



# Information Letter Series

## Overview of Changes Proposed in USDA Federal Milk Marketing Order Recommended Decision

[Information Letter 24-01](#)

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**Christopher Wolf**

*Dyson School of Applied Economics and Management, Cornell University*

***USDA recently released a set of recommended decisions for modifying Federal Milk Marketing Orders (FMMOs) based on hearing testimony and analysis of 22 proposals. The recommendation included five categories of changes to FMMOs including milk composition, surveyed products, manufacturing allowances, base Class I skim milk price, and Class I and II differentials. This information letter briefly describes each recommendation as well as brief background and testimony for and against.***

### Introduction

On July 1, 2024 USDA released a recommended decision from a hearing process in response to 22 proposed changes that took place between August 2023 and January 2024. The recommendation, based on the evidentiary record from voluminous dairy industry participant testimony, includes proposed Order amendments related to milk pricing: milk composition factors, surveyed commodity products, Class III and Class IV formula factors, base Class I skim milk price, and Class I differentials. USDA has a mandate to weigh the impacts on producers and consumers but only producers may vote on the revised order with the recommendations included. The recommended decision by USDA includes detailed descriptions of testimony and arguments pro and con for each proposed change. In order to facilitate informed decision making, a series of Dairy Markets and Policy Information Letters describes and analyzes the recommendations. This paper presents and discusses each of the proposed categories of changes.

## 1. Milk Composition Factors

Milk composition factors represent the protein, other solids and resulting nonfat solids in skim milk. These composition factors are relevant to the Class III and Class IV skim milk price formulas. Table 1 presents the current and proposed levels of these skim milk factors. The recommendation increases the protein factor from 3.1 to 3.3% (+6.45%) and the other solids factor from 5.9 to 6.0% (+1.67 percent).

**Table 1. Skim milk composition factors**

Component	Current	Recommended
		%
Protein	3.1	3.3
Other solids	5.9	6.0
Nonfat solids	9.0	9.3

This proposed increase is in response to proposals from National Milk Producers Federation (NMPF) and National All Jersey (NAJ) to have base prices reflect current milk composition. All milk component levels—butterfat, protein and other solids—have increased since the last update in 2000. Component levels are increasing because of economic incentives provided by prices and are facilitated by improving genetics and nutrition among other management variables. Increasing the composition factors will result in increased Class III and Class IV skim milk prices and, therefore, Class I skim milk price. Estimates provided in testimony asserted that these changes would increase the Class I skim milk price by \$0.60-\$0.70/cwt. The contention of multiple witnesses was that increasing milk composition factors would assist in aligning Class milk prices which would encourage orderly marketing by encouraging movement to Class I uses as well as discouraging milk depooling. Opponents of these proposals maintained that increased component levels have no financial or economic benefit to Class I handlers so that this increased cost of milk cannot be recovered in the marketplace. Further details about the recommended changes to milk composition are discussed in Information Letter 24-05 (Wolf, 2024).

## 2. Surveyed Commodity Products

Minimum farm Class milk prices are determined using what is called product pricing. Wholesale dairy product prices for four manufactured products (butter, cheese, nonfat dry milk (NFDM), and dry whey) are surveyed each week to determine monthly averages. Milk components values are determined using these wholesale prices as well as allowances for manufacturing costs and yields.

Class III prices are for milk used in cheese with dry whey as a co-product. In order to determine cheese prices, wholesale cheddar prices are surveyed using a weighted average of 40-pound blocks and 500-pound barrels (adjusted for moisture). The recommended

decision would remove 500-pound barrel cheddar cheese from the surveyed dairy products and determine the wholesale cheese price for formulas solely from 40-pound blocks.

There were four different proposals related to surveyed commodity products submitted by NMPF, American Farm Bureau Federation (AFBF) and the California Dairy Campaign. The proposal from NMPF was to drop 500-pound barrels. The other commodity survey proposals included: adding 640-pound cheddar blocks to the survey; adding unsalted butter to the survey (which is exclusively salted butter); and adding mozzarella to the survey. The only option accepted in the recommendation is dropping 500-pound barrels.

