

Federal Milk Marketing Order Modernization *Analyzing the National Milk Producers Federation Proposal*

The most recent change to the Federal Milk Marketing Orders (FMMO) occurred in conjunction with the 2018 Farm Bill. The Class I base price, often referred to as the Class I mover, was changed from being the higher of the advance Class III and Class IV prices to be the average of the advance Class III and IV prices, plus \$0.74/cwt.

Within two years of implementation the new price was discovered not to be revenue neutral as intended, but instead had asymmetrical risk with more downside than upside. At that point the National Milk Producers Federation (NMPF) drafted a proposal to address the inequity. Before submitting the proposal to USDA and requesting a hearing, Secretary of Agriculture, Tom Vilsack, stated that he wanted the industry to come to consensus on FMMO solutions before initiating the formal rulemaking process. In response several industry organizations began looking at all aspects of FMMO pricing with the goal of developing a comprehensive package of potential modifications. NMPF's task force worked for over a year and drafted a set of six recommendations which the NMPF board approved in late October. NMPF is the first organization to publish a specific set of proposals.

Updates dairy product manufacturing allowances contained in the USDA milk price formulas

FMMO component prices are based on end product pricing formulas. These formulas utilize wholesale prices for butter, cheese, dry whey and nonfat dry milk to determine values for butterfat, protein, other solids and nonfat solids. End-product pricing formulas include a fixed deduction called a make allowance, i.e., a processing credit for turning raw milk into finished dairy commodities. Make allowances are based on an estimate of the costs associated with converting a hundredweight of raw milk into commodity dairy products. The current make allowances are based on a hearing held in 2007, and obviously costs have increased in the past 15 years.

NMPF proposes to update make allowances in two steps. The first update would be implemented in conjunction with a national hearing expected to be held in 2023 and would be considered a short-term solution. These initial make allowances would serve as a bridge to a more comprehensive update.

While NMPF hasn't published the make allowances they recommend for the first step, NAJ has learned they are:

- \$0.24/lb. for cheese (an increase of about four cents),
- \$0.23/lb. for dry whey (an increase of about three cents),
- \$0.21/lb. for butter (an increase of about four cents), and
- \$0.21/lb. for dry whey (an increase of about four cents).

The overall impact of these make allowances will be to lower the Class III price by about \$0.54/cwt. and the Class IV price by about \$0.52/cwt.

The second step proposes implementing a system to regularly update make allowances but requires enabling legislation in the 2023 Farm Bill. Earlier this year USDA published results of a processing plant cost survey done by Dr. Mark Stephenson. The analysis began by identifying the 153 manufacturing plants required to provide USDA with weekly wholesale prices of cheddar cheese (both 40-pound blocks and 500-pound barrels), dry whey, butter, and nonfat dry milk. All the plants were invited to provide their processing costs. However, participation was voluntary, and only 61 plants responded with usable data. As a result, a concept gaining industry consensus is that the processors required to participate in the weekly wholesale price survey should also be required to provide USDA with their processing costs. The processing cost survey could be conducted annually or bi-annually and would provide the basis for regular make allowance updates. However, USDA does not currently have the authority to mandate processing costs be provided but enabling language could be included in the 2023 Farm Bill.

Return to the "Higher Of" Class I mover

As outlined in the introduction to this newsletter, the modification to the Class I price formula in the 2018 Farm Bill has not been revenue neutral compared to the previous "higher of" formula as intended. As a result, producer revenue has been lower. Two modifications were considered. One was to retain the current "average of" formula but to update the \$0.74/cwt. adjuster on a regular basis. The other option was to return to the "higher of" formula.

Re-establishing the “higher of” formula will remove the asymmetrical risk embedded in the current price and thereby increase producer revenue. However, “higher of” will have little, if any, impact on depooling. The primary cause of depooling is the spread between Class III and Class IV prices, not the Class I price.

Update milk component factors for protein, other solids, and nonfat solids in the Class III and Class IV skim milk price formulas

The Class III skim milk price formula assumes skim milk contains 3.1% protein and 5.9% other solids. The Class IV skim milk price formula assumes skim milk contains 9.0% nonfat solids. These standardized values were established in conjunction with federal order reform prior to 2000. Producers increased milk’s protein content over the past 20-plus years, which by default also increased nonfat solids. Today’s skim milk contains nearer 3.3% protein and 9.2% nonfat solids. Other solids hasn’t changed much, if at all.

