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Penn State
FARM AND DAIRY

Business Seminar of the Week

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minimum prices for their milk sold in the milk marketing orders. The CCC purchases of dairy products are designed to assure that the M-W price is at least at the level of the target price or desired support price.

There are, in effect, three types of demand for dairy products: commercial demand, demand for dairy products by the government, and the artificial demand created by CCC purchases designed to support the price of milk.

The commercial demand is simply the amount of milk used in products purchased by consumers and is affected by those factors previously discussed.

The government uses dairy products for the military and in programs such as the school milk program,

donations to the needy in the United States, and the PL 480 program.

The artificial demand is the amount of product needed to be purchased to assure the M-W price is at or near the support price. This demand is often called the milk surplus.

In the creation of this artificial demand, the CCC buys butter, cheese and nonfat dry milk which the commercial and government market will not buy. It accomplishes this by paying prices for these products which have been calculated to enable the manufacturing plants in the Minnesota-Wisconsin area to pay farmers prices that are at or very near the desired support price. In the creation of this artificial demand all the milk offered by the producers is

used, either by the commercial and government markets or by the CCC in the form of product purchases.

A situation in which the price determination process, similar to the one occurring in an unregulated market, results in a decrease in the price to the level at which the consumers (or commercial demand) will accept all that is offered will not occur. Purchases are made by the CCC to assure that prices will be very near the target or support price.

However, since the price is maintained by creating an artificial demand, the M-W price does not necessarily equal the support price. Because the demand and supply situation is constantly changing, the M-W price also constantly changes but, even at its lowest, hovers around the support price.

In some cases, the M-W falls below, although usually only by a small amount, the support price. At these times, CCC product purchases are usually quite high since they are needed to assure that the M-W price is near or equals the support price.

The M-W prices are lowest and the CCC purchases are highest during the spring and early summer months. During these months the supply of milk is the largest. The commercial market is unwilling

to purchase all of the milk offered and price declines.

The CCC purchases the milk that the commercial market is unwilling to buy (in the form of butter, cheese, and nonfat dry milk) at levels necessary to achieve the desired support price. In the fall and winter, the M-W price is usually the highest since

One main element in all of these programs was to reduce the support price in an effort to reduce the production and supply of milk. These decreases would have a positive impact on consumption as well since retail prices were expected to decrease in conjunction with decreases in the farm price of milk. There were also other elements in these programs that were designed to reduce the milk supply.

One of these programs was the Diversion Program. It was fairly successful in the short run (for 1984). CCC purchases, that artificial demand, were cut in half in 1984 from 1983 levels. The support price was also decreased 50-cents per hundredweight.

Commercial consumption increased 3.3 percent from a year earlier as opposed to a previous annual increase in 1983 of 0.3 percent. This can be attributed, in part, to an increased advertising and promotion campaign as well as the decline in milk prices. This had a very positive impact on farm prices during the year and even with the 50-cent decrease in the support price, the M-W price was only 27-cents lower than the previous year.

The M-W price responded to the effects of the decreasing artificial demand (CCC purchases) and improving commercial demand and was 43 cents higher in the second half of 1984 than in the first half.

During the second half of 1984, the M-W price was 6 cents higher than in the second half of 1983 despite the 50-cent decline in the support price. This illustrates the effects that a strong commercial demand and a smaller artificial demand can have on milk prices, even with a cut in the support

price.

Since the effects of the Diversion Program along with the cut in the support price were short lived, other steps were necessary to control CCC purchases and costs. In the first quarter of 1985, CCC purchases were again at very high levels. In another effort to reduce CCC purchases and costs, the support price of milk was reduced \$1 per hundredweight in the first half of 1985.

However, CCC purchases were still quite high for 1985, 57 percent higher than in 1984. As can be expected, the M-W price dropped considerably as a result in the cuts in the support price and averaged 76 cents per hundredweight lower than in 1984. However, commercial demand increased 3.2 percent for the year, perhaps in response to the accompanying decreases in retail prices and increased advertising and promotion in the industry. Without this healthy increase in commercial demand it is quite likely that farm prices would have been even lower than they were.

Two things are illustrated in the events of 1985. The first is that the farm price of milk was still too high since it, among other things, encouraged dairy farmers to increase production and offer much more milk than consumers would accept at those given prices.

Secondly, the impact of a strongly increasing commercial demand is illustrated since the farm level price did not fall as much as it would probably have with a weaker commercial demand.

With the coming of a new year, 1986, another program, the Dairy Termination Program, designed to reduce CCC purchases and costs was initiated. A voluntary supply control program resulted in dairy farmers whose 1985 marketings amounted to 12.2 billion pounds signing up to discontinue milk production for at least five years. The support price was not reduced in 1986 but two 25-cent reductions were scheduled in January and October 1987 with annual cuts up

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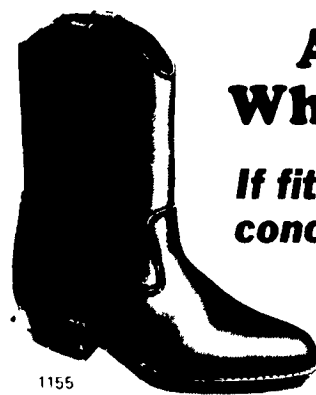


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