The Missing 39 Percent: Is it a Concern?

The dairy industry is devoting considerable resources to updating or reforming the federal milk marketing orders (FMMOs). While many aspects of the orders are being scrutinized, the two facets perceived to have the greatest impact are the Class I price formula and make allowances.

However, a third important issue is receiving virtually no attention. In 2021 only 61% of U.S. production was pooled in the federal orders, meaning 39% of production was marketed outside the regulated system. Why is this important?

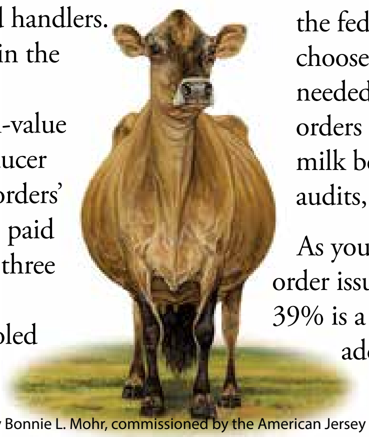
First, it's important to understand why some milk is not pooled. Not all areas of the U.S. are within the federal order system, most notably Idaho and Utah, and Idaho is the number #3 state for milk production. However, the majority of the non-pooled milk is Class III or IV produced within the federal order marketing areas.

While Class I milk is required to be pooled, manufacturing milk has the option to be pooled. From the beginning federal order pricing was designed to have Class I be the highest priced milk, which combined with the high volume of Class I sales, would entice Class III and IV to be pooled to share in the Class I revenue. However, milk market dynamics have changed dramatically in recent years. Fluid milk sales continue to decline and now represent less than 20% of total production. Therefore, Class I contributes less revenue to the orders' statistical uniform prices than previously. Furthermore, increased demand for manufactured products, including exports, can increase Class III and IV prices to the point that in many months one will exceed an order's statistical uniform price. Pooling Class III or IV milk when its price is higher than an order's statistical uniform price would require the III or IV handler to share their revenue with the other pooled handlers. By not pooling their milk handlers can retain the high-value revenue.

Why is this a concern? Not pooling high-value manufacturing milk lowers the orders' Producer Price Differentials (PPD), and thereby the orders' statistical uniform prices and in turn, prices paid to producers. What can be done? There are three options.

1. Entice manufacturing milk to be pooled by raising Class I revenues. It is important to note that revenues are a function of both price and volume. Current discussions focus on modifying and increasing the Class I price. However, the concern of depooled Class III and IV milk cannot be addressed through the Class I price. Today's lower Class I volumes mute the impact the Class I price will have on an order's statistical uniform price making it more likely that the Class III or IV price will exceed the statistical uniform price.
2. Each order has its own pooling rules, and most restrict how Class III and IV milk can rejoin the pool after it's left the pool. Making it harder for manufacturing milk to be re-pooled would increase the risk of leaving the pool. Tighter pooling standards would discourage the practice of Class III or IV toggling out of the pool when it would be required to pay into the order and toggling back into the pool when it could draw from the order. Keeping manufacturing milk pooled would also support the two original premises of creating federal orders, establishing minimum prices and pooling revenues. However, the reality is that with tighter pooling standards handlers may opt to simply keep manufacturing milk out of the federal order pools permanently rather than pooling their milk to share in ever-declining Class I revenues.
3. Ignore the milk that isn't pooled and is, therefore, unregulated. Choosing this option is, by default, choosing for an increasingly unregulated milk market with no transition plan in place. As Class I sales continue to decline and overall production continues to increase, the percentage of milk marketed outside the federal orders will increase. If the industry chooses to go down this path a transition plan is needed to address the myriad of services the federal orders provide to producers and handlers of pooled milk beyond just pricing. These include market data, audits, and payment terms and conditions.

As you attend industry functions this fall and federal order issues are discussed, be sure to ask if the missing 39% is a concern, and if so, what is being proposed to address that concern.



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