What Really Determines Milk Prices?

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If most dairy farmers were asked this question, their answer might be, "Why the government does." At first thought, this appears to be correct since the government, through the price support program, establishes a target or desired minimum farm price for milk.

However, the correct answer is: **demand.** The demand for milk establishes farm milk prices.

In an unregulated market, the price of a product is determined by the interaction of supply and demand. For any given price at a particular point in time, there exists a demand for the product and a supply of the product. The demand for a product is simply the amount consumers are willing to purchase at that given price. The supply of the product is the amount producers are willing to sell at that given price. As the price goes up, consumers are willing to purchase less of the product but producers are willing to sell more of the product. When the price decreases, the reverse is true: consumers are willing to purchase more but producers are willing to sell less.

Of course other factors influence both the consumers' and producers' decisions to purchase or sell a product. On the consumers' side, decisions to purchase a product are also influenced by prices of substitute products, income levels and tastes and preferences. On the producers' side, the decision to sell a product is influenced by costs of inputs needed to produce the product, profitability of other commodities that can be produced, technology, government policy, and an increasingly more important factor: cash flow needs of the producer.

A market price is then the price associated with the quantity of product that the consumers are willing to purchase and the producers are willing to sell. An agreement is reached by consumers to purchase and producers to sell a quantity of

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