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FEDERAL MILK ORDERS: THEIR DEVELOPMENT AND FUTURE

by

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FEDERAL MILK ORDERS - THEIR DEVELOPMENT AND FUTURE

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Two of the most significant events affecting the pricing and marketing of milk produced for fluid use occurred when Congress passed the Agricultural Adjustment Act of 1933, and subsequently the Agricultural Agreements Act of 1937, which authorized the Secretary of Agriculture to issue Federal milk orders.

The first orders were issued in 1936, and by 1947 there were 29 orders in force. They increased in number to a maximum of 83 in 1962, and then gradually decreased to 47 by 1978, primarily as a result of mergers. The amount of milk marketed under Federal orders has increased over time and amounted to about $8.4 billion in 1978. This included two thirds of the value of all farm milk in the U.S., and 79 percent of the value of all milk produced for fluid use. Most Grade A milk not regulated under Federal milk orders is regulated under state orders. Manufacturing grade milk is not regulated under Federal or state milk orders.

Idaho Grade A producer milk is marketed regularly in three Federal order markets - the Inland Empire in the North, the Oregon-Washington on the West, and the Great Basin in the Southeast. A hearing was held in Boise in December 1978 to consider a proposal to put milk marketing Southwestern Idaho and Eastern Oregon under a Federal order. The USDA in its recommended decision ruled against an order at this time.

Federal milk orders were first authorized and issued during the depression of the 1930s following periods of chaotic prices and marketing conditions caused in part by the perishable nature of milk, seasonal imbalances in the supply and demand for milk, and the relatively weak bargaining position of producers versus handlers.

The objectives of Federal orders are to (a) assist farmers in developing steady, dependable markets by providing prices for their milk which are reasonable in relation to economic conditions, and (b) assure consumers at all times of adequate supplies of pure and wholesome milk [1].

They operate to correct conditions of price instability and needless flucuations in price which (a) give unwarranted "stop" and "go" signals to production, (b) result in unnecessarily depressed prices to farmers that do not properly reflect supply and demand conditions, and (c) jeopardize the quality of the milk and the dependability of its supply.

The objectives of Federal orders are attained by bolstering market conditions with a legal framework of rules and procedures on which orderly marketing activities can be based to the benefit of all parties concerned. These rules and procedures serve to (a) give farmers, milk handlers and the public an active voice in determining minimum farm milk prices through a procedure of public hearings, (b) equalize ingredient cost of milk to handlers through the use of classified pricing, (c) establish minimum blend prices that assure farmers as much for their

milk as general supply and demand conditions in the market warrant, and assure the market of adequate supplies of milk, (c) provide for the orderly marketing of surplus milk through marketwide pooling and a pricing method by which farmers are assured uniform prices for the milk they deliver to individual handlers in the market, (d) reduce the danger of unwarranted and harmful fluctuations of prices paid to farmers, (e) assure farmers of accurate weights, tests, classification and accounting for milk, and (f) make available information on the handling of milk in the marketing area so as to enable interested parties to evaluate the market situation.

Federal milk orders do not control milk production, restrict the volume of milk marketed, or fix consumer prices. Nor does the USDA unilaterally impose Federal milk orders on the dairy industry. Dairy farmers must initiate request for an order, develop proposed provisions, demonstrate the need for an order at a public hearing, and approve orders before they become effective, and can direct by referendum their termination.

While most of the "benefits" of Federal milk orders are directed toward producers and consumers, handlers also benefit to the extent that sufficient supplies of milk are generated, all competitors pay the same minimum price for milk according to the way they use it, and orderly marketing if fostered.

Federal milk orders have now been in operation for more than 40 years. The economic, regulatory and political environment has changed significantly since then. While many have been reasonably satisfied with the operation of Federal orders, others have not. Criticism has increased in recent years, particularly by those outside of the industry.

This raises the question of whether Federal milk orders are here to stay, or whether they have outlived their usefulness. In discussing these questions, I would like to share with you the views and comments of three prominant economists in the dairy industry.

