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## *Approach D*

### MULTIPLE PRICING

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The major objectives commonly associated with multiple pricing are to: (1) maximize total returns to farmers, (2) stabilize total returns to farmers, (3) minimize the supply response by producers to an increased level of price, and (4) encourage a desired seasonal pattern of production. Unlike most other types of farm programs in this country, the objectives of multiple pricing are achieved primarily within the market place.

#### GENERAL FEATURES

The multiple pricing approach divides the market into segments according to differences in the rates at which prices respond to changes in supply. No attempt is made to increase demand, but the existing demand schedule is segmented according to differences in elasticity. In fact, the applicability of multiple pricing depends upon the degree to which the total market can be administratively divided into segments having different demand elasticities. The segment of the market with the less elastic demand is referred to as the "primary market" and the segment with the more elastic demand as the "secondary market." This division is made either on the basis of location such as domestic and foreign markets, or on the basis of utilization, such as food and feed uses of a product.

Prices and/or supplies in the primary market are fixed administratively to take advantage of the less elastic demand for this segment of the market. Prices in the secondary market are usually allowed to fluctuate in response to supply and demand with a minimum of administrative interference. Annual or seasonal changes in supply are thus reflected mainly in the secondary market where demand is more elastic and the price response to changes in supply is smaller than in the primary market. Isolating the primary market in this manner from changes in production and total supply makes it possible to stabilize or to increase returns to producers.

One method is to establish prices in the primary market administratively; then allow supplies to flow to this market in the quantities

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\*The other members of the work group who reviewed the preliminary draft and assisted in the development of the final report were: T. E. Atkinson (Chairman), Harry Anderson, Wallace Barr, G. Max Beal, Karl Shoemaker, and C. O. Youngstrom.

demanded at the established price. The remaining supply flows to the secondary market for whatever price this market will return. With this type of multiple-price program, proportionate shares of the primary and secondary market sales are usually allocated to individual producers by some type of pooling mechanism.

Another method is to allocate supplies to the primary market to increase returns from this market; then, the remaining supply is allowed to flow to the secondary market at whatever price this market will return. With this type of multiple pricing, shares in the primary market are usually allocated to producers on the basis of production in an administratively selected base period.

A wide range can exist in prices between the primary and secondary markets and in the proportion of total supply that is allocated to the primary and secondary markets. These variations influence the effect that multiple pricing has upon producer returns. The procedures followed and the effects of the program will vary from commodity to commodity and with the objectives of the program. The effects of a multiple-price program for a given commodity also depend not only on the characteristics of its markets but also upon whether production restrictions, import quotas, price supports, and other devices are employed at the same time.

Multiple pricing can be applied to producers as well as to the market. The primary objectives of multiple pricing to producers are: to minimize the supply response to an increased level of price and to shift production toward a particular seasonal pattern. Individual producers are paid a higher price that reflects returns in the primary market for part of their production, and a lower price that reflects returns in the secondary market for their remaining production. In this manner, the price of the share of the product flowing to the lower priced secondary market is reflected to the individual producer. The return for added production thus is less than if all producers were paid a single unit or blended price for their total production.

Multiple pricing to producers is employed seasonally for milk to influence the seasonal pattern of production. With this type of multiple-price program, the returns from the highest priced segment of the market are allocated to individual producers according to their production in a base period.

#### **SOME EXAMPLES**

The McNary-Haugen plan, twice passed and twice vetoed in the 1920's, is evidence of the early interest and great controversy in multiple pricing. The proposal would have utilized the domestic feed grain and foreign export outlets as secondary markets for wheat.

The multiple pricing principle is practiced in marketing some manufactured goods, and in establishing transportation rates and public utilities charges. It has also been included in various forms and degrees in farm legislation during the past twenty-five years. Examples include: Domestic Allotment Act of the early 1930's; International Wheat Agreement; various forms of export subsidies; non-systematic arrangements for surplus disposal, including Section 32 export operations; Public Law 480 and other CCC disposal programs.

Most purchase and storage programs in this country have developed into multiple-price programs. As stocks have accumulated through the purchase program, disposal programs have been developed to move stocks at less than domestic market prices.

Marketing agreements and orders are probably the best example of the continued use of multiple-price programs in this country. Under these orders, prices are established administratively and applied according to the utilization of the milk.

A number of fruit and vegetable marketing agreements are also in effect throughout the country. These programs do not establish multiple prices directly, but are used to allocate supplies to various uses or segments of the market in a manner that will stabilize or increase returns to producers. The allocation of tree nuts between in-shell and shelled outlets is an example of the use of the multiple-price principle in marketing agreements.

#### **EFFECTS ON FARMERS**

Returns to producers of some commodities can be increased by multiple pricing. The possibilities for increasing returns are greater in the short run than in the long run. Long-run gains are possible, however, when the market can be effectively divided into elastic and inelastic segments. The price effect of increased supply can be minimized when the increase can be directed to the more elastic segment of the market. Producers receive higher returns for their resources or market more resources at the same price when multiple pricing is used in this manner.

For many commodities, the market cannot be effectively divided into elastic and inelastic segments. (Political considerations often prevent extensive use of secondary markets to absorb greatly increased supplies.) Increased producer returns often stimulate output so that income benefits to producers are limited to the short run. The problem of devising and enforcing effective supply restraints is just as difficult with multiple pricing as with other programs designed to increase returns to producers.

Multiple pricing is an effective means of stabilizing returns to producers. The price effect of supply fluctuations can be effectively minimized. When multiple pricing is used to stabilize returns in this manner, the problem of supply response is reduced.

Marketing orders and agreements use multiple pricing primarily to stabilize rather than to increase long-run returns. These programs have been used over time without direct supply restraints.

