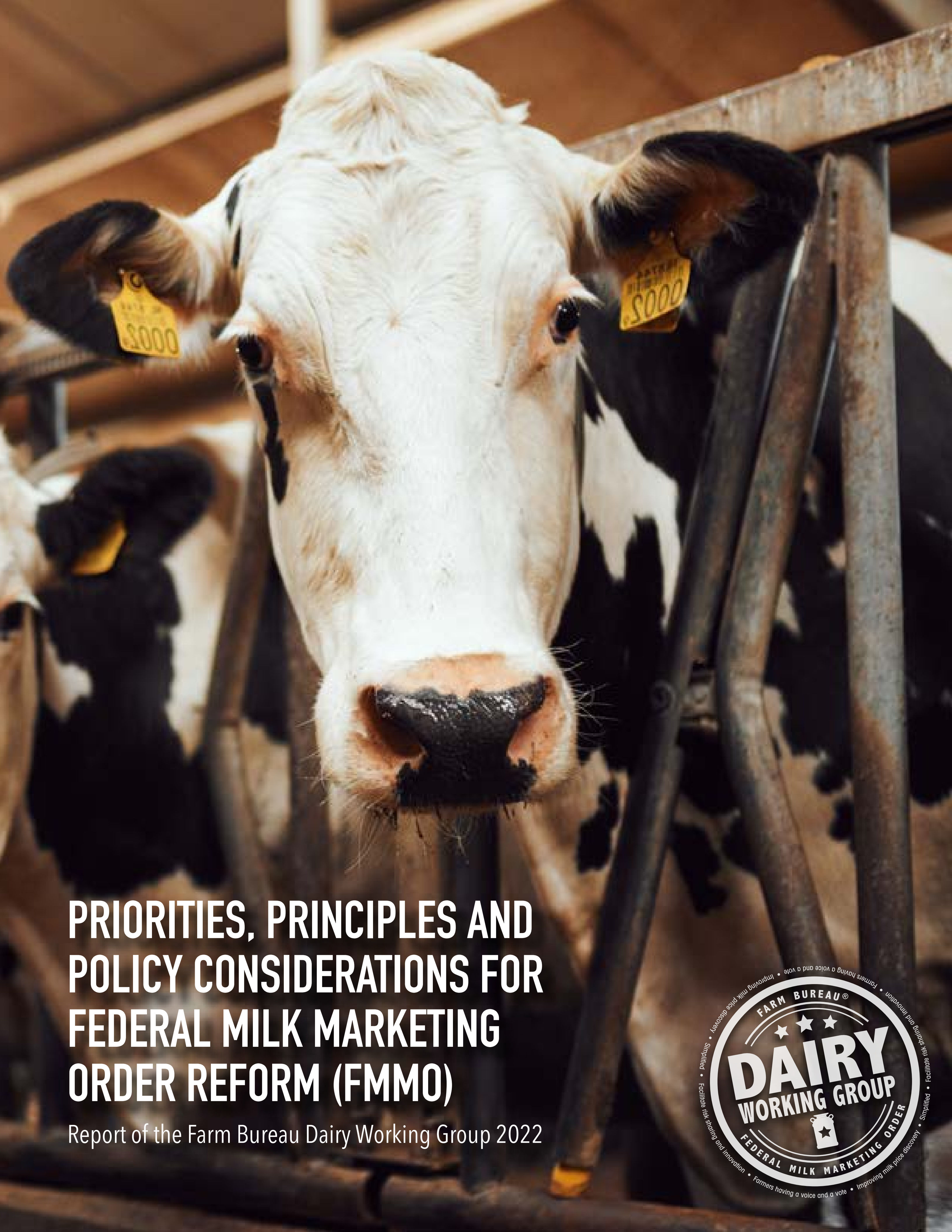

PRIORITIES, PRINCIPLES AND POLICY CONSIDERATIONS FOR FEDERAL MILK MARKETING ORDER REFORM (FMMO)

Report of the Farm Bureau Dairy Working Group 2022

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DAIRY
WORKING GROUP
FEDERAL MILK MARKETING ORDER
Farmers having a voice and a vote • Improving milk price discovery • Simplified • Facilitate risk sharing and innovation

Priorities, Principles and Policy Considerations for Dairy Policy Reform

Background: In January 2022, voting delegates to the American Farm Bureau Federation's 103rd Annual Convention recommended to the AFBF board of directors that AFBF continue the Farm Bureau- and producer-led Dairy Working Group to explore options and additional recommendations for strengthening the dairy industry through the 2023 farm bill and modernizing the current Federal Milk Marketing Order (FMMO) system.

The AFBF board also supported the request of the 2021 Dairy Working Group and voting delegates to plan an AFBF-led industry-wide dairy conference to discuss dairy pricing and meaningful changes to the Federal Milk Marketing Order system, with dairy farmers being the majority of the participants.

AFBF's executive committee opted to reconvene the same 12 members of the 2021 Dairy Working Group, which includes three dairy farmer representatives from each of the four Farm Bureau regions. Only one member, from Illinois, declined to participate during 2022 and was replaced with another Illinois dairy farmer.

Between March and November 2022, the working group held seven virtual meetings, one in-person meeting and a national Federal Milk Marketing Order Forum. Virtual meetings primarily served as planning meetings for the Federal Milk Marketing Order Forum to establish an event vision, programming and general logistics.

The in-person Dairy Working Group (DWG) meeting was held on June 28 in AFBF's Washington, D.C., office. This meeting featured several invited speakers including Dr. Marin Bozic on behalf of Edge Co-op; Paul Bleiberg, senior vice president of government relations at the National Milk Producers Federation; and Trevor White, professional staff for the House Agriculture Committee. Working group members discussed 2023 farm bill priorities related to risk management and nutrition programs.

Representatives from over 180 farms, cooperatives, processors and other industry organizations from over 35 states joined the American Farm Bureau Federation in Kansas City Oct. 14-16 for a successful first-of-its-kind industry-wide Federal Milk Marketing Order Forum. After in-person remarks by AFBF President Zippy Duvall and USDA Deputy Under Secretary Gloria Montaño Greene and video remarks from Secretary Vilsack, the conference was split into four half-day segments, each with a three-speaker panel session and Q&A followed by a roundtable discussion during which groups of eight attendees discussed issues brought up during the panel session. Attendees were assigned to tables to ensure regional and organizational diversity for the roundtable discussions.

This document reflects the consensus of the working group members and may be used to inform grassroots policy development.

EXECUTIVE SUMMARY

In the more than 20 years since they underwent major reform, Federal Milk Marketing Orders have been only slightly modified. Meanwhile, milk and dairy markets have changed dramatically.

There are nearly 50% fewer dairy operations today than in 2003, while the average number of milking cows per farm has nearly doubled.

