Hearing Clerk
STOP 9200-Room 1031
United States Department of Agriculture
1400 Independence Ave SW
Washington, DC 20250-9200

Delivered By Email

Dear Hearing Clerk:

Dairylea Cooperative Inc. files this brief in response to the hearings called relative to the Federal Order make allowance issue. Specifically, this brief is in reply to the reopened hearing occurring on September 14-15, 2006.

The members of Dairylea, as do many dairy farmers, feel that a better solution to adjusting make allowances is to correct the NASS survey pricing circularity problem as it relates to setting Class III and IV milk prices. Correcting this issue can eliminate the need to adjust make allowances.¹

Dairylea recognizes that a make allowance is a necessary component in product pricing formulas when using wholesale product prices to determine minimum raw milk prices. However, Dairylea takes issue with the fact that manufacturers can receive a regulated adjustment to their minimum raw milk price for changes to their input costs for such things as energy, fuel, labor, insurance, interest rates and other factors, while dairy farmers can not. Over the last five years, dairy farmers' costs of producing milk have increased substantially – for the same reasons that manufacturers' costs have increased. Yet, at issue, the United States Department of Agriculture is considering increasing make allowances for the manufacturers. Doing so will decrease Class and blend prices to dairy farmers. A Federally mandated decrease in the milk price to dairy farmers is not the appropriate response to the cost of production challenges and the cost-price squeeze facing dairy farmers.

Over the last five years, many manufacturing companies have found ways to mitigate their profitability issues relative to rising input costs. These actions have included reducing over-order premiums paid on their milk purchases, trimming unnecessary costs from their operations, buying inputs in a way that achieve increased pecuniary economies and implementing risk management strategies to manage their input costs. Indeed, some have even increased the sales price of its products to pass along the higher costs. It is well known that this last option, increasing the price of the product is not a viable solution if the manufacturer's product is included in the NASS pricing survey – due to the circularity issue.

¹ Dairylea filed a Class III and IV hearing proposal on September 28, 2006 that deals with correcting the circularity issue and eliminating the need for adjusting make allowances.
There is a real issue with the circularity problem. A change needs to be made. As decisions to adjust the make allowance are made, keep in mind that only about 10 percent of the milk produced in the United States is made into manufactured products that have a circularity problem. Most cheese types do not have a circularity problem and Cheddar cheese production that is not included in the NASS price survey does not have a circularity problem. Additionally, the circularity problem does not exist at all for any of the milk used in Class I or Class II – which represented 51.9 percent of all milk pooled under Federal Orders in 2005.

Presently, dairy farmers are under a very severe cost price squeeze that is placing the future of many family dairy farms in peril. Over the past few months, dairy farmer milk prices have declined by $2 or more per hundredweight. Although blend price levels are slightly better than they were during 2002 and 2003, dairy farm returns are far worse. Worldwide geopolitical events, economic activity and weather disasters have conspired to significantly increase input prices for necessities in operating a dairy farm. Since 2002 and 2003, the average cost of producing milk has risen significantly – by $1 per hundredweight or more. Declining milk prices and rising costs have created a psychologically stressful and financially tenuous environment on most, if not all, dairy farms.

Significant milk production increases earlier this year have been the leading contributor to the lower milk prices. However, the strong growth in milk production has not led to, or is part of, a chronic milk surplus situation. Today the situation is far different than existed in 2002 when the last milk price crisis occurred. At this time during 2002, the Commodity Credit Corporation (CCC) had cumulative year-to-date purchases of skim solids equivalent to 6.8 billion pounds of milk. Right now for 2006, CCC has purchased a cumulative skim solids equivalent to 0.7 billion pounds of milk – just 10 percent of the 2002 amount. In so much as their have been purchases by the CCC this year, the process has been one of handling the year's seasonal milk surplus and holding it for use later – as opposed to removing the milk from the marketplace with no prospects of future use.

So the dilemma being faced is that farm cost of production has increased, prices have decreased, there is no milk surplus and USDA is considering lowering minimum blend price levels paid to dairy farmers.

In the Agricultural Marketing Agreement Act of 1937 (AMAA), Congress "declared that the disruption of the orderly exchange of commodities in interstate commerce impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and that these conditions affect transactions in agricultural commodities with a national public interest and burden and obstruct the normal channel of interstate commerce."\(^2\) It was this law and this will of Congress that led to the Federal Milk Marketing Order program. Federal Orders were

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An administrative lowering of blend prices does not appear to meet the spirit of the congressionally enacted law during a time period of rising milk production input costs, low blend prices and a milk supply situation that is, for the most part, equally matching the demand requirements.

Dairylea and its member dislike the system that allows for the circularity issue but recognizes that it exists and there needs to be a fix. If in the wisdom of the Secretary, the present needs of the manufacturing industry, as established in the hearing record, justify the need to change make allowances, then such is the case. However, the Secretary must also immediately reopen the Class III and IV hearing to develop a permanent fix to the circularity issue so additional make allowance changes are no longer necessary.

Regardless, the AMAA does not support lowering blend prices by an administrative adjustment to Class I and II prices. In fact in order to lower Class I and II price levels, the Secretary would have to conclude that rising input prices and production costs on dairy farms and a balanced supply and demand situation necessitate lowering prices to dairy farmers.

Failing to hear the dairy producers’ issues relative to holding Class I and II prices harmless, has backed the Secretary into a corner relative to developing a temporary fix to the circularity issue in light of the AMAA prohibition on lowering milk prices in the current economic environment faced by dairy farmers.

Dairylea offers the following solution to this conundrum.

- Identify the extent of the make allowance changes justified by the record after taking all other issues into consideration.
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