USDA Agricultural Marketing Service
Hearing to Reconsider Class III and Class IV Milk Pricing Formulas

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Thank you for the invitation to share my suggestion to drop the marketing allowance from product pricing formulas.

My husband, sons, and I have owned and operated a dairy farm west of Cross Plains in southern Wisconsin since 1981. I also teach agriculture at nearby Mt. Horeb High School. I trust USDA will carefully consider equitable treatment of both family farmers and processors in the decision making process regarding product price formulas, and recognize the financial and industry structural barriers keeping producers from physically attending this hearing. Please accept this written testimony. I will be commenting on proposals brought to this forum in a post hearing brief which will be submitted at the appropriate time. It is important USDA recognizes the substantial impact product price formulas have on the livelihoods and futures of America's dairy farm families.

In the final rule, USDA states, " Neither the time nor the resources are available to construct models for determining make allowances at this time." USDA makes reference to research validating the use of surveys in determining make allowances. The methods used to combine, then average processing costs from California and a survey conducted by the Rural Cooperative Business Service (RCBS) are explained for each product. To each of the product make allowance calculations (both California and RCBS), a $0.015 marketing cost allowance is added before averaging. A return on investment calculation of about a penny per pound for each product is added to the RCBS survey costs to make them consistent with costs included in the California calculations.

The marketing allowance should be dropped. Make allowances should include only true processing costs. The purpose of the make allowance calculation is to ensure processors are not regulated into paying farmers a price that leaves inadequate funds to cover their processing costs. As USDA states in the final rule, and I agree, "failure to cover processors' costs of converting milk to finished products results in a disincentive to produce finished dairy products". From a producer standpoint, severe decreases in the number of processors would facilitate concentration and increased occurrence of market signal inaccuracies resulting from thin competition.

Conversely, make allowances should not be adjusted or hedged to guarantee profit for processors. In times of milk surplus and low prices, make allowances with unsubstantiated adjustments, such as the "marketing allowance", would push a greater percentage of the financial burden to dairy farm families. Some may argue farmers have traditionally shouldered this burden under past formulated price structure - but certainly USDA should not implement price formulations that, in fact, regulate this situation. Besides being unfair, such an action would increase the validity of farmers' claims USDA does not adhere to the 1937 federal law requiring inclusion of milk production costs in federal order pricing. If USDA accepts producer relief should be generated by assistance mechanisms such as the Dairy Price Support program, Dairy Market Loss Assistance program, feeding initiatives, etc. - then the same principles should be applied to processors. Indeed, processors benefit from assistance programs as well, including the Dairy Price Support program, feeding initiatives, and export subsidy programs. USDA should resist attempts by both processor and producer groups to use this forum to enhance income. Make allowances should simply cover processors' costs of converting milk to finished dairy products.

The marketing allowance appears to be an "adjustment" or "hedge" rather than a true processing cost for several reasons. First, "marketing allowance" is not defined in the final rule. No mention is made of the types of costs that would be included in such an allowance. If one assumes this term reflects a traditional definition of "marketing", it can easily be argued this is not a true processing cost associated only with conversion of milk to finished product - USDA reports dairy producers contributed a total of $242 million to dairy marketing check-off programs in 1999.

Second, the marketing allowance in the final rule is the same per pound - $.015 - for each of the different types of product price formulations being developed. A true processing cost would reflect differences associated with each product. The make allowance calculated by both California and RCBS is certainly different for each product. If true cost data existed for processors regarding "marketing", differences among types of product would be evident.

Third, the notion of make allowances is not new. If "marketing" were truly a cost associated with conversion of milk to finished product - data would exist that could be surveyed. Neither the California system nor the RCBS, both long existing entities, thought to include "marketing" in their processor cost evaluations.

On a closely related issue, the "return on investment allowance" should be subtracted from the California processor costs before averaging with RCBS survey costs. The final rule adds this allowance to RCBS survey costs before averaging to make the sets of data comparable. Both sets could be made comparable by subtracting the return on investment from California costs instead. This would be more consistent with a make allowance level that provides adequate revenue to cover the conversion of milk into finished product - but does not draw criticism for protecting processor interests over those of producers.

In summary, America's dairy industry leaders must continue to seek methods increasing the profits to both processors and producers. Those methods, however, should be derived from other programs and strategies disassociated with calculation of make allowances. Make allowances should simply include processors' costs to convert milk to finished product.