Dr. Truman F. Graf, Professor of Agricultural Economics at University of Wisconsin recently reviewed criticism of Federal milk orders in testimony before the U.S. House of Representatives Dairy and Poultry Subcommittee. Referring to remarks made by speakers at the Consumer Nutrition Institute Conference, Washington, D.C., December 4-5, 1975, he summarized the following criticisms [2]:

1. U.S. Senator Edward Kennedy: "There is something wrong with a system that first sets regulated prices artificially high, and then allows monopolistic cooperatives to extract premiums over and above those prices. This conference is a starting point for a Congressional inquiry."

2. Jonathon Rose, Assistant Attorney General for Antitrust: "Federal milk order regulation has preversely contributed to declining milk consumption by creating a price beyond the financial means of those who need it most."

3. Tanya Roberts, Public Interest Economic Center: "There do not seem to be any compelling reasons why Federal milk orders are necessary, either to stabilize markets, enhance dairy farmer incomes, improve the bargaining power of farmers, or provide an adequate supply of milk. The combined effects of milk orders cost consumers millions of dollars."

4. William Lilly, Council on Wage and Price Stability: "Milk pricing is an area too important to be left to the people who have been working on it."

5. John E. Kwoka, Jr., Economist, Federal Trade Commission: "At least it its current form, Federal regulation of milk markets is one idea whose time has passed."

In addition to CNI conference criticisms, the U.S. Justice Department Task Group on Antitrust Immunities criticized Federal milk orders for (a) creating an overproduction of Grade A milk by setting prices too

high and (b) reducing the consumption of fluid milk and other dairy products by raising the price of Grade A milk for fluid purposes, and in conjunction with the price support program, elevating the general price level for dairy products to consumers.

Graf went on to say that the major criticism of Federal milk orders appears to be that they have unduly enhanced farm milk prices to the detriment of consumers and society generally. He then testified that he saw no evidence to support this charge. On the contrary, even with Federal milk orders, he indicated that dairy farmers are still struggling to achieve equitable prices in light of their costs.

In defense of his testimony he offered the following evidence:

1. Dairy farmers in Wisconsin keeping electronic farm records with 50 cow herds and an investment of approximately $300,000, receive less for their labor and management than manufacturing workers in the U.S. with zero investment in their jobs, $13,820 compared with $15,575 per year.

2. Prices paid by farmers in the U.S. increased 72 percent between 1972 and 1978, compared with an increase in Federal milk order blend prices of only 67 percent.

3. The Consumer Price Index for dairy products rose 86 percent between 1967 and 1978, compared to a 95 percent increase in all prices to consumers, and an 111 percent increase in the price of food.

4. Milk prices have been declining rather than increasing relative to average wage levels. For example, it took 11 minutes at average manufacturing wage rates to earn enough to buy a half gallon of milk in 1967, compared to 8.6 minutes today.

5. Dairy farmers are dropping out of business in record numbers. Wisconsin had 132,500 dairy herds in 1951 but only 47,000 in 1978 - a 65 percent decrease. The number of U.S. dairy farms dropped from

1,100,000 in 1950 to 379,530 in 1978, also a 65 percent decrease.

6. U.S. milk production has been declining - from 124.2 billion pounds in 1965 to 121.9 billion pounds in 1978 - a 2 percent drop.

7. Farmers received only 51 cents of the consumer's dollar for dairy products, and 55 cents of the consumer's dollar for fluid milk in 1978. Marketing margins cost the consumer almost as much as the milk itself.

8. Farm milk prices were 75 percent of parity for manufacturing as well as all milk in June 1979, considerably below the minimum of 80 percent of parity specified in current law.

9. Negotiated premiums over Federal milk order Class I prices have been going down, not up, in recent years, and averaged 44 cents per hundredweight in June 1979. Negotiated premiums over Federal order minimum prices amounted to an average of $277 per producer shipping to the Chicago market in 1978.

