AFBF FEDERAL MILK MARKETING ORDER WORKING GROUP
BACKGROUND ON MILK PRICE FORMULA MAKE ALLOWANCES
JULY 2019

Issue:

Milk prices regulated by Federal Milk Marketing Orders are determined based on end-product pricing formulas. These formulas utilize wholesale prices for butter, cheese, dry whey and nonfat dry milk to determine milk component values for butterfat, protein, other solids and nonfat solids, as well as the classified value of milk. These end-product pricing formulas include a fixed deduction called a ***make allowance****, i.e., a processing credit as well as* ***yield factors*** *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 including butter, cheese or dry milk powder. The yield factor is an estimate of how much product can be produced from a certain quantity of milk components. Milk pricing formulas were last modified in 2007.

USDA recently commissioned the University of Wisconsin to update and review the costs of production for many dairy processing plants. The study is expected to reveal the current weighted average costs of production of the various types of cheddar cheese, butter, whey and nonfat dry milk for processing plants in the U.S. The results of that study may be used to support a request for a FMMO hearing to adjust milk price formulas, specifically make allowances and yield factors. Higher make allowances would result in lower regulated milk prices to farmers in the short-run.

Background:

A review of milk pricing regulations was provided in the Background of Milk Pricing document. Make allowances and yield factors were last modified in 2007 following a USDA Class III/IV make allowance hearing. The dairy farmer and company perspectives on make allowances and yield factors submitted in relation to this hearing are found here: Class III/IV Price Make-Allowances - Comments and Exceptions.

Several dairy farmers wrote in opposition to higher make allowances, while most of the dairy companies wrote in support of make allowances at or above USDA's proposed levels – which were based on industry testimony and multiple cost of production surveys.

The current make allowances and yield factors as approved during the Class III/IV hearing are as follows:

Commodity	Make Allowance ($/lb.)	Yield Factor
Butter	$0.1715	1.211
Nonfat Dry Milk	$0.1678	0.990
Dry Whey	$0.1991	1.030
Cheese	$0.2003	1.383

Through the end-product pricing formula, these make allowances can be converted into the equivalent make allowance for protein, butterfat, nonfat solids and other solids.

Component	Make Allowance ($/lb.)
Protein	$0.4267
Butterfat	$0.2077
Other Solids	$0.2051
Nonfat Solids	$0.1661

Then, using the end-product pricing formulas, the make allowances can be converted into dollars per hundredweight based on 3.5% butterfat content.

Classified Value	Make Allowance at 3.5% Butterfat ($/hundredweight)
Class I *	$2.67
Class II	$2.17
Class III	$3.17
Class IV	$2.17

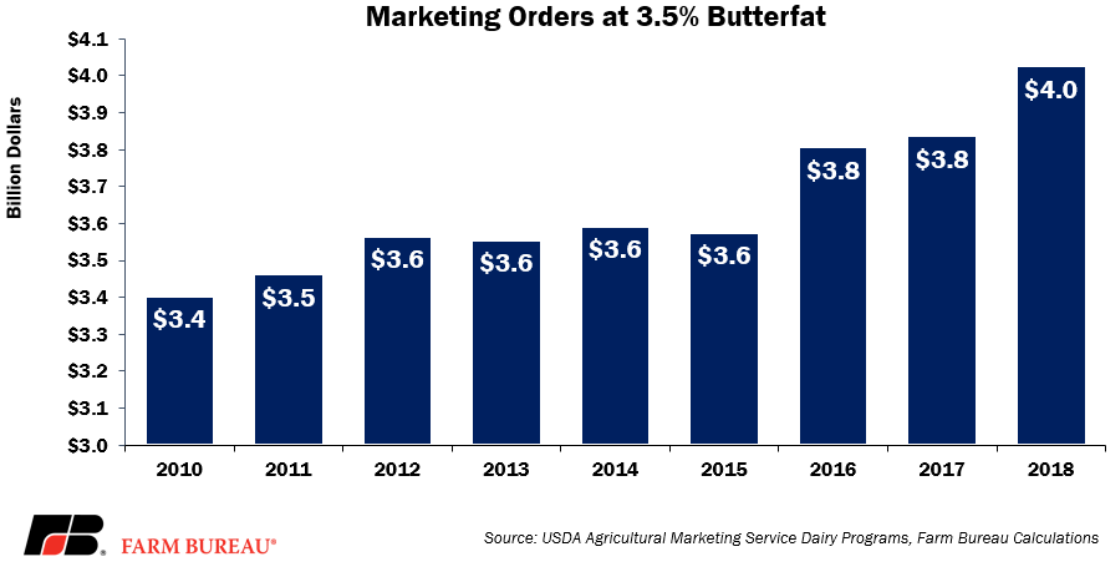
** Based on new fluid milk pricing provisions in the 2018 farm bill.*

These fixed make allowances range from $2.17 per hundredweight to $3.17 per hundredweight and effectively reduce the classified value of milk. Since make allowances are used in the end-product pricing formulas for Class I and II milk, the make allowances effectively reduce the regulated value of milk in all classes.