Per capita consumption of all dairy products has grown nearly 10%, but consumption of fluid milk products has declined by nearly 30%.

When FMMOs were last reformed in 2000, the U.S. exported less than 5% of annual milk production; in 2021 the industry exported over 18% of U.S. milk production by value.

Milk production continues to grow and is expected to reach nearly 230 billion pounds in 2022. Much of that will be used to produce the dairy products in high demand, such as cheeses, butters and other value-added dairy products and ingredients. At the same time, fluid milk consumption is expected to decline and will likely be surpassed by exports as a percentage of U.S. milk production.

Furthermore, the COVID-19 pandemic battered dairy producers with lopsided supply chains that resulted in the dumping of milk, hundreds of millions in Class I revenue losses under a new price formula, widespread negative producer price differentials (PPDs), and a general lack of confidence in the existing milk pricing framework.

Many of these reasons compelled the American Farm Bureau Federation's voting delegates to reconvene the DWG to consider dairy policy simplifications that better position U.S. dairy farmers and the industry for future success. This included FMMO modernization and simplification as well as a review of dairy policy often included in the farm bill such as Dairy Margin Coverage (DMC) specifications and milk regulation within federal nutrition programs.

One of the guiding principles from the 2021 DWG report noted that consensus across industry stakeholders is needed for meaningful change. This principle was associated with a recommendation that AFBF host an industry-wide conference to approach FMMO issues, including how FMMOs are amended and updated. The DWG believed helpful changes would not come without unity among farmers, cooperatives and processors. After approval of a resolution at AFBF's annual meeting to host such a conference, the 2022 DWG was also tasked with planning and executing what became the Federal Milk Marketing Order Forum that took place Oct. 14-16 in Kansas City, Missouri.

The first section of this report summarizes the primary consensus items from the Federal Milk Marketing Order Forum that DWG members hope to prioritize in any future FMMO hearings. The second section of the report outlines several non-FMMO recommendations positioned to support 2023 farm bill discussions.

Priorities for Federal Milk Marketing Order Reform

Priorities related to FMMO reform from the 2022 DWG are based on in-person roundtable discussions held during the Federal Milk Marketing Order Forum. These priorities reflect the list of most commonly written and supported concepts during the forum's second, third and fourth discussion sessions.

1. Return the Class I mover to a higher-of formula
2. Increase Class I differentials to reflect changes in the marketplace
3. Make processing cost surveys of plants mandatory and audited by USDA to ensure the accurate data
4. Tighten pooling provisions
5. Update make allowances routinely with mandatory cost surveys
6. Expand the number of products used in USDA's pricing survey
7. Simplify and add uniformity to milk checks
8. Use modified bloc voting instead of bloc voting

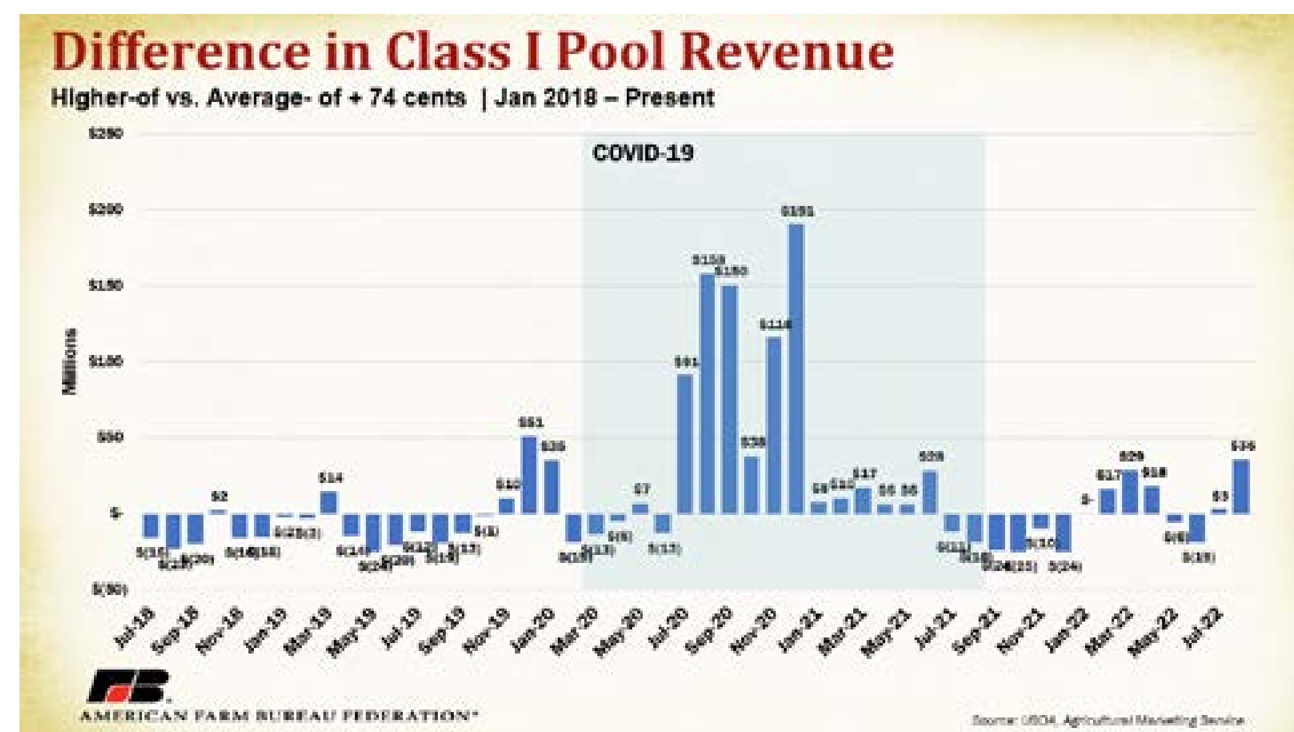
1. Return Class I Mover to a higher-of formula

Background: Since the 2018 farm bill, the price for Class I skim milk, i.e., skim milk used to produce beverage milk products, has been calculated using the simple average of advanced Class III (cheese) and Class IV (milk powders) skim milk prices plus 74 cents. In years prior, the formula was the higher-of advanced Class III and Class IV skim milk prices. The change was made at the request of dairy industry stakeholders and was intended to improve risk management opportunities for beverage milk. COVID-19-induced volatility combined with the 2018 farm bill formula change resulted in hundreds of millions of dollars in Class I pool revenue losses, renewing industry discussions on optimal Class I pricing methods.

In January 2022 AFBF voting delegates approved the following policy related to the Class I mover:

(We support) USDA developing an improved method to determine the Class I milk mover base price that is not reliant solely on manufacturing dairy products, better reflects local market conditions, provides more appropriate economic incentives to fluid milk producers and processors, recognizes the costs in servicing a fluid milk market and continues to ensure fluid milk consumers have a quality and adequate supply of fresh fluid milk.

