

# Dairylea

Cooperative Inc. ❖

October 2, 2006

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.<sup>1</sup>

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.

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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 there 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.

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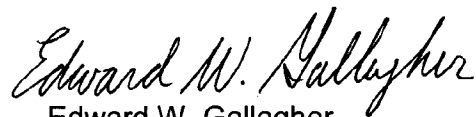
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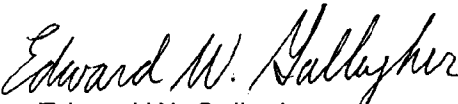
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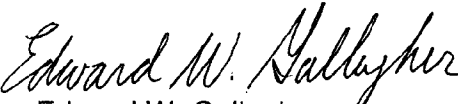
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In fact, the issues relating to milk were in the forefront of Congress' minds when writing the AMAA as it set out very specific parameters relative to milk prices – far more detailed than any other commodity under the AMAA. So specific was Congressional intent that it, in Section 18, identified that when establishing minimum prices or changing minimum prices that such prices “reflect the price of feeds, the available supplies of feed, and other economic conditions which affect the market supply and demand for milk or its products” and if prices are not reasonable relative to these issue the Secretary may “fix such prices as he finds will reflect such factors, insure a sufficient quantity of pure and wholesome milk and be in the public interest”<sup>3</sup>.

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.
- Reduce the change by 52 percent – the average Class I and II utilization under all Federal Orders during 2005.

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<sup>3</sup> Excerpts taken from the Agricultural Marketing Agreement Act of 1937, as amended.

- Implement the reduced make allowances. Immediately hold an emergency hearing to develop the record to hold Class I and II prices harmless to a make allowance change.
- Upon the implementation of the “hold harmless” decision, increase the make allowances to reflect 100 percent of the change as established in the forthcoming decision on make allowances.
- Expedite the hearing process to reach a permanent solution to the circularity issue.

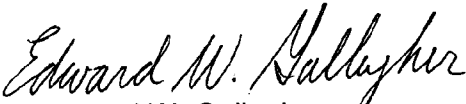
This approach to the challenge will effectively result in the same impact on blend prices during the initial implementation of the make allowance change as the Class I and II “hold harmless” would have.

Dairylea’s members can not support changes to make allowances that also lower Class I and II price levels. Its members, grudgingly, could accept the temporary solution as outlined above, provided it leads to immediate hearings on the Class I and II issue and the circularity issue.

Dairylea appreciated the opportunity to respond to the make allowance issue. If you need additional information or further clarification, please do not hesitate to contact me at 1-800-654-8838, extension 5658.

Dairylea Cooperative Inc. is a farmer-owned agricultural marketing and service organization with more than 2,500 member farms located throughout the Northeast. As the largest milk-marketing organization based in the region, Dairylea sells more than 5.5 billion pounds of raw milk annually through a milk-marketing network that reaches from Maine to Ohio to Maryland. Through its Dairy Marketing Services joint venture, Dairylea members are pooled on Federal Orders 1, 5 and 33.

Sincerely,



Edward W. Gallagher  
Vice President, Economics and  
Risk Management