Data from USDA's Agricultural Marketing Service combined with the make allowances per hundredweight indicate total make allowances – based on 3.5% butterfat content -- have represented nearly $33 billion in processing costs since 2010. In recent years, the total value of make allowances has increased as more milk is pooled on the FMMO and due to California joining the order program in late 2018. This value is likely a lower bound as most milk in the U.S. has an average butterfat content higher than 3.5%.

Make allowances reached a high of $4 billion in 2018 following the addition of the California FMMO. Through the first 5 months of 2019 make allowances have totaled $1.9 billion and is up $260 million or 16% from prior-year levels.

Figure 1. Total Make Allowances for Milk Pooled on Federal Milk Marketing Orders at 3.5% Butterfat



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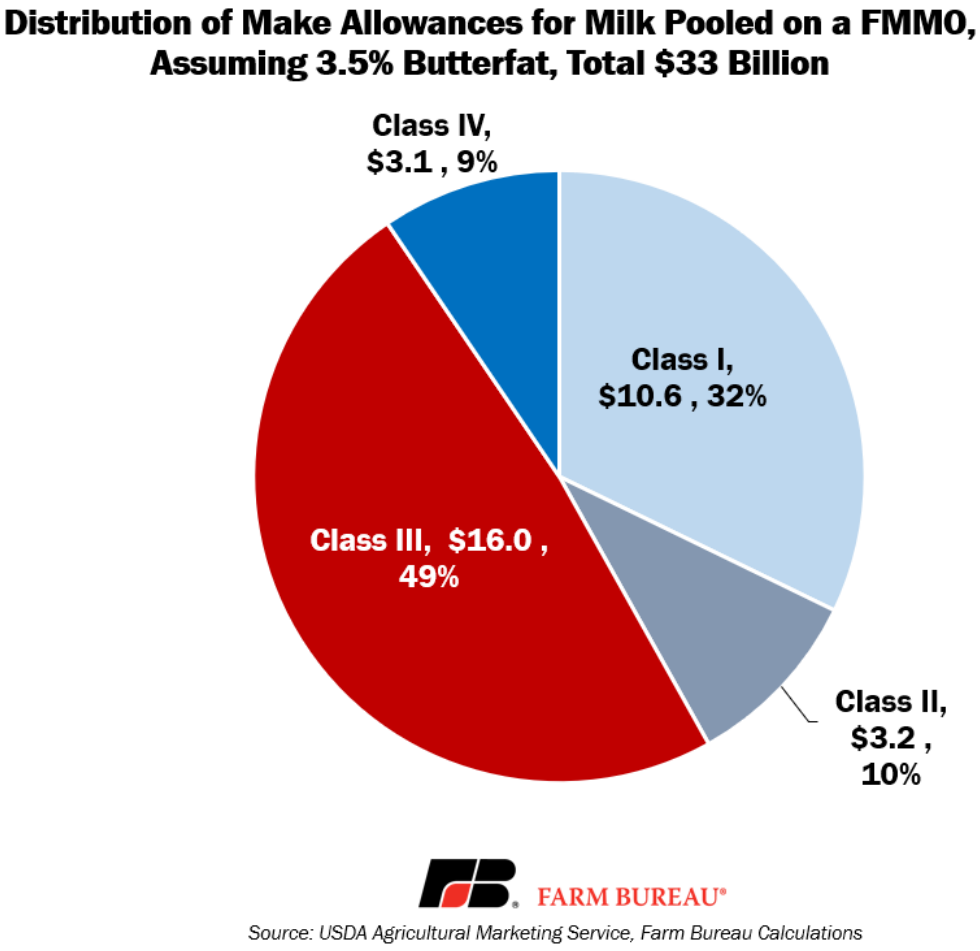
Source: USDA Agricultural Marketing Service Dairy Programs, Farm Bureau Calculations

Since 2010, 1.2 trillion pounds of milk have been pooled on the FMMO. Class III represents the majority with 503 billion pounds of milk pooled or 43% of the utilization of milk. Following Class III is Class I milk at 381 billion pounds of 32%. Class II and Class IV milk represent 146 billion and 144 billion pounds of milk pooled, respectively, or approximately 25% of the milk utilization.

If follows, then that make allowances were the highest in Class III at $16 billion since 2010. Following Class III milk was Class I milk – adjusted for the higher-of – at nearly $11 billion. Class IV make allowances represented $3.1 billion and Class II make allowances represented $3.2 billion. Total make allowances since 2010 have represented $33 billion.



Current Farm Bureau Policy:

None