Until an improved method is developed, we support going back to the "higher-of" the class III or class IV plus 74 cents in price calculating the monthly FMMO Class I mover.



The policy allows flexibility in supporting mover formulas that improve milk marketing conditions and are sensitive to regional variation while also supporting a switch back to the higher-of formula plus the 74 cents from the average-of formula passed in the 2018 farm bill. The 74 cents add-in was maintained to make up for Class I losses associated with de-pooling behavior during 2020. Originally, the 74 cents was included in the current "average-of" formula to buffer producers against wide spreads between the Class III and IV skim prices. It was calculated using the historical difference between a higher-of and average-of calculation and was expected to make the current formula equal to the old formula in the long run, but failed to do so during COVID-19-induced market disruptions.

Working Group Recommendations:
The working group emphasizes the number one consensus item of the Federal Milk Marketing Order Forum: return to a higher-of formula. The group heavily discussed whether or not they would like to continue supporting the inclusion of a 74 cents add-in within the formula. The group noted that the primary goal should be to switch back to the higher-of option with hopes that modernization within other FMMO policies would bring higher Class I prices and make the 74 cent add-in unnecessary. Any changes to FMMOs that reduce prices producers receive must be offset. If FMMO modernization in other areas does not offset losses, working group members support maintaining a premium inclusion of some decided value, if not necessarily 74 cents.

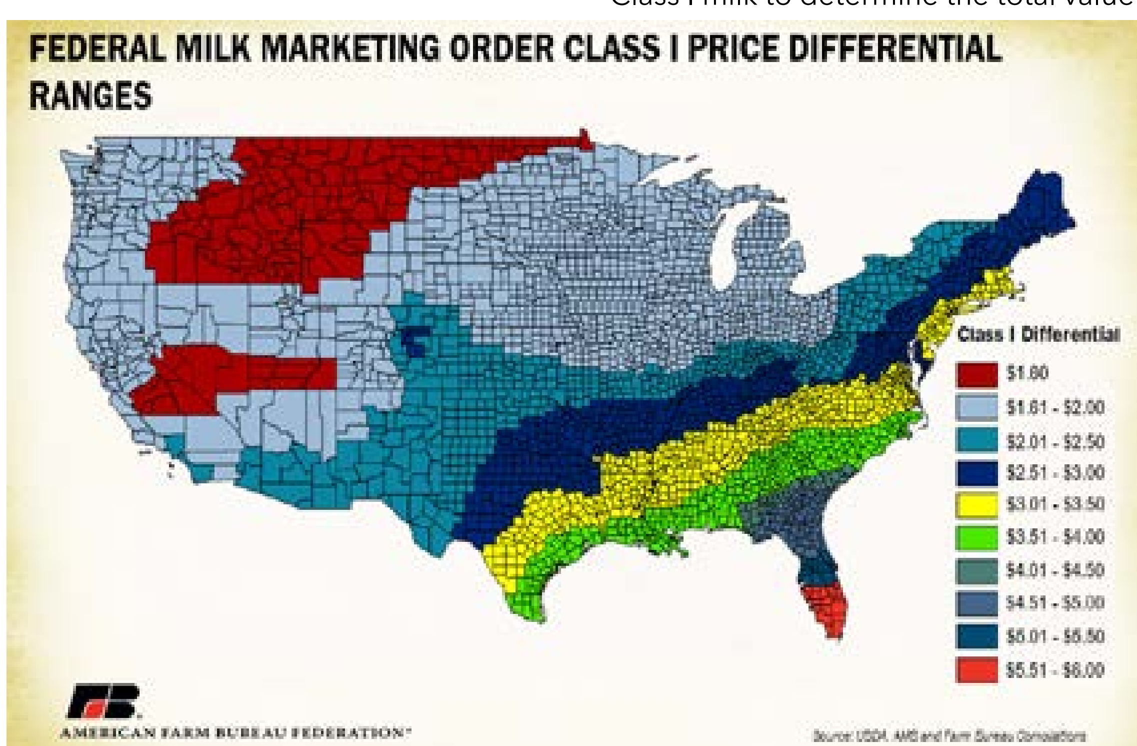
The DWG also recognizes and supports existing AFBF policy 238.1.2.1.12., which states:

(We Support) Revisions to the FMMO, including fluid milk pricing, progress through the normal channels at USDA that will provide thorough economic analysis and public hearings for producers to be engaged, rather than through legislative override.

This policy opposes congressional actions on FMMO issues that can occur through an FMMO hearing process. However, given the circumstances of the Class I mover change, which occurred legislatively without producer engagement, our DWG members believe the return to the higher-of should be done in the most expedient manner possible. The DWG group supports an exception to policy 238.1.2.1.12 to return to the higher-of Class I formula through Congress if it results in a more expedient change. Beyond this exception, DWG members maintain committed to the FMMO hearing process and existing policy 238.1.2.1.12.

2. Increase Class I differentials to reflect changes in the marketplace

Background: Every U.S. farmer has a different regulated minimum milk price based on the classified value of milk produced, its components and return from the revenue sharing pool. A critical element of the revenue sharing pool and farm-level milk price is the Class I location differential, which is added to the base value of Class I milk to determine the total value of Class I



milk. Every U.S. county is assigned a Class I location differential. 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 (USDA map of Class I location differentials). The figure *on page 4*, highlights the slope of Class I differentials from surplus regions to deficit milk production regions. Deficit milk production regions are areas of the country where milk production is below the needed volume to supply the Class I beverage milk demand.

Class I location differentials were last updated more than a decade ago, based on a U.S. dairy sector simulation model of supply and demand conditions calibrated to 2008 milk marketing information.

The challenge is that milk supply and demand changes daily while milk prices and location adjustments are fixed on both a monthly and annual basis. For example, daily milk receipts at bottling plants fluctuate during the week, with peak receipts early in the week and less milk received as the weekend approaches. Additionally, on a monthly basis milk supplies and demand are not always aligned. For example, in the Florida marketing order, milk supplies exceed Class I demand during the first half of the year, but in the second half of the year milk supplies are not enough to meet local demand.

These seasonal imbalances result in Class I price and location differentials not being flexible enough to facilitate orderly movement and balancing of milk supplies.

Working Group Recommendations:
The working group emphasizes the number two consensus item of the Federal Milk Marketing Order Forum: increase Class I differentials to reflect changes in the marketplace. They highlight current AFBF policy 238.1.2.1.21, which states:

(We support) Flexible Class I location differentials that are adjusted for seasonality. We support more frequent evaluation of Class I location differentials. We support an update to Class I location differentials that includes higher differentials in surplus milk production regions to limit milk moving into deficit regions of the U.S.