Dr. Herbert L. Forest, Director, Dairy Division, U.S. Department of Agriculture, remarked at the annual meeting of the National Milk Producers Federation, San Francisco, California, November 30, 1976, as he spoke on the future role of Government in milk marketing regulation [3]:

> There is no denying that milk marketing conditions today are vastly different from what they were in the early 1930s when Congress passed legislation involving the Federal Government in milk marketing. In fact, conditions are vastly different today from what they were 20 years ago and even 10 years ago.
>
> When the Federal Government first became involved in milk pricing arrangements:
>
> There were a large number of small producers.
>
> Cooperatives were small and in a very weak position as far as bargaining with the firms who bought fluid milk and manufactured dairy products.

Classified pricing plans, pioneered by cooperatives, were collapsing.

Widespread disorder in milk marketing existed.

Markets for milk and dairy products were depressed.

Price instability threatened the development of dependable supplies of good quality milk for consumers.

The responsibility of milk procurement was largely that of milk dealers.

The dairy industry was looked upon as having two separate components - a fluid segment and a manufacturing grade milk. This separation of the industry was reflected in Government programs with milk orders tied to the fluid segment, and price supports more oriented to the manufacturing side - although the influence of both overlap.

Today:

Dairy farmers are substantially fewer in number and significantly larger in size.

Cash receipts from dairying are at a record high.

Forces are at work that eventually will lead to one grade of milk. The fluid and manufacturing segments are becoming more and more intertwined. They are rapidly dissolving as separate segments.

The structure, role and bargaining strength of cooperatives in most markets have changed. Large regional cooperatives undertake procurement operations - including assembly and management of fluid milk supplies, routing raw milk to distributors as needed and managing reserve supplies. Cooperatives have been able to negotiate prices higher than Federal order minimums.

Changes in the intervening period have not eliminated the essential cause of market instability in dairying which gave rise to the need for marketing orders at their inception....

We haven't got scientists to change a basic characteristic of milk, its perishability;

We haven't got cows to give as much milk in the fall as in the spring;

We haven't got people to drink as much milk in the spring as in the fall;

We haven't got milk dealers committed not to drop producers in the spring;

We haven't got trucks to move milk at no expense to cities;

We haven't got producers to share proceeds of the fluid market voluntarily with their neighbors; and

We haven't got a situation where reserve supplies are handled equally by all parties in a market.

While the need for Government involvement in milk marketing arrangements still exists, this does not mean that the Government's role needs to be the same. During the early period of the milk order program, in fact for many years, the emphasis was on getting prices up and making them uniform between handlers. Cooperatives accepted order minimum prices as effective prices. Today, in many markets, the emphasis has changed from one of Government setting the price to one of undergirding over-order prices established by cooperatives.

After discussing various alternatives for Government involvement in milk pricing, Mr. Forest concluded:

If producers want the Federal milk marketing order and dairy price support programs to continue, they have to expect that Government is going to set down conditions under which these programs operate. Also, consumers may influence or "mute" the role Government can play in programs which establish milk prices. The more Government is requested to divorce prices from the realities of the marketplace the more basis consumers have for saying dairy programs are not in the public interest.

Dr. Hugh L. Cook, Professor of Agricultural Economics, University of Wisconsin-Madison, reviewed "Pricing Under Federal Milk Market Regulation," by John E. Kwoka and "The Social Costs of Federal Regulation of Milk," by Richard A. Ippolito and Robert T. Masson, the primary sources for U.S. Justice Department and other attacks on Federal milk orders [4]. He infers that the results of these studies which show that Federal milk orders unduly increase price, reduce consumption, and result in uneconomic patterns in milk production, are only as valid as their assumptions. According to Cook, these studies are based on the assumptions that:

1. In the absence of Federal orders, there would be no attempt at classified pricing (or pricing according to use);

2. There is no need for milk reserves in Federal order markets;

3. With little or no Class I differentials, adequate supplies for fluid milk needs would be produced at current manufacturing milk prices, at times and places needed;

4. Processor-distributors would pass on to consumers essentially all the expected savings in producer pay prices; and

5. There is little net social benefit associated with any increased price and income stability provided by the Federal milk orders.