The existing rules assume that barrel cheese has a \$.03/lb cost discount to blocks. Witnesses in favor of dropping barrels asserted that the spread between barrels and blocks cheese prices has been volatile. They also asserted that dropping barrel cheese from the price calculations would create more orderly marketing conditions by reducing uncertainty for dairy farmers and manufacturers. Witnesses in favor of this change also testified that the CME block cheddar cheese price is used to price 90 percent of the natural cheese produced in the US. Opponents to this proposed change asserted that dropping barrel cheese would reduce by more than half the market value of cheddar cheese in the survey resulting in a distorted estimate of the commodity cheddar market price. Opponents also asserted that removing 500-pound barrels removes the product most closely reflecting the market supply and demand balance. Further details about the recommended changes to surveyed dairy products are discussed in Information Letter 24-05 (Wolf, 2024).

The recommended decision proposes to remove the 500-pound barrel cheddar cheese from the survey and determine the monthly average cheese price for formulas using only the 40-pound cheddar cheese price.

### **3. Class III and IV Formula Factors**

As discussed in the previous recommendation, FMMOs survey four wholesale commodity prices (butter, cheese, NFDM and dry whey) to determine the farm value of milk. In order to derive the raw milk value, an allowance is made for the manufacturing cost of the dairy product. This manufacturing cost is often called the “make allowance.” For each component, the component prices are generally derived as:

$$\text{Component price} = (\text{Wholesale product price} - \text{Make allowance}) \times \text{Yield factor}^1.$$

The make allowances used to determine milk component prices from wholesale commodity prices have not been changed since 2008. The current and proposed make allowances in terms of per pound of the dairy product are displayed in Table 2. The proposed increases on a per pound basis are between 5 and 6.62 cents. In relative terms, the increases proposed are between 26.8 and 35.2% above the existing product manufacturing allowances.

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<sup>1</sup> The formula to determine the protein price from cheese is more complicated but the basic idea is the same.

**Table 2. Product Make Allowances**

Product	Current	Recommended
	\$/lb product	
Cheese	0.2003	0.2504
Dry Whey	0.1991	0.2653
Nonfat Dry Milk	0.1678	0.2268
Butter	0.1715	0.2257

There were three proposals to amend make allowances submitted by NMPF, the International Dairy Foods Association (IDFA), and Wisconsin Cheese Makers Association (WCMA). All proposed an increase in product make allowances although the values and implementation timelines differed. Some of the proposals included methods for automatic adjustments in future periods.

Surveys of manufacturing plants and estimates using cost indices were used by witnesses to establish recent manufacturing costs. While there was widespread agreement from witnesses that manufacturing costs had increased significantly since the last change in make allowances, the proposed magnitudes of changes differed depending on source. Inadequate make allowances disadvantage manufacturers and discourage investment. Increasing make allowances, all else equal, results in a lower milk price for dairy farmers. Witnesses testified that a short-run decline in farm milk price was expected from increased make allowances but that in the longer-run, markets would adjust and the impact would likely be moderate. More about the make allowance proposal is discussed in Information Letter 24-03 (Nicholson, 2024).

In addition to the make allowances in Table 2, the recommended decision changes the amount of butterfat recovered when making cheese. The butterfat recovery factor has been 90% since 2000 while this recommendation would change that to 91%. The result is that the butterfat yield factor in cheese will increase from 1.572 to 1.589.

#### **4. Base Class I Skim Milk Price**

Class I skim milk price is currently calculated as the weighted monthly average of the average of the Class III and Class IV advanced skim milk price plus \$0.74/cwt. This method was introduced in May 2019. Prior to that change, the Class I skim milk price was calculated as the higher of the Class III and Class IV advanced skim milk price.