The DWG believes price surfaces and the associated map should be updated on a specified, frequent basis. They emphasized that milk that serves the Class I market should be compensated for serving that market.

3. Make processing cost surveys of plants mandatory and audited by USDA to ensure accurate data

Background: 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. Make allowances were last updated in 2007. The current make allowances for butter and nonfat dry milk (NFDM) were computed by taking a weighted average of the California Department of Food and Agriculture (CDFA) and Cornell Program on Dairy Markets and Policy (CPDMP) surveys using national commodity production as the weights and adjusting for USDA-defined marketing costs. The dry whey make allowance was solely based on the CPDMP 2006 survey and adjusted for USDA-defined marketing costs, while the cheese make allowance was solely based on the CDFA 2006 survey and adjusted for USDA-defined marketing costs.

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

A USDA-commissioned study out of the University of Wisconsin-Madison provided new weighted average costs of production for cheddar cheese, butter, whey and NFDM for processing plants based on surveys of 61 plants across the U.S. This study was voluntary, meaning it may not adequately reflect actual cost values of the modern milk market. Producers have expressed concern over using voluntary cost studies to update make allowances and yield factors given they may give biased results and could shortchange farmers when used as a basis for FMMO hearing changes.

Working Group Recommendations:
The working group emphasizes the number three consensus item of the Federal Milk Marketing Order Forum: make processing cost surveys of plants mandatory and audited by USDA to ensure accurate data. AFBF does not currently have policy on dairy processing cost surveying. The group echoes the discussions of the FMMO Forum: mandatory cost surveys are needed prior to any updates to make allowances. The DWG added that yield factor updates must also be considered in any mandatory surveying. Surveying should be done on a frequent basis to reflect ever-changing market conditions. The DWG recommends new AFBF policy that reflects these ideas. Sample policy language follows:

(We support) Frequent and mandatory cost and make allowances reporting from dairy processing plants audited by the USDA prior to any changes to current make allowances.

4. Tighten pooling provisions

Background: In component pricing orders, proceeds from the pool are based on the difference between the classified value of the milk and the Class III component value of the milk. When the component value of the milk exceeds the blended classified value of the milk, the proceeds from the pool are negative and result in a negative producer price differential (PPD). When their pool draw is expected to be negative, handlers may seek to de-pool higher-valued manufacturing milk to avoid paying into the pool. When milk is de-pooled it is not included in Federal Order statistics and is not subject to FMMO processes or minimum pricing. De-pooling manufacturing milk is generally allowed under FMMO rules. Bottling (Class I) plants cannot de-pool. Pooling and de-pooling rules are set at the order level to better reflect regional milk marketing conditions. Different orders have different regulations on how often and in what manner handlers may pool and de-pool milk. For instance, the Northeast Order (#1) has the most restrictive pooling regulations, which can block milk from returning to the Class I pool for up to six months depending on the month of de-pooling (see guide for determining when a de-pooled producer can be re-pooled).

During 2020, partly as a result of the Class I formula change in the 2018 farm bill, the Class III price was well above the uniform price in many months in many markets, which incentivized many manufactured milk handlers to de-pool their milk. This resulted in large negative producer price differentials that lowered the value of many producers' milk checks. In some orders, handlers may jump in and out of the pool at will. Many producers believe this flexibility adversely impacts the ability for dairy farmers to receive the full value of their milk.

Working Group Recommendations:
The working group emphasizes the number four consensus item of the Federal Milk Marketing Order Forum: tighten pooling provisions. The group strongly believes changing pooling provisions are an order-by-order issue, though issues have been felt at the national scale. The group believes states and dairy organizations within particular orders should work together to review and update de-pooling provisions in a manner that limits the possibility of negative producer price differentials. Some members hoped AFBF could help coordinate coalitions within orders to review pooling provisions. Some members highlighted that other changes to FMMOs may result in fewer incentives to de-pool milk, lessening the need for major restrictions.

The DWG emphasizes existing AFBF policy 238.1.2.1.2, which states:

(We support) Changes to the FMMO program to reduce or eliminate negative Producer Price Differentials (PPD) and reduce the economic incentives to de-pool milk including but not limited to modifications to the Class I milk pricing formula, adjustments to pool qualification criteria and stricter limitations on producer milk receipts in months following the de-pooling of milk;

5. Update make allowances routinely with mandatory cost surveys

Background: Please refer to background under priority number three. This priority expands on the issue of make allowances and supports their being updated in accordance with the mandatory cost studies supported in priority three.

Working Group Recommendations:
The working group emphasizes the number five consensus item of the Federal Milk Marketing Order Forum: update make allowances routinely with mandatory cost surveys. FMMO Forum attendees highlighted the importance of make allowances in maintaining manufactured product processing capacity. They believe that **if** mandatory routine cost surveying audited by USDA becomes a reality, both make allowances and yield factors should be updated accordingly. The group says the inclusion of yield factor changes in any future updates is essential.

If future cost studies result in an increase in make allowances, DWG members believe the increase should occur in a tiered process over a decided period of time that minimizes impacts to producers' milk checks. Some members floated the idea of multi-tiered make allowances for different sized processors to help preserve smaller or specialty processing capacity. Others hoped that handlers tasked with helping balance milk markets have their costs partly offset through a tiered make allowance system. The group realized that tiered allowances could contribute to more complication in the broader FMMO system.

AFBF does not currently have policy in support of routine updates to make allowances and yield factors based on mandatory surveying. The DWG supports new policy that addresses this gap and is sensitive to existing AFBF policy, which opposes indexing of make allowances to economic factors like inflation, labor and energy costs (238.1.2.2). Sample policy language follows:

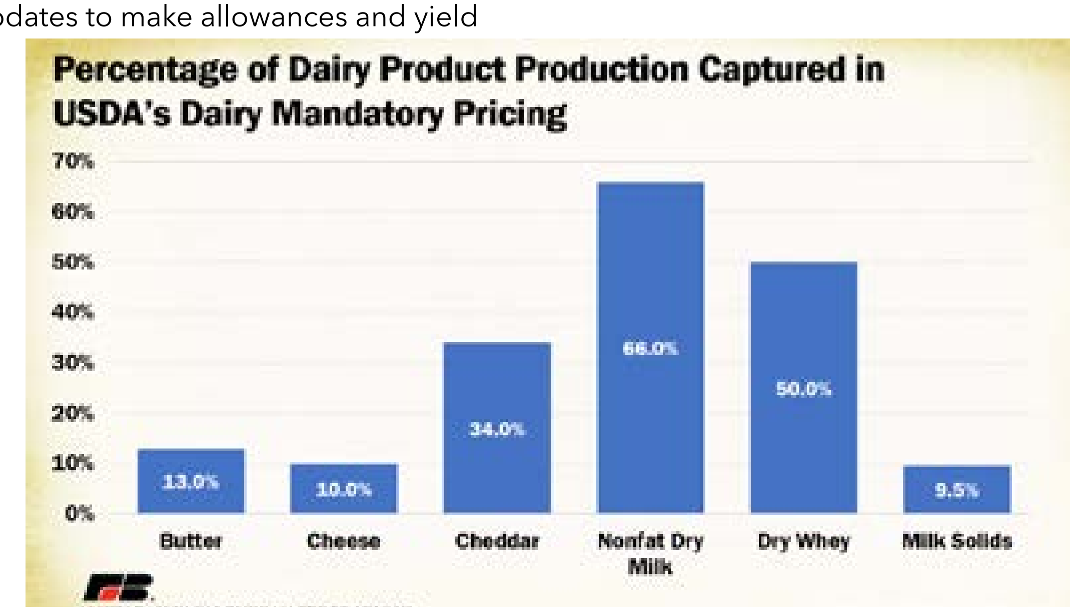
(We support) Routine updates to make allowances and yield factors based on frequent mandatory surveying of dairy processors audited by USDA.

Additional policies related to tiered increases may be added to reflect the DWG's conversations.

6. Expand number of products used in USDA's pricing survey

Background: Dairy mandatory price reporting regulations require USDA to collect and release sales information only for products used in Federal Milk Marketing Order milk pricing formulas. The products include cheddar cheese, butter, dry whey and nonfat dry milk meeting certain product specifications.

Data from USDA reveals that the department's mandatory pricing survey captures only a small percentage of U.S. dairy plants and a small percentage of the milk solids and dairy products produced. The number of dairy products captured in the survey is so limited because of restrictions related to dairy product specifications, standards of identity and packaging, product age, type of product and product sold under terms of a forward contract, as well as any product sold for export and receiving export assistance payments. The 2019 AFBF Dairy Working Group's make allowance report can be found here.



Working Group Recommendations:
The working group emphasizes the number six consensus item of the Federal Milk Marketing Order Forum: expand the number of products used in USDA's pricing survey. Several members brought up the inclusion of mozzarella in the price reporting survey. The DWG supports the existing AFBF policy 238.1.1.1.5, which states:

(We support) Improving price discovery through mandatory daily electronic reporting of most dairy products, including reporting and auditing of prices and inventories, including high-value dairy products as well as prices paid for milk and milk components. Consideration should be given to including different product specifications and products sold under terms of a forward contract.

7. Simplify and add uniformity to milk checks

Background: The milk checks that dairy farmers receive differ from handler to handler and region to region. They are typically difficult to understand and often do not show how the values for components, premiums, producer price differentials, deductions and other market adjustments are calculated. Increased prevalence of distrust between producers and their handlers exacerbates distrust with the numbers presented on received milk checks.

Working Group Recommendations:
The working group emphasizes the number six consensus item of the Federal Milk Marketing Order Forum: simplify and add uniformity to milk checks. The group believes this could be a great first step in improving trust and transparency between handlers and dairy farmers. Members noted that producers should be able to compare their milk checks directly and see exactly where differing values come from. The DWG supports existing AFBF policy 238.1.2.1.3, which states:

(We support) A more transparent and consistent format for processors to use on milk checks to producers including listing percentage of pooled and de-pooled milk by each processor and PPD calculations;

8. Use modified bloc voting instead of bloc voting

Background: Under current provisions, the Agricultural Marketing Agreement Act allows for cooperatives to bloc vote with respect to the approval or disapproval of any amendments to the Federal Milk Marketing Order program. If a cooperative elects to vote and cast one ballot on behalf of its members it shall submit with its ballot a certified copy of the resolution authorizing the casting of the ballot. Cooperatives are not required to provide each producer a description of the question presented in the referendum together with a statement on how the cooperative plans to vote on behalf of the membership. Cooperatives may request that their members receive an individual ballot, but in this case the cooperative may not bloc vote for members not casting a ballot.

Promotion programs, i.e., the Dairy Checkoff, provide an alternative voting process for producers and cooperatives. During a producer referendum for promotion programs, if a cooperative plans to bloc vote it must first notify the membership how the cooperative intends to cast the ballot. If a producer elects to vote individually, the cooperative must inform the producer of procedures to follow to cast an individual ballot. The cooperative may vote on behalf of all members not casting an individual ballot. This form of voting is often referred to as modified bloc voting.

Many producers believe current bloc voting flexibilities offered to cooperatives limit the voice of the individual producers in the FMMO hearing process.

Working Group Recommendations:
The working group emphasizes the number six consensus item of the Federal Milk Marketing Order Forum: utilize modified bloc voting instead of bloc voting during future FMMO hearing processes. The group recognizes this would require a legislative, statutory change. Members noted that modified bloc voting allows individual producers to have a voice while maintaining voter turnout within the hearing process. The DWG supports current AFBF policies 238.1.2.1.14 and 238.1.2.1.24, which state:

(We support) Dairy farmers being able to vote independently and confidentially during an FMMO approval or referendum process.

(We support) A change to bloc voting that would require cooperatives to give notice to members of their intended vote and the member's right to opt out of that vote and vote independently and confidentially.

Other FMMO-Related Recommendations:
The DWG discussed several other FMMO topics they hoped to prioritize. One topic was updating milk composition factors for components like protein, other solids, and nonfat solids in producer milk more regularly. Like routine updates to yield factors and make allowances, to be most reflective of modern market and production characteristics these milk composition factors should also be updated. The DWG supports a method the updates composition metrics regularly.

The DWG also emphasized removing barrel cheese in the FMMO protein component price formula as they believe it has lowered Class III values. They support this in addition to existing AFBF policies 238.1.1.1.6 and 238.1.1.1.7, which state:

(We support) Improvements in milk price formulas to eliminate adverse impacts such as the wide block barrel spread, whey price inversion or other price misalignments;

(We support) Removing barrel cheese from CME Spot markets;

The DWG discussed other miscellaneous issues relevant to FMMOs. Some members brought up the need for a simplified definition of what falls under Class I "fluid milk." Random exceptions for products such as Kefir, certain yogurt drinks, energy drinks and meal replacements from Class I categorization lower the price to producers. Concerns about the impact of Aseptic Ultra-high-temperature processing (UHT) and extended-shelf-life (ESL) milk on the fresh fluid market are also prevalent. Members believe fresh fluid milk needs more investment and innovation. Schools should prioritize fresh fluid milk purchases over UHT and ESL products.

Finally, DWG members also discussed the failure of existing risk management programs to protect against negative PPDs. They hope that updates to FMMOs reduce the frequency of negative PPDs but would like to explore risk management programs that protect producers from negative PPDs.

