FAPRI At the University of Missouri
Food and Agricultural Policy Research Institute

Dairy Policy Analysis Alliance

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Dairy Policy Brief #9d: Federal Milk Marketing Orders—Pooling

What is the Program?

Under federal milk marketing orders, producer milk value is determined through *pooling*. Simplifying what is a complex process, total pool value is calculated by applying minimum class prices to the volume of milk used in each of the four classes, I through IV. Producers affiliated with handlers regulated under the order are paid a common price for milk that is equivalent to total pool value divided by total pool volume, regardless of how their milk is used.

The terms, pool and pooled, are also used in federal order language to refer to plants that either must or may be part of the overall pooling process and to producers eligible to share in the pool distribution. Class I handlers within an order marketing area are called *pool distributing plants*. These plants are required to be pooled, that is, they are obligated to pay minimum Class I prices for the milk they receive. For manufacturing plants, called *pool supply plants*, pooling is optional. But there is usually an economic incentive for doing so because they receive producer settlement fund payments to pay producers.

Producers may ship their milk to any handler and share in the marketing order pool under which the receiving handler is regulated. Dairy cooperatives sometimes "pool" some of their affiliated producers on distant markets to take advantage of higher producer prices.

What are the issues?

- ***Distant pooling.*** In most federal order markets, producers receive Class III milk component prices for their butterfat, protein and other solids plus a producer price differential (PPD) per hundredweight of milk. The PPD represents the market-wide combined marginal value of other classes of milk relative to Class III, and varies positively across markets with Class I prices and utilization. When cooperatives pool producers' milk outside the producers' marketing area, all of the pooled milk receives the PPD for the receiving market. But not all the milk that is pooled has to be shipped to receive the PPD—the shipper need only demonstrate the capability of providing the pooled milk as defined by the receiving market's order qualification standards. Consequently, there has been a strong incentive to pool milk on markets with a relatively high PPD, which increases the volume of pooled milk and decreases the average pool value in the receiving order. Several orders have recently been amended to tighten qualification standards in order to reduce economic incentives for distant pooling.

- ***Depooling.*** Because Class I prices are announced six weeks before Class III prices, the monthly Class III price infrequently ends up higher than the Class I price. This *"price inversion"* means that the PPD becomes negative. It also means that pooled Class III handlers, who normally draw money from an order's producer settlement fund, would have to pay into the fund. To avoid this payment, Class III handlers often depool—disassociate from the order—when there is a price inversion. The effect of depooling is to remove higher-priced milk from the pool, further reducing the PPD. Some orders have been and are being amended to make it more difficult for plants to depool.

- ***Producer-handlers.*** Dairy farmers who package and sell fluid milk exclusively from their own herds are exempt from federal order regulations. There are only a few producer-handlers and most have small herds and limited fluid milk sales. But some exempt producer-handlers have grown large enough to materially reduce Class I sales of regulated handlers. This reduces marketing order pool dollars and average milk value to producers. Recent federal legislation (the Milk Regulatory Equity Act) regulates large producer-handlers selling fluid milk in the Arizona-Las Vegas marketing area.