Producers who rely primarily on the secondary market for their returns are disadvantaged by multiple-price programs. The additional supplies flowing to the secondary market reduce prices in the secondary market. The reaction by secondary market producers, both domestic and foreign, is one of the major factors that limits the use of multiple-price programs. For example, producers of milk for manufacturing object to federal orders that increase supplies of surplus or manufacturing milk. Canadian wheat producers object when U. S. wheat stocks are sold at reduced prices on world markets in which they compete. Domestic feed grain producers would likely oppose a two-price program for wheat that established a relatively high price for food wheat and resulted in a reduced market price for feed wheat.

Multiple-pricing programs have been most acceptable and effective when production is sufficiently concentrated so that essentially all producers of a particular commodity are included in the program, and none are wholly dependent upon the secondary market.

Marketing agreements used for fruits and vegetables usually apply to a major production area of a particular fruit or vegetable and include all of the producers within the area. Fluid milk marketing orders apply to all producers delivering milk to plants which supply a particular market.

Multiple pricing may be equally applicable to a commodity with widely scattered production, but it is difficult to develop a program satisfactory to widely scattered producers.

Multiple pricing is most effective when a high proportion of the supply moves to the primary market. The advantages of multiple pricing are very limited for a crop like corn, which goes so largely to feed or secondary market use. By contrast, a large part of U. S. wheat goes to the relatively inelastic domestic food market.

Allocating returns from the primary market is one of the major difficulties in applying multiple pricing and determines how one producer is affected as compared with another. Either pooling or primary market allotments may be used to allocate primary market returns to producers.

Pooling is used in milk marketing orders. A proportionate share of primary market returns is allocated to each producer either on a market-wide or individual dealer basis.

The pooling of primary and secondary market returns tends to encourage increased production. Returns to individual producers for increased production do not directly reflect the lower secondary market prices. Individual producers receive a greater return for increased production than the added product actually returns in the secondary market. Producers who increase production thus receive an increased share of total primary market sales, unless the proceeds are distributed on the basis of past, rather than current, production. Primary market returns to producers may be made according to production in a designated base or quota period. This reduces the incentive to increase production.

If the same base is used to allocate returns over a period of years, producers who increase production receive a decreasing share of their returns from the primary market. Younger farmers who are in the process of expanding the size of their farm operation tend to be disadvantaged relative to older, well established farmers.

#### **EFFECTS ON DOMESTIC CONSUMERS**

Multiple pricing usually places the cost of income benefits to producers mainly on primary market consumers. This means of increasing farm income, therefore, results in more consumer opposition than programs which depend upon tax revenue as the source of additional producer income. Multiple pricing is not an effective means of increasing producer income unless primary market demand is relatively inelastic. The loss of primary market sales for commodities which have readily available substitutes minimizes or eliminates, in the long run, the income benefits to producers from multiple pricing. Production of substitute products is stimulated by increased primary market prices and, in the long run, competition is increased. For example, high domestic cotton prices stimulate the development and production of synthetic fibers and over time reduce domestic cotton sales.

When multiple pricing is applied selectively to different commodities, all consumers are not equally affected. For example, the application of multiple pricing to wheat would increase the cost of bread to domestic consumers. Low-income consumers who are the heaviest users of bread would pay more than high-income consumers.

Multiple pricing reduces prices to secondary market consumers, but increases price fluctuations. With multiple pricing of wheat, the price of wheat used for food could be increased and the price of wheat used

for feed would decrease. Bread prices, therefore, would tend to increase relative to meat prices.

Consumer opposition to increased prices in the primary market is one of the major factors which limits the use of multiple-price programs.

#### **EFFECTS ON TAXPAYERS**

Taxpayers usually bear only a small portion of the cost of increasing farm income by multiple pricing. The administrative costs may be wholly or partially borne by taxpayers.

When purchase and storage programs develop into multiple-price programs, secondary market sales usually are subsidized from tax revenue and thus the cost of this indirect type of multiple-price program is borne by taxpayers as well as by primary market consumers.

Inasmuch as multiple-price programs do not normally depend upon tax funds, these programs are somewhat less subject to the political climate than programs depending directly on tax funds. Yet, the sensitivity of lawmakers to their consumer constituents does not entirely relieve multiple-price programs of political hazards.

#### **EFFECTS ON FOREIGN COUNTRIES**

Foreign countries are affected in different ways by multiple-price programs. Consumers in importing countries tend to gain where foreign outlets are used as secondary markets, but producers in importing countries will be injured. Producers in other exporting countries are adversely affected. These countries frequently attempt to offset their economic disadvantage by taking retaliatory measures.

High domestic or primary market prices necessitate import quotas or tariff barriers to restrict imports. Thus, multiple pricing between domestic and foreign markets tends to create barriers in the free flow of trade and to aggravate international relations.

In fact, the reaction of foreign countries to multiple pricing is one of the major factors that limits the use of this type of program for export commodities.

#### **SUMMARY**

Multiple pricing is a possible method of increasing returns to producers of some commodities. This method of pricing is effective for commodities which have markets that can be administratively divided into segments with different rates of price response to changes in supply.

Reactions of producers competing in secondary markets, primary market consumers, and foreign exporting countries are all major factors which limit the use of multiple pricing as a means of increasing domestic producer returns.

Multiple pricing is an effective means of stabilizing producer returns of some commodities. Here again it must be possible to divide markets into segments which have differing demand elasticities. Short-run price fluctuations can be minimized, and fluctuations in production and returns can be stabilized over time.

Multiple pricing is not a panacea for the income problem of commercial agriculture, but it is one of several approaches that may contribute to the solution of the problem.