Non-FMMO Policy Priorities

The following non-FMMO policy recommendations from the 2022 DWG are based on discussions from the June in-person meeting.

1. Increase catastrophic margin levels within the Dairy Margin Coverage program.
2. Clarify AFBF production history policy within the Dairy Margin Coverage program.
3. Support premium alfalfa milk cost updates within Dairy Margin Coverage.
4. Support a change in dietary guidelines to include whole milk and full-fat dairy products.
5. Support congressional jurisdictional change of milk in schools.

1. INCREASE CATASTROPHIC MARGIN LEVELS WITHIN THE DAIRY MARGIN COVERAGE PROGRAM

Background: The Dairy Margin Coverage program provides payments to dairy farmers when the national average income-over-feed cost margin falls below a farmer-selected coverage level. Program payments are based on the amount of milk covered in the program and may range from 5% to 95% of a farm's milk production history in 5% increments.

Producers are required to select a margin trigger rate and a percentage of production history to be covered (traditionally capped at 5 million pounds). Coverage is available for margins between $4 and up to $9.50 under a Tier I CAT (Catastrophic) level or between $4 and $8 for a Tier II level in 50 cent increments. Production history for each operation is established using the highest of the operation's marketings from the 2011, 2012 or 2013 calendar years.

Unprecedented increases in input costs have further pressured dairy farmers' margins. Input costs outside of the scope of feed are not accounted for in DMC calculations. Unaccounted for costs include veterinary and medical services, hired labor, capital recovery on machinery and equipment and energy expenses. Increasing the $9.50 margin protection limit could allow for more flexibility in hedging against increases in these other production expenses.

Working Group Recommendations:
The DWG isolated outdated AFBF policy 239.9.2.3.4.2.4, which states:

(We support) Increasing the catastrophic margin level from $4.00 to $5.00 and maintaining the ability to buy up to $8.00 margin coverage;

Under the 2018 farm bill, which transitioned the margin protection program into DMC, the maximum Tier I coverage level was lifted from $8 to $9.50. Given the existing AFBF policy is no longer relevant, DWG members hope to increase margin coverage offerings up to $12.00. Members understand the coverage would likely be costly but would like to have the option to protect against larger margin spreads given recent unpredictable market conditions. The DWG recommends amending policy 239.9.2.3.4.2.4 to state:

(We support) Increasing the catastrophic margin level from $4.00 to $5.00 and adding the ability to buy up to $12.00 margin coverage;

2. Clarify AFBF production history policy within the Dairy Margin Coverage program

Background: Under the DMC program, production history for each operation is established using the highest of the operation's marketings from the 2011, 2012 or 2013 calendar years. Many operations continue to increase their milk production. In 2002, 29% of dairy cow inventory was on farms with more than 999 cows. In 2017, this percentage was increased to 55%. A production history baseline that is nearly 10 years old is not reflective of a farm's current operations.

Under the Consolidated Appropriations Act of 2020, Supplemental DMC (SDMC) based on 75% of the difference between 2019 marketings and the old base calculation (2011-2013 milk marketings) number was passed into law. The new policy allows operations to opt for higher milk production coverage if changes to herd size were made since the 2011-2013 basis years (within the 5-million-pound limitation). For this expansion of coverage, $580 million has been set aside. It will apply to the 2021 (retroactively), 2022 and 2023 calendar years. After making any revisions to production history under SDMC, producers were able to apply for 2022 traditional DMC coverage. This means future DMC contracts will include the updated production history figures that account for 2019 marketings. Expansion of this coverage is not in place past 2023.

Working Group Recommendations:
The Dairy Working Group isolated three existing AFBF policies that contradict one another related to production history inclusions under DMC. Policies 239.9.2.3.4.2.6, 239.10.2.42. and 239.8 state, respectively:

(We support) Allowing enrolled farms the option to use a three-year rolling production average or current production for payment calculations;

(We support) Allowing dairy farms to update their historical production numbers on a rolling five-year average;

We support including the Dairy Margin Coverage (DMC) improvements in the next farm bill.

The last of these three policies refers to the supplemental DMC calculation changes such as the inclusion of 2019 marketings. The DWG recommends clarifying AFBF's stance on production history within DMC. The group recommends striking the three existing policies listed above and has drafted the below policy to address the conflicting text:

(We support) Updated production history once every five years based on the highest of a prior three-year history, until then we support supplemental DMC production history changes.

The group also recommends striking another outdated policy, which was addressed in the Bipartisan Budget Act of 2018.

Strike: 239.9.2.3.4.2.1. Adjusting the program trigger to function monthly

DMC triggers currently function monthly.

3. Support premium alfalfa milk cost updates within Dairy Margin Coverage

Background: Under Supplemental Dairy Margin Coverage the Farm Service Agency adjusted the calculation of alfalfa within the factored average feed costs figure using 100% premium alfalfa hay rather than 50% in hopes of making future DMC payments more reflective of dairy expenses. This change reduced DMC milk margins by an average of 22 cents/cwt a month linked to an average $15.95/ton increase in alfalfa prices under the updated formula for 2021. For example, in October 2021, the DMC margin dropped from $8.77/cwt to $8.54/cwt under the adjustment. This will allow enrolled producers to retroactively recoup payments they would have

qualified for under the feed cost formula change – if the difference was large enough to trigger a higher payment level covered under their plan. Expansion of this coverage is not in place past 2023.

Working Group Recommendations:
Based on the previous recommendation, which strikes policy 239.8, the DWG recommends the following text to reiterate continued support of premium alfalfa prices being utilized in the feed cost calculation within DMC:

(We support) Premium alfalfa milk cost updates being incorporated in DMC permanently.

4. Support a change in dietary guidelines to support whole milk and full-fat dairy products

Background: Nutrition standards and food service nutrition standards for school meals have changed throughout the history of school meal programs. The most recent child nutrition reauthorization, in 2010, required USDA to update the nutrition standards for school meals within 18 months of the law's enactment based on recommendations from the Food and Nutrition Board at the National Academies of Sciences, Engineering, and Medicine. USDA published the updated nutrition standards for school meals in 2012. They were based on the 2010 Dietary Guidelines for Americans (per an existing statutory requirement), as well as the recommendations from the National Academies of Sciences, Engineering, and Medicine. The standards required increased servings of fruits, vegetables, whole grains and meats/ meat alternates in lunches and breakfasts. They also restricted milk to unflavored low-fat (1%) and flavored and unflavored fat-free varieties, set limits on calories and sodium, and prohibited trans fats, among other changes. The revised nutrition standards largely took effect in school year 2012-2013 for lunches and in school year 2013-2014 for breakfasts. Some schools experienced difficulty implementing the new standards, and subsequent changes to the whole grain, sodium and milk requirements were made through appropriations acts and USDA rulemaking. For school year 2019-2020 and onward, schools are operating under the regulations as amended by a final rule published by the Food and Nutrition Service on Dec. 12, 2018, which allows flavored 1% milk, requires at least 50% of grains offered weekly in school meals to be whole grain-rich, and delays the implementation of stricter sodium limits for school meals. Schools must offer 5 cups per child of fluid milk each school week (one per day).