There were six proposals to amend the base Class I skim milk price considered in the hearing. These proposals were submitted by NMPF, IDFA, the Milk Innovation Group (MIG), Edge Dairy Cooperative (two proposals), and AFBF. These proposals were different schemes of higher of and average of calculations often with lags or lookbacks. Witnesses testified that the “higher-of” method was chosen in the 2000 FMMO reform process because it addressed disorderly marketing by tending to maintain Class I as the highest priced class as

well as reducing milk price volatility. Witnesses explained that the average of plus \$0.74/cwt is lower than the higher of in any month when the absolute difference between Class III and Class IV advanced skim milk prices differ by more than \$1.48/cwt. In recent years, the difference between the Class III and IV skim milk price often exceeded \$1.48 reaching \$5.19/cwt in December 2020. Witnesses estimated that the change had resulted in cumulative market losses totaling hundreds of millions of dollars for dairy farmers from May 2019 through August 2023.

Concerns were raised by many witnesses that the primary motivation to change from the higher of to the average of was to provide certainty for milk processors about the sources of their raw milk costs and facilitate risk management. A lagged adjuster was one method discussed to facilitate risk management. There was disagreement about the extent to which the 2019 change had increased risk management activity. Further details about the recommended changes to base Class I skim milk price are discussed in Information Letter 24-05 (Wolf, 2024).

The recommended decision is to return to the higher of Class III or IV skim milk price but also to adopt a Class I ESL adjustment equal to the difference between the higher-of and average-of plus a 24-month rolling adjuster with a 12-month lag.

## **5. Class I and II Differentials**

NMPF proposed increasing Class I differentials to address increased hauling costs, changes in milk supply and demand locations, changes in supply patterns resulting in longer hauls, and insufficient over-order premiums to cover the cost of servicing Class I markets. As with many of the other FMMO aspects in the hearing, Class I differentials outside of the three southeast orders have not been updated since 2000. Regional considerations were discussed for each FMMO. There was disagreement about the level of the \$1.60/cwt base differential and whether it was required to reflect the costs of maintaining Grade A status and incentivize Class I milk deliveries. MIG proposed lowering the base Class I differential to zero. Opponents to increasing Class I differentials testified that if more money was required to attract fluid milk supplies, it should be negotiated in the marketplace (i.e., over-order premiums) rather than mandated by FMMO provisions.

Inelastic fluid milk demand is a necessary condition for higher Class I prices to result in higher farm milk revenue from classified pricing. Several researchers testified about the milk price elasticity with disagreement about the appropriate demand elasticity and, thus, the resulting impacts of increasing Class I differentials. A different proposal sought to increase the Class II differential from \$0.70/cwt to \$1.56/cwt

The recommended decision is to keep the \$1.60/cwt base Class I differential and adopt new location-specific differential values to reflect current marketing conditions. Further details about the recommended changes to Class I differentials are discussed in Information Letter 24-04 (Nicholson, 2024).

## **Next Steps**

USDA is currently collecting comments on the recommended decision which will be considered before a final decision is made. Dairy farmers will then have the opportunity to vote on whether to accept the proposed modified orders. When voting, the options are either adopt the order with the changes or reject/end the order. Maintaining the status quo—the previous incarnation of the order—is not an option. Other Information Letters in this series examine the recommendations in detail focusing on implications for farm milk price.

## **References**

Congressional Research Service. Federal Milk Marketing Orders: An Overview. R45044. December 2017.

Nicholson, C. Proposed Changes to Product Make Allowances in the Recommended Decision and Potential Farm Milk Price Impacts. Dairy Markets and Policy Information Letter 24-03. July 2024.

Nicholson, C. Proposed Changes to Class I Differentials in the Recommended Decision and Potential Farm Milk Price Impacts. Dairy Markets and Policy Information Letter 24-04. July 2024.

Wolf, C. Proposed Changes in Milk Composition, Surveyed Commodity Products, and Base Class I Skim Milk Price in the Recommended Decision and Potential Farm Milk Price Impacts. Dairy Markets and Policy Information Letter 24-05. July 2024.