The Class III and Class IV skim milk price formulas are:

- Class III Skim Milk Price = (Protein Price x 3.1) + (Other Solids Price x 5.9)
- Class IV Skim Milk Price = Nonfat Solids Price x 9.0

If the Class III skim milk price used 3.3% protein instead of 3.1, October’s announced Class III price would have increased by \$0.49/cwt. ($0.2 * \$2.4512/\text{lb. protein}$). If the Class IV price used 9.2% nonfat solids instead of 9.0, October’s announced Class IV price would have increased by \$0.28/cwt. ($0.2 * \$1.40/\text{lb. NFS}$). However, there would have been no impact on the value of pooled Class III and Class IV milk because pool value is determined by the pounds of protein and nonfat solids that are pooled, not by component percentages. Likewise, producers are paid for their pounds of components, not their component percentages.

The Class I price will be positively impacted by updating milk component factors. The Class I skim milk price is based on the Class III and Class IV skim milk prices. Increasing the assumed protein and nonfat solids content of skim milk will increase the skim milk price. As outlined in the preceding paragraph, if the protein content is increased 0.2% and protein is worth \$2.50/lb. the skim milk price will increase by \$0.50/cwt., which will be reflected in the value of pooled Class I skim milk. In this example, increasing the Class I price by \$0.50/cwt. almost offsets the proposed increase in the make

allowances for Class III and Class IV.

Discontinue including barrel cheese in the protein component price formula

Cheddar cheese prices determine the federal order protein price. The price formula includes a weighted average of both block and barrel prices. For many years the prices for blocks and barrels tracked closely. However, recently either blocks or barrels have been priced at a premium to the other. Barrel prices higher than blocks results in a protein price that is higher than can be recouped by selling block cheese, and vice versa. However, 85% to 90% of all cheeses marketed are priced off the block price. Eliminating barrels from the protein price formula will ensure that the resulting protein price will more closely align with the value of most cheeses.

Extend the current 30-day reporting limit to 45-days on forward priced sales of nonfat dry milk and dry whey

The mandatory weekly price reporting stipulates that sales must have occurred in the past 30 days. Many export sales are priced more than 30 days prior to when the product is shipped, and, therefore, are excluded from the price reports used to calculate component prices. Extending the reporting limit to 45 days will allow for more exports sales to be included in price discovery..

Updating Class I differentials

Every U.S. county is assigned a Class I location differential. The differentials function to recognize the cost of moving milk from areas of surplus to areas deficit for fluid milk. Class I differentials range from \$1.60 per hundredweight in surplus regions such as the Upper Midwest to \$6.00 per hundredweight in deficit regions such as the Southeast and Florida. The differentials were last updated in 2008, and then only for the three federal orders in the Southeast. NMPF recognizes the need to update the Class I differentials but had not completed a plan prior to their annual meeting in late October. They expect to finish that work prior to the end of the year, and to include it in their overall package of proposals.

The NMPF put forth the first comprehensive package to update federal orders. Additional proposals will be drafted by other organizations. Some will require legislative action, and others will be part of a national hearing affecting all federal orders. Next year promises to be very busy for dairy policy with both a Farm Bill and a complex national federal order hearing.



