



**AEDE** Agricultural, Environmental,  
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Ohio State University Extension  
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A handwritten signature in black ink, appearing to read "Cam Thraen".

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**National Milk Producer Federation Proposal to Change the Class 1 and Class 2 milk pricing rules: A short exposition...**

**Introduction**

By now you are fully aware that the United States Department of Agriculture, Agricultural Marketing Service, has issued a Tentative Final Decision (TFD) from the national hearing on Class 4 & 3 make allowances. Dairy producers across the United States, operating in Federal Milk Market Orders, are voting or have voted, as I write this piece. The TFD increases the make allowance for cheese, butter, nonfat dry milk, and dry whey. These changes will, as a matter of rule, lower all milk prices to dairy farmers. While the focus was on these make allowances in Class 4 and Class 3 pricing rules only, the fact that Class 1 and Class 2 prices are tied by rule to the Class 4 and Class 3 prices, they also will be lowered.

As a direct result of the TFD, National Milk Producer Federation (NMPF), petitioned the USDA/AMS for a national hearing on Class 1 and Class 2 pricing rules in Federal Milk Orders. This hearing is ongoing in Pittsburgh, PA, during the week of December 11, 2006. This purpose of this exposition is to provide an explanation of the NMPF proposal and the implications, should it be adopted, for Class prices. The NMPF proposal can be obtained at: [http://www.ams.usda.gov/dairy/class\\_I\\_II/classI\\_II\\_pr\\_for.htm](http://www.ams.usda.gov/dairy/class_I_II/classI_II_pr_for.htm)

The primary argument put forth by NMPF in its proposal to the USDA/AMS is that the cost of servicing the Class 1 and Class 2 market has increased, just as the cost of processing milk into Class 3 and Class 4 products has increased. The NMPF proposal argues that this increase in cost can be associated with three areas: [1] the cost of maintaining Grade A standards; [2] the cost of marketing or balancing milk to the Class 1 market; [3] a 'competitive factor' reflecting the cost of attracting milk to Class 1 uses. NMPF puts this total additional cost at \$0.73 per hundred pounds of milk. Based on this

assessment the NMPF proposal puts forth new pricing rules for Class 1 milk and the Class 1 movers.

To assist your understanding of these issues, I have completed a comparative evaluation of the new pricing rules and the potential impact on Class prices, both skim and butterfat, for all orders and for the Mideast Federal Milk Marketing Order 33. In summary form, these impacts are shown in the following table. As you can see, the NMPF proposed Class 1 and 2 pricing rules would have no direct impact on the Class 4 or 3 prices. This is not to say that they may have a long-term impact by making Class 1 and Class 2 products more expensive, thereby reducing demand and shifting more milk to the Class 3 and 4 markets. This requires a more complex dynamic analysis.

The direct impact would be on Class 1 and Class 2 prices and the Statistical Uniform Price SUP. The NMPF rule changes are each designed to deliver the additional \$0.73 per cwt. back to producers through the Class 1 market. The impact on the Statistical Uniform Price would be an increase of 27.25 cents per cwt. The negative impact on the SUP in the current Class 4 and 3 TFD is 22.8 cents and the NMPF proposed price changes exceed this by +4.37 cents per cwt. If adopted as presented, the reduction in producer prices will be more than compensated by the increase in the cost of milk to Class 1 and 2 users. While not stated directly in the NMPF proposal, the logic behind this proposal is that users of Class 1 and 2 milk are not subject to fixed make allowances and therefore can extract this additional premium from the retail market, i.e., from the consumer.

| Impact of NMPF Proposal on FO33 Pricing                                                                                                                                   |               | Average Use  |  |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|--------------|--|
|                                                                                                                                                                           | NMPF Impact   | by Class (%) |  |
| Cl. 4 Skim                                                                                                                                                                | NC            |              |  |
| <b>Cl. 4 Price</b>                                                                                                                                                        | NC            | <b>0.064</b> |  |
| Cl.3 Skim                                                                                                                                                                 | NC            |              |  |
| <b>Cl. 3 Price</b>                                                                                                                                                        | NC            | <b>0.413</b> |  |
| Cl.2 Skim                                                                                                                                                                 | 0.0074        |              |  |
| Cl. 2 Bfat.                                                                                                                                                               | 0.016         |              |  |
| <b>Cl. 2 Price</b>                                                                                                                                                        | <b>0.0641</b> | <b>0.164</b> |  |
| Cl. 1 Skim (C4 Mover)                                                                                                                                                     | 0.73          |              |  |
| Cl. 1 Bfat. (C4 Mover)                                                                                                                                                    | 0.0073        |              |  |
| <b>Cl. 1 Price (C4 Mover)</b>                                                                                                                                             | <b>0.73</b>   | <b>0.359</b> |  |
| Cl. 1 Skim (C3 Mover)                                                                                                                                                     | 0.73          |              |  |
| Cl. 1 Bfat. (C3 Mover)                                                                                                                                                    | 0.0073        |              |  |
| <b>Cl. 1 Price (C3 Mover)</b>                                                                                                                                             | <b>0.73</b>   |              |  |
| <b>FO33 Statistical Uniform Price SUP</b>                                                                                                                                 | <b>0.2725</b> |              |  |
| NC = no change as a result of the NMPF proposal.<br>Skim price impacts are on a cwt basis, and butterfat is on a pound basis. Class price impact is on a 100 pound basis. |               |              |  |