II, and III prices in the Upper Midwest marketing area (Federal Order No. 68).

farmers $10.14 ($10.04 + $0.10). Under a market-wide type of pool, each handler is able to pay farmers the same price regardless of how much milk fell in different use classes.

Other adjustments are made in the market-wide blend price before an individual farmer is paid for milk. The costs of certain market services such as making butterfat tests can be deducted. This is a cost to farmers. However, the cost of administering the federal order program itself is paid by the handlers and cannot be deducted from the blend price.

The price received by individual farmers also reflects adjustments from the uniform price for location and butterfat differentials. Generally, federal orders zone the milk supply area based on the nearest population centers. Dairy farmers delivering to plants located in the more distant zones are paid less than farmers close to the central population centers. This is to reflect costs of transporting milk from the farm delivery plant into the central city. The farm to delivery plant transportation cost is paid by the farmer.

The butterfat differential adjusts an individual farmer's price to reflect the milk's butterfat test.

A cooperative may also "repool" total returns. This means that the milk price received by a farmer-member of the cooperative can also be influenced by the cooperative's policy on repooling and the allocation of certain charges and costs.

IMPACT OF FEDERAL ORDERS ON MANUFACTURING MILK PRICES

Farmers who produce grade B (manufacturing grade) milk do not participate in the pricing and pooling provisions of federal milk marketing orders. Rather, grade B sellers receive the going manufacturing milk price. This is most significant for farmers in Minnesota and Wisconsin because the two states account for most of the grade B milk production.

Federal orders can directly increase (decrease) the blend prices paid to grade A dairy farmers by increasing (decreasing) the differential between Class I and Class III milk prices (Class I differential). Whether these differentials also affect prices received by grade B dairy farmers depends on whether the manufacturing milk price is at the government support price or above it. If the manufacturing price is above the support level, then an increase in the Class I price differentials tends to decrease the price received by grade B farmers by encouraging more milk production and discouraging fluid consumption. These changes send more milk into manufacturing causing the manufacturing milk price to fall.

If the U.S. manufacturing milk price is at the support level, increasing the Class I price differential increases the amount of government purchases but does not affect prices received by grade B farmers.

PURPOSES OF FEDERAL ORDERS

Whole milk must be consumed within a few days of being processed. Its perishability, combined with seasonal variations in production, and the fact that milk must be grade A to be used as a fluid beverage, creates fluid milk's potential price instability.

Also, some grade A dairy farmers could not expect to sell milk for fluid use year-round, making market security a potential problem. Classified pricing and pooling of milk contributes to Class I price stability by providing price incentives for farmers to product grade A milk. This additional grade A milk provides a fluid milk reserve to avoid seasonal and daily shortages of fluid eligible milk.

Pooling returns from Class I sales with Class II and III sales provides market security for some dairy farmers who, during the high production and low consumption seasons of the year, probably would be cut off from the fluid market. Under federal orders, this milk can be diverted into manufacturing uses, but farmer producers still are paid based on the uniform milk price.

Federal orders also provide for impartial audits of dairy plants to insure fair and accurate payments to dairy farmers, verification of weights and milk tests and current market data. Also, by specifying minimum price payments by handlers, lower prices, which sometimes occur because of retail price wars, cannot be passed back to farmers.

Classified pricing may be used to increase total returns to the dairy industry. However, these increased returns are shared only among grade A farmers.

How Is a Federal Milk Marketing Order Established?

To establish a federal order, dairy farmers (directly or through their cooperative associations) petition the Secretary of Agriculture to regulate milk prices in a specific market area. The Secretary initiates a preliminary investigation on the need and feasibility for an order. If it is decided that an order may be needed, the Secretary sends out a notice for a public hearing to obtain views on the proposed order and its specific provisions. Based on the evidence received at the hearing, a recommended decision and order is then issued for further discussion and comment by all interested individuals. A final decision or order is then voted on in a referendum of the producers selling milk in the marketing area. If the necessary two-thirds majority vote is obtained, then the marketing order takes effect.

The federal order is supervised by the Dairy Division, Agricultural Marketing Service, USDA, Washington, D.C. Each individual order is administered locally by a market administrator appointed by the Secretary of Agriculture.

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