Milk & Component Outlook - September 2022 Jersey Price Comparisons

<u>September '22 STATISTICAL BLEND PRICE</u>		<u>September '22 MONTHLY MILK VOLUME</u> (Million #)		<u>September '22 JERSEY REGULATED BLEND PRICE</u>	
Northeast (Boston)	\$24.82	Northeast (Boston)	2,187	Northeast (Boston)	\$27.74
Appalachian (Charlotte)	\$26.53	Appalachian (Charlotte)	431	Appalachian (Charlotte)	\$29.94
Southeast (Atlanta)	\$27.17	Southeast (Atlanta)	292	Southeast (Atlanta)	\$30.53
Florida (Tampa)	\$28.58	Florida (Tampa)	189	Florida (Tampa)	\$32.68
Midwest (Cleveland)	\$22.64	Midwest (Cleveland)	1,303	Midwest (Cleveland)	\$26.99
Upper Midwest (Chicago)	\$20.28	Upper Midwest (Chicago)	2,774	Upper Midwest (Chicago)	\$24.23
Central (Kansas City)	\$22.20	Central (Kansas City)	1,290	Central (Kansas City)	\$26.42
California (Los Angeles)	\$21.80	California (Los Angeles)	1,842	California (Los Angeles)	\$22.89
Southwest (Dallas)	\$22.55	Southwest (Dallas)	1,133	Southwest (Dallas)	\$26.43
Arizona (Phoenix)	\$23.81	Arizona (Phoenix)	361	Arizona (Phoenix)	\$27.63
Pacific Northwest (Seattle)	\$22.54	Pacific Northwest (Seattle)	611	Pacific Northwest (Seattle)	\$25.60
ALL FMMO MARKET AVERAGE	\$23.90	ALL FMMO MARKET TOTAL	12,412	ALL FMMO MARKET AVERAGE	\$27.37
<p>Prices reflect Federal Order minimum blend prices for city shown.</p> <p>Total Grade A milk volume sold under FMMO during month.</p> <p>Prices reflect FMMO minimum prices at Jersey component values.</p>					
<u>September '22 JERSEY BLEND WITH ESTIMATED PROTEIN OR CHEESE YIELD PREMIUMS</u>		<u>September '22 DOLLAR DIFFERENCE: JERSEY MILK WITH PREMIUMS VS. STATISTICAL BLEND PRICE</u>		<u>September '22 PERCENT DIFFERENCE: JERSEY MILK WITH PREMIUMS VS. STATISTICAL BLEND PRICE</u>	
Northeast (Boston)	\$27.99	Northeast (Boston)	\$3.17	Northeast (Boston)	12.8%
Appalachian (Charlotte) (includes protein prem.)	\$30.29	Appalachian (Charlotte)	\$3.76	Appalachian (Charlotte)	14.2%
Southeast (Atlanta)	\$30.53	Southeast (Atlanta)	\$3.36	Southeast (Atlanta)	12.4%
Florida (Tampa)	\$32.68	Florida (Tampa)	\$4.10	Florida (Tampa)	14.4%
Midwest (Cleveland) (includes protein premium)	\$27.48	Midwest (Cleveland)	\$4.84	Midwest (Cleveland)	21.4%
Upper Midwest (Chicago) (includes cy premium)	\$24.49	Upper Midwest (Chicago)	\$4.21	Upper Midwest (Chicago)	20.8%
Central (Kansas City)	\$26.42	Central (Kansas City)	\$4.22	Central (Kansas City)	19.0%
California (Los Angeles)	\$22.89	California (Los Angeles)	\$1.09	California (Los Angeles)	5.0%
Southwest (Dallas)	\$26.43	Southwest (Dallas)	\$3.88	Southwest (Dallas)	17.2%
Arizona (Phoenix) (includes protein)	\$27.97	Arizona (Phoenix)	\$4.16	Arizona (Phoenix)	17.5%
Pacific Northwest (Seattle)	\$25.60	Pacific Northwest (Seattle)	\$3.06	Pacific Northwest (Seattle)	13.6%
ALL FMMO MARKET AVERAGE	\$27.53	ALL FMMO MARKET AVERAGE	\$3.62	ALL FMMO MARKET AVERAGE	15.3%
<p>Includes a protein premium of \$0.05 for every 0.01% increase in protein over the market average.</p> <p>Prices reflect difference between Jersey price with premiums, and the statistical blend price.</p> <p>Percent difference in Jersey price with premiums, over the statistical blend price.</p>					
<u>ESTIMATED JERSEY MILK COMPOSITION</u>		<u>REGULATED MILK PRICES</u>		<u>AVERAGE JERSEY PRICE ADJUSTMENT PER CWT: Aug-22</u>	
Butterfat	4.84	FMMO Milkfat	\$ 3.5653	FMMO Milkfat Adjustment	\$3.22
TRUE Protein	3.80	FMMO True Protein	\$ 1.8847	FMMO True Protein Adjustment	\$1.09
Other Solids	5.73	FMMO Other Solids	\$ 0.2998	FMMO Other Solids Adjustment	(\$0.01)
Solids Not Fat (SNF)	9.53				
Cheese Yield (90% Fat Recovery, 38% Moisture)	13.01				
CME Block Cheese Price	\$ 1.95				