Current dietary guidelines that represent the basis of school lunch programs are outdated and no longer parallel modern nutritional science, which has proven the benefits of full-fat dairy products for human health.

Working Group Recommendations:
The most recent Dietary Guidelines for Americans, which effectively prohibit whole and 2% milk in schools, contradict modern nutritional science – likely promoting unhealthy nutritional habits. Whole and 2% milk options, including flavored options, are at least as healthy as skim and low fat milk and should be available to students to promote childhood nutrition through more consistent consumption of school milk. The DWG believes the Dietary Guidelines should be updated to reflect these realities. This is consistent with current AFBF policy:

(We support:) Requiring schools to offer all pasteurized fluid milk and milk products, including flavored and unflavored whole milk, as part of the school lunch program without losing federal subsidies;

(We support:) The repeal of Public Law No: 111-296, the 2010 Healthy, Hunger-Free Kids Act, which removed all dairy except for no-fat and low fat products from schools.

5. Support congressional jurisdictional change of milk in schools

Background: House Rule X broadly outlines the jurisdiction of each of the standing committees of the House of Representatives. Most of Rule X was drawn from 19th and 20th century precedents and codified in the Legislative Reorganization Act of 1946. Under House Rule X, food programs for children in schools is under the jurisdiction of the Committee on Education and the Workforce and not the Committee on Agriculture. This precedent limits the ability for agriculture stakeholders to have a voice in school lunch policy updates though the Committee on Agriculture generally handles issues related to human nutrition and home economics.

Working Group Recommendations:
The DWG emphasizes AFBF's support for the inclusion of whole and 2% milk options in school nutrition programs but recognizes they have an uphill battle in Congress given school food programs are under the jurisdiction of the Committee on Education and the Workforce rather than the Committee on Agriculture. Though the group recognizes this precedent is likely unchangeable they strongly support shifting committee jurisdiction of food programs for children in schools to the Committee on Agriculture.

Appendix A: Federal Milk Marketing Order Forum Report

Federal Milk Marketing Order Forum | Kansas City 2022

Discussion Report:
Representatives from over 180 farms, cooperatives, processors and other industry organizations from over 35 states joined the American Farm Bureau Federation in Kansas City Oct. 14-16 for a successful first-of-its-kind industry-wide Federal Milk Marketing Order (FMMO) Forum.

After three years of intense exploration of dairy policy by AFBF's Dairy Working Group, in January the AFBF delegate body recommended that the board hold an industry-wide dairy conference with farmers as the primary participants, to bring their voice to the fore.

The dairy industry is preparing for a likely USDA hearing in 2023 on pricing in the Federal Milk Marketing Orders; so while the conference discussions were free-ranging, they focused on pricing, thus answering the call from USDA Secretary Tom Vilsack to bring the dairy producer community together to discuss FMMO modernization.

After in-person remarks by AFBF President Zippy Duvall and USDA Deputy Under Secretary Gloria Montaño Greene and video remarks from Secretary Vilsack, the conference was split into four half-day segments, each with a three-speaker panel session and Q&A followed by roundtable discussions during which groups of eight attendees discussed issues brought up during the panel session. Attendees were assigned to tables to ensure regional and organizational diversity for the roundtable discussions. This report summarizes the written notes of those discussions.

Executive Summary:
The following section provides a list of the most commonly written and supported concepts in the second, third and fourth discussion sessions. Parentheses represent the number of tables that reported the same concept (i.e., the higher the number, the more tables that wrote down that concept). Not all tables had notes for every session or wrote notes on each topic. Tables may have reported more than one concept for each topic. If items were duplicated between sessions, the top number was presented here. Returning to a higher-of Class I formula option was agreed upon by 21 tables as a consensus item, making it the most widely supported concept.

- Return the Class I mover to a higher-of formula (21)
- Increase Class I differentials to reflect changes in the marketplace (15)
- Make processing cost surveys of plants mandatory and audited by USDA to ensure accurate data (13)
- Tighten pooling provisions (12)
- Update make allowances routinely with cost surveys (12)
- Expand number of products used in USDA's pricing survey (12)
- Simplify and add uniformity to milk checks (12)
- Use modified bloc voting instead of bloc voting (11)

Discussion Session 1: Origins and Purposes of Federal Milk Marketing Orders

Advantages, Disadvantages and Purposes of Federal Orders

Tables were asked to report what they believed were the advantages, disadvantages and general purposes of Federal Milk Marketing Orders. The following summarizes those statements.

Parentheses represent the number of tables that reported the same concept (i.e., the higher the number, the more tables that wrote down that concept). Not all tables responded to every question. Tables may have reported more than one concept for each topic.

Advantages

- Provides timely payments and terms of payment (16)
- Provides order and stability to markets (14)
- Ensures level pay price for producers (12)
- Provides auditing and government oversight of payments (11)
- Provides higher producer prices via Class I and pooling (10)
- Provides pricing data (7)
- Provides testing of milk components (6)
- Helps keep production in all regions and in population-heavy areas (5)
- Maintains markets for smaller dairies and processors (3)

Disadvantages

- Complicated (10)
- Limits true free markets (8)
- Too slow to change when consumer behavior changes (8)
- Lack of transparency/ hard to find reports (6)
- Allows for de-pooling issues (8)
- Farmers pay for transportation – why not buyer? (4)
- The 2018 farm bill Class I mover change to the average of + $0.74 (3)
- No advantages if not in a Federal Order region (2)
- Cooperative bloc voting limits voice of individual farmers (2)
- Make allowances tied within Class I price (2)
- Cooperatives can pay below minimum price (2)
- Differentials outdated/don't reflect full value of milk in deficit areas (2)
- Sometimes price of milk is below cost (1)
- Doesn't capture all dairy products (1)
- Possible elimination of orders through a "no" vote (1)

Purposes

- Orderly movement of milk, market stabilization (17)
- Guarantee fresh fluid milk to consumers in every region (13)
- Limit market power asymmetries between producers and buyers (7)

Discussion Session 2: Class I Pricing Issues

Tables reported what they would like to change relative to Class I pricing issues including, but not limited to, the Class I mover equation, location differentials and de-pooling.

Parentheses represent the number of tables that reported the same concept (i.e., the higher the number, the more tables that wrote down that concept). Not all tables responded to every question. Tables may have reported more than one concept for each topic.

