The End of the Tunnel

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There's an old saying that when an optimist and a pessimistic see light at the end of the tunnel, the former takes it as an indication that he's almost through the tunnel, while the latter believes it's just an oncoming train.

In the case of the dairy industry, I think we can optimistically predict that the light we see in the tunnel of milk prices is in fact, the end of the terribly long, dark and depressing two-year hole in which we've been buried. Farm-level milk prices started their sharp retreat almost exactly two years ago, in the fall of 2001, and things have finally turned around this summer. Just as no one could have accurately predicted that prices would stay depressed for two whole years, no one forecast that prices would turn around as rapidly and as strongly as they have. The July Class III price was $11.78 per hundredweight, up $2.03 from June, and up $2.45 from July 2002 (although it's still way below July 2001's $15.46). The August Class III prices will improve about $2 more, leading to the strongest prices since the summer of 2001.

Now, how long the price recovery lasts is also a tough thing to predict. The futures markets do not forecast $14 levels to be sustained the remainder of the year. Still, prices should remain stronger than they have been, which at least allows us to wiggle free from the restrictions of that dark tunnel. We also now have Cooperatives Working Together to help smooth out and stabilize prices so we don't fall back to the levels we saw this spring.

One of the ongoing frustrations of dairy farmers during this economic depression has been not just their low prices, but the high prices they see in stores for dairy products. Farmers know all too painfully well how low their prices have been since 2001. And since they shop in supermarkets

Key Messages on Dairy Pricing

- America's dairy farmers do not set the price of milk. Neither does the federal government. The price is determined by market supply and demand, and is established by a combination of factors, including processing and transportation costs, and retail store margins.

- On average, farmers receive about 30 cents of every dollar consumers spend on dairy products. The other 70 percent is split among others in the marketing chain, including processors, distributors and retailers.

- Dairy farmers are hurting economically. The prices they have received for milk have increased recently from historically low levels experienced over the past two years, when dairy farmers received essentially the same price for milk that they were paid during the 1970's. Unlike most other businesses, dairy farms cannot directly pass on increasing production costs.

- Over the past two years, while on-farm milk prices have been at rock-bottom, the average retail price of milk has not decreased in proportion.

- Even with recent retail milk price increases, dairy products continue to offer great taste and good nutrition, making them the best value for the money in the food market basket.

along with typical consumers, they also know that consumers hardly benefited at all from the lowest raw milk costs since the late 1970s.

The U.S. Department of Agriculture reported that earlier this summer, while the price that farmers received had dropped by more than one-third since September 2001, the retail price for milk declined only 9 percent. The price for cheddar cheese dropped only 8 percent. And ice cream's price hardly changed at all. So the insult added to the injury of low farm prices is that consumers didn't reap any real savings, while others in the food marketing chain had the opportunity to make killer profits at the expense of both farmers and shoppers.

Now that farm-level prices are rising to more normal levels, processors and retailers are warning that consumers should expect to see higher costs for dairy products. And that's yet another source of enormous frustration for dairy producers. Retail prices hardly budged at all when the farm price dropped by 30+ percent. Why should retail prices need to be boosted now that prices are stabilizing?

This doom and gloom drumbeat by the retail community is yet another example of an economic trend that's become obvious in the past 20 years: namely, that when the farm price for milk drops, the retail price changes little; but when the farm price increases, there's an almost immediate reaction upward in stores. The net effect of this trend is the growing spread between farm and retail dairy prices. Today, farmers receive on average only 30 cents of every dollar that consumers spend on dairy products. That portion is down from about 50 cents 20 years ago.

It's true that farmers don't control their price for milk, and that until they own every aspect of the food production and marketing chain, they also can't control retail prices either. But we have an obligation to tell an accurate story about the growing disconnect between farm and retail prices, and point out that farmers get a small and shrinking share of the consumer's dairy dollar. The bulk of the money spent goes to others in the distribution chain. So changes in the farm-level price need not necessarily be directly and proportionately reflected in the retail price.

The fact is that, regardless of the retail price, dairy foods remain one of the greatest nutrition and taste bargains in the entire supermarket. Profit margins in the dairy case are among the highest in the store because of the popularity of dairy foods. Retailers realize this, and that's why they continue to charge what they think the market will bear – and even then, butter, cheese, milk and ice cream continue to fly off the shelves. That's great news from a marketing standpoint, but it doesn't serve as much solace when the milk check arrives.

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MMPA Flint

July 2003

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