Milk & Component Outlook - 2022 Prices through September

2022 AVERAGE STATISTICAL BLEND PRICE FOR EACH FEDERAL ORDER		2022 MILK VOLUME (Million #)		2022 AVERAGE JERSEY REGULATED BLEND PRICE	
Northeast (Boston)	\$25.29	Northeast (Boston)	20,207	Northeast (Boston)	\$30.06
Appalachian (Charlotte)	\$26.65	Appalachian (Charlotte)	4,049	Appalachian (Charlotte)	\$29.98
Southeast (Atlanta)	\$27.15	Southeast (Atlanta)	2,996	Southeast (Atlanta)	\$30.37
Florida (Tampa)	\$28.60	Florida (Tampa)	1,840	Florida (Tampa)	\$32.32
Midwest (Cleveland)	\$23.80	Midwest (Cleveland)	12,767	Midwest (Cleveland)	\$28.53
Upper Midwest (Chicago)	\$22.41	Upper Midwest (Chicago)	22,810	Upper Midwest (Chicago)	\$27.53
Central (Kansas City)	\$23.46	Central (Kansas City)	11,665	Central (Kansas City)	\$28.07
California (Los Angeles)	\$23.44	California (Los Angeles)	16,422	California (Los Angeles)	\$25.60
Southwest (Dallas)	\$23.97	Southwest (Dallas)	10,266	Southwest (Dallas)	\$28.20
Arizona (Phoenix)	\$24.60	Arizona (Phoenix)	3,641	Arizona (Phoenix)	\$28.26
Pacific Northwest (Seattle)	\$23.60	Pacific Northwest (Seattle)	5,783	Pacific Northwest (Seattle)	\$27.29
ALL FMMO MARKET AVERAGE	\$24.82	ALL FMMO MARKET TOTAL	112,448	ALL FMMO MARKET AVERAGE	\$28.75

2022 AVERAGE JERSEY BLEND WITH ESTIMATED PROTEIN OR CHEESE YIELD PREMIUMS		2022 AVERAGE DOLLAR DIFFERENCE: JERSEY MILK WITH PREMIUMS VS. STATISTICAL BLEND PRICE		2022 AVERAGE PERCENT DIFFERENCE: JERSEY MILK WITH PREMIUMS VS. STATISTICAL BLEND PRICE	
Northeast (Boston)	\$30.32	Northeast (Boston)	\$5.01	Northeast (Boston)	19.8%
Appalachian (Charlotte) (includes protein prem.)	\$30.35	Appalachian (Charlotte)	\$3.49	Appalachian (Charlotte)	13.0%
Southeast (Atlanta)	\$30.37	Southeast (Atlanta)	\$3.19	Southeast (Atlanta)	11.8%
Florida (Tampa)	\$32.32	Florida (Tampa)	\$3.78	Florida (Tampa)	13.3%
Midwest (Cleveland) (includes protein premium)	\$29.04	Midwest (Cleveland)	\$5.05	Midwest (Cleveland)	21.1%
Upper Midwest (Chicago) (includes cy premium)	\$27.80	Upper Midwest (Chicago)	\$4.67	Upper Midwest (Chicago)	20.2%
Central (Kansas City)	\$28.07	Central (Kansas City)	\$4.39	Central (Kansas City)	18.5%
California (Los Angeles)	\$25.60	California (Los Angeles)	\$1.76	California (Los Angeles)	7.4%
Southwest (Dallas)	\$28.20	Southwest (Dallas)	\$3.93	Southwest (Dallas)	16.2%
Arizona (Phoenix) (includes protein)	\$28.63	Arizona (Phoenix)	\$3.86	Arizona (Phoenix)	15.6%
Pacific Northwest (Seattle)	\$27.29	Pacific Northwest (Seattle)	\$3.40	Pacific Northwest (Seattle)	14.2%
ALL FMMO MARKET AVERAGE	\$28.91	ALL FMMO MARKET AVERAGE	\$3.87	ALL FMMO MARKET AVERAGE	15.6%

ESTIMATED JERSEY MILK COMPOSITION		REGULATED MILK PRICES		AVERAGE JERSEY PRICE ADJUSTMENT PER CWT:	
Butterfat	4.90	FMMO Milkfat	\$3.2202	FMMO Milkfat Adjustment	\$2.95
TRUE Protein	3.83	FMMO True Protein	\$2.7822	FMMO True Protein Adjustment	\$1.63
Other Solids	5.73	FMMO Other Solids	\$0.4647	FMMO Other Solids Adjustment	(\$0.03)
Solids Not Fat (SNF)	9.56				
Cheese Yield (90% Fat Recovery, 38% Moisture)	13.16				
CME Block Cheese Price	\$2.07				

Prices reflect Federal Order minimum blend prices for city shown. Total Grade A milk volume sold under FMMO. Prices reflect FMMO minimum prices at Jersey component values.

Includes a protein premium of \$0.05 for every 0.01% increase in protein over the market average. Percent difference in Jersey price with premiums, over the statistical blend price. Percent difference between Jersey price with premiums, and the statistical blend price.