Class I Mover:

- Return to the higher-of formula (21)
  - Advantages
    - We know how it works, it's simple and easy to understand (2)
    - Keeps Class I at high end of pricing (2)
    - Keeps more milk pooled (1)
  - Disadvantages:
    - Higher volatility (2)
    - Co-op/processor unable to hedge long term (1)
- Higher-of plus $0.74/ or $0.74 flex (to address cost margins) (3)
- Second choice to higher-of is average-of with rising adjustor (1)
- $0.74 can be deferred to other formula changes or Class I surface increases (1)
- Higher-of plus $1.50 (1)
- Do not change via farm bill (1)

Class I Differentials:

- Price surfaces must be increased to reflect changes in marketplace (15)
- Redo the map on a specified, frequent basis (3)
- Increase touch-base days required by milk handlers, producers and sellers (3)
- Should transportation credits be adjusted? (1)
- Should market decide? (1)
- Improve information producers receive so they can negotiate this value (1)
- Update every three-five years (1)

De-Pooling

- Pooling/ de-pooling provisions need to be tightened (12)
- Have localized discussions on pooling/ de-pooling and what works for the region (but also what role a national policy has) (4)
- Annual mechanism to enter or exit the order (4)
- De-pooling needs to be eliminated nationally (1)
- Concerns that some processors/cooperatives will just opt out (1)
- De-pooling is a national issue (1)
- Add a qualifier to de-pooling: to receive make allowance you must pool (1)
- Consolidate orders to have larger pools (1)

Other

- Make all orders component pricing (3)
- Concerns about consolidation (2)
- Fresh fluid milk needs to innovate with longer shelf-stable beverages/ need more investment (2)
- The milk that serves the Class I market should be compensated for serving the Class I market (2)
- Transportation issues are challenging Class I markets (1)
- An FMMO hearing should consider Class I mover and Class I surface together (1)
- Negative PPDs are eroding gains (1)
- Prioritize fresh milk over extended-shelf-life (ESL) milk (1)
- USDA increase support for school purchases of fresh milk (1)

Discussion Session 3: Class III and IV Pricing Issues

Tables reported what they would like to change relative to Class III and IV pricing issues including, but not limited to, make allowances, yield factors and price discovery (such as block/barrel cheese pricing dynamics).

Parentheses represent the number of tables that reported the same concept (i.e., the higher the number, the more tables that wrote down that concept). Not all tables responded to every question. Tables may have reported more than one concept for each topic.

Make Allowances

- Make allowances need to be updated regularly (12)
    - Support increases IF return to higher-of (1)
    - Support increases IF pooling restrictions are tightened (1)
    - Support increases IF tied to margin protection for farmers (1)
- Cost surveys should be mandatory across plants for accurate data (13)
    - Must have a USDA audit function (7)
- Increase make allowances in tiered, small levels (4)
    - In phase one only increase $0.02-$0.04 cents/lb. (1)
    - No more than $0.15/cwt one-time increase (1)
- Have multi-tiered make allowance for different size processors (3)
- Plants in price surveys should match those in cost surveys (2)
- No increase to make allowances (2)
- Annual adjustments via mandatory surveys (1)
- Third-party unbiased study with recommendations of what true make allowances should be – including impact to the farmers, processors and consumers (1)

Yield Factors

- Yield factors should also be updated routinely to reflect modern production technologies (5)

Price Discovery

- Expand number of products used in USDA pricing survey (12)
    - Mozzarella (2)
- Elimination of barrel pricing (7)
- Analyze expanding survey period to 45 days and assess the impacts of including additional export sales, which might depress the surveyed average (4)
    - 45 days reporting on powder (1)
- Make price reporting mandatory for all milk products (2)
- Weighted block/barrel pricing instead of elimination of barrel (80/20 breakdown) (1)

Other

- Update milk composition numbers to reflect modern production characteristics (4)
- Any changes must take place via an FMMO hearing (2)
- Combine Class III and IV into one manufacturing class so that manufacturers only deal with one price (1)
- Add a Class V for export pricing and to assist in balancing over pricing that cannot be utilized domestically (1)

Discussion Session 4: Simplifying Federal Milk Marketing Orders | Final Thoughts

Tables reported their top FMMO issues and came up with a list of three statements or policies they found complete consensus on.

Parentheses represent the number of tables that reported the same concept (i.e., the higher the number, the more tables that wrote down that concept). Not all tables responded to every question. Tables may have reported more than one concept for each topic. You will notice lots of overlap with prior sessions.

Policy Changes

- Return to the higher-of (17)
    - Add flex premium based on costs (1)
- Simplify and add uniformity to milk checks (12)
    - Contract transparency (2)
    - Have USDA provide references of standardized check (1)
- Modified bloc voting instead of bloc voting (11)
- Mandatory cost reporting surveys audited by USDA (10)
    - Should include yield specs as well (1)
    - Third-party study – update every five years (1)
    - Every two years (1)
- Update make allowances routinely (9)
    - Tiered/phased updates only (3)
    - Can this be tied to innovation investments? (1)
- Increase Class I price surface (8)
- Changes to FMMO progress through a hearing process and not legislatively (6)
- Tightening pooling restrictions (6)
    - Pooling is a national issue (1)
    - Standardization of pooling rules (1)
    - Annual commitment to pooling/de-pooling (1)
- Eliminate barrels in pricing (3)
- 45 days on data collection (2)
- The milk that serves the Class I market should be compensated for serving the Class I market (2)
- Updating milk composition numbers to reflect modern production characteristics (1)
- FMMOs need to be updated routinely to match changing market conditions (1)
- Support of an innovation fund (1)
- Whole milk back in schools (1)
- Consider two classes (1)
- Address regional concerns on an order-by-order basis (1)
- Increasing touch base days (1)
- Expand items included in price report (1)
- Mozzarella (1)
- Make allowance changes should be pushed to consumer (1)

Other Items of Consensus

- Meetings like this need to happen more often (8)
- Fantastic conference (6)
- Education for producers (6)
- Federal Orders are important to U.S. milk markets (5)
- Exports are essential to the future of dairy (1)
- Regional USDA meetings with farmers (1)
- Need to address lack of trust between producers and their cooperatives (1)
- Can FMMO reform help share cost of innovation in fresh fluid products? (1)
- Uniform benefits across the system (1)
- Support milk deficit regions (1)

NEXT STEPS

Farm Bureau grassroots leaders and dairy farmers may review the recommendations of the Dairy Working Group and adopt priorities, principles and policies to guide the organization during FMMO and milk pricing reform.

Upon the development of new policies, American Farm Bureau Federation will partner with dairy industry stakeholders to achieve new and existing policy goals on Capitol Hill and with the administration. Our goal is to better position the U.S. dairy farmer and the rest of the industry for success by modernizing and improving federal dairy policy.

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