In reality, these are not very valid assumptions. Dr. Cook suggests that before we conjecture what would happen if Federal milk orders were removed, it is appropriate to re-examine the situation that existed before the orders were put into effect. He cites the following conditions:

1. There were no audits of dealer reports on receipts and utilization available to producers, to their cooperatives, to other dealers, nor to state and Federal governments.

2. Dealers almost always sought milk from producers as nearby to the city as possible. This meant two things;

a. Few distant producers shared Class I sales; and

b. Those who did shared inequitably in Class I sales and received little reward for carrying the surplus.

3. Some dealers attempted classified pricing but there was little uniformity as to which milk uses were to receive the highest prices. Some dealers in the same milk shed paid on a flat price basis. So, dealers had to compete with each other based on pay prices for milk as well as on sales prices and consumer services.

4. Increases in dealer prices to producers were always fully passed on to consumers; decreases may or may not have been passed on. Dealer margins were protected.

5. When producer associations were formed in the various major sheds in the United States, notably the northeastern sheds, Chicago, and some of those on the west coast, the only way these associations had to enforce their prices was by milk strikes, which meant that consumers

were entirely or largely without milk for several days until producer associations won or the strike was broken by dealers and nonmembers. The record of these associations was very unstable as to their increases in prices to producers and the services they were able to furnish to the milk shed.

Dr. Cook advises that:

> The removal of the Federal order system would put further pressure on the dealers in that they would have to concern themselves with the price they pay farmers for milk (without knowing what the competition pays), as well as competing for resale accounts. So far as dealers pay prices are concerned, the situation might return to where it was in 1937, in that some would attempt classified pricing and some in the same market area might pay on a flat price basis. Again there might be no uniformity as to what milk uses were to receive the highest prices. Much of this might depend on the relative strength of the cooperatives. However, with no producer settlement fund from which to draw, the problem of equitable sharing of the surplus burden would be sure to emerge. Many dealers could not pay the blend price, and indeed many cooperatives now classified as handlers could not pay the blend, if they had low Class I utilization. Handlers, therefore, would seek milk from producers as near to the city as possible. All this might add up to some redistribution of returns among producers and lower and less stable producer prices, and generally less bargaining power by dairy farmers. What the effect might be on total milk production, on Grade A surpluses, and on prices paid by consumers is open to speculation.

In conclusion, let me return to the question of whether Federal milk orders are here to stay, or whether they have outlived their usefulness. It is my opinion that as long as the consuming public continues to demand and drink fresh milk marketed in fluid form, in order to assure adequate supplies, equitable pricing and orderly marketing, there will continue to be a need to:

1. Pay a differential for milk used for fluid to obtain an adequate supply at the times and places demanded.

2. Carry reserve supplies of fluid milk.

3. Equitably share the proceeds from the fluid differential among producers and the cost of handling reserve supplies among handlers.

This is largely being done now through the classified pricing, pooling, and blend pricing provisions of Federal (and state) milk orders, and service charges assessed by cooperatives.

Federal milk orders, which can cover multi-state marketing areas where needs be, will probably continue to be the most efficient way to perform most of these necessary functions. They can be expected to change in the future as economic and political conditions change. Should Federal orders fall into public disfavor in the wake of widespread public sentiment for Government deregulation, however, there is a possibility that dairy cooperatives, which have increased considerably in size and bargaining power in recent years, could perform them, at least in some areas of the country. In some situations responsible handlers might also successfully perform them to the extent that they operated their own audited classified pricing plan and individual handler pool and together with their producers, provided and handled their own milk reserves.

Should critics prevail to the extent that public disfavor falls upon both Federal milk orders and cooperatives so much so that neither is able to operate classified pricing, pooling and blend pricing programs for lack of either legal sanction or competitive ability, in some markets we may have to relearn from experience the lessons of the past 40 years concerning the unique characteristics of fluid milk which have led to the marketing institutions, laws and programs that exist today.

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