

Report to the Secretary of Agriculture

by the

Federal Milk Order Study Committee

**Produced through the facilities
of the
U. S. Department of Agriculture**

Washington, D. C.

April 1962

LETTER OF TRANSMITTAL

March 16, 1962

Honorable Orville L. Freeman
Secretary of Agriculture
Washington 25, D. C.

Dear Mr. Secretary:

I have the honor to transmit to you herewith the report of the study Committee you set up last April to make an evaluation of the milk marketing order system and to present recommendations pertinent to its future. This report is more voluminous and its date of delivery later than I had intended, but the program, as you well know, is extensive and complicated.

The report which we now submit may be viewed as falling naturally into two complementary documents. Parts I and III (with its Addendum) outline the analytical framework in which we attempt to appraise the operation of fluid milk marketing orders and to further improve the order system as an institution of government for serving private business in the public interest. This analysis and the recommendations growing out of it reflect the truth of the old adage, "Doctors disagree." But, as remarked in the text, "We feel that the report is enriched rather than weakened (for the purposes you had in mind) by the inclusion of individual and group dissents or alternative views," both of operational facts and of logical inferences from such facts. Part II of the report presents the factual and theoretical working papers developed by the committee members as their documentation of the judgments arrived at. The ambivalence to be found in these judgments is matched by the amplitude of supplementary footnotes attached to all four sections of Part II.

Respectfully submitted,
Edwin G. Nourse
Chairman

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REPORT TO THE SECRETARY OF AGRICULTURE BY THE FEDERAL MILK
ORDER STUDY COMMITTEE
PART I - PRINCIPLES AND CRITERIA

In announcing, on March 27, 1961, that he had appointed a committee to study and report to him on problems connected with the pricing of fluid milk under Federal milk marketing orders, and again in addressing the committee at its initial session, Secretary Freeman made three broad issues very clear. First, he asked us to appraise the pricing system used under the Secretary's orders in the light of technological and commercial developments during recent years. Second, he desired that we should view the problem in its national scope and impact, not as local agreements locally arrived at (to Paraphrase Woodrow Wilson). Third, his limitation of membership in the committee to persons unconnected with the Federal government services reflected his intention that he secure "an outside audit" of the procedures and the results attained by an agency of his DePartment. While we have thus been commissioned to develop an analysis and make recommendations, not write a history, the present situation can best be approached in brief historic perspective.

A Bit of Background - The roots of the present system of Federal milk orders go far back in the evolution of our private "free" market institutions and our traditional concepts of governmental "regulation" of market structures and practices. Major factors in the shaping of the present system were the increasing urbanization of the country, advancing technologies, and the growing concentration of operative organization in the milk trade. This concentration was characterized by the merging of many small local milk handlers into large market corporations, often operating in many metropolitan areas--even nationally--and by the growth among producers of strong cooperative bargaining associations.

All three of these factors have elements that go far beyond anything that farmers or their Secretary of Agriculture could remedy or about which they could devise an effective "policy." Urbanization and technological change will appear as important ingredients of many of the marketing and price situations which we shall deal with at various places in our report. But our study focuses primarily on issues closely related to the third factor--namely, the trend toward concentration of the fluid milk business in the hands of large-scale distributors and of cooperative associations of producers. Not only did the structures and practices evolved by these large producer and handler organizations furnish the background for the milk marketing order system, but also these organizations still are the major channel through which the system operates. In 1933, when a marketing agreements section was incorporated in the first Agricultural Adjustment Act, this new departure in farm product marketing, especially with respect to milk, was based largely on pre existing cooperative structures and practices in the area of perishable commodities. The very concept of collective bargaining in marketing farm products was indigenous to the metropolitan milk markets and was used elsewhere to a limited extent with sugar beets and canning crops. Fluid milk cooperatives had succeeded in working out, in the several markets, methods of price classification, pooling, and formula settlement with producers and handlers which, with local variations and changes in detail over the years, had won considerable acceptance among both farmers and handlers. At least, up to 1930 or '31, the milk producers had not

been clamoring for government aid to supplement or supersede the cooperative structures and practices they had already achieved. During the early 1920's when grain, cotton, and tobacco farmers were in economic distress, dairymen had been able to maintain a fair degree of prosperity. But when, after the market crash of October 1929, the economy moved into a period of general recession, they, like the rest of agriculture, were convinced that their local efforts needed to be complemented by some form of government reinforcement. The fluid milk co-ops felt that separate attention should be given to their special problems and interests and this was done by including milk and dairy products in the Marketing Agreements section of the Agricultural Adjustment Act of 1933. It provided a system of "licenses" for handlers--a device designed to make the pricing arrangements effective throughout the market in the emergency situation.

Up to that time, producer efforts to deal with urban handlers of fluid milk had been limited practically to the problems of the single market. Controversies and proposed remedies focused on conflicts of interest among local groups or individuals, though in some instances efforts were made to reconcile relationships between adjacent or overlapping market areas and between fluid milk and its manufactured products. A number of state milk control boards were established in the hope of stabilizing prices and raising producers's incomes.^{1/} But very little attention had been given to the need or possibility of articulating fluid milk, the dairy industry, or agriculture as a whole with the general economy.

^{1/} Several of these state agencies were abandoned after the inauguration of the national program, but some of them (or new ones) are still in operation at the present time.

The Federal "licensing" procedure was modified in 1935 into a system of "Secretary's Orders." As still further modified in the Marketing Agreements Act of 1937 (and minor subsequent amendments), this legislation expresses four broad purposes: (a) to bring all distributors ("handlers") in a prescribed marketing area under the scope of the regulatory mechanism, (b) to place them all in the same competitive position in respect to a minimum price for milk entering the same use, (c) to provide for uniform participation in market sales value by the several producers, (d) to overcome the instability of the fluid milk market inherent in classified price and pooling plans which covered only part of the milk entering the market. It had been a major defect of early collective bargaining approaches to regulation of the fluid milk markets that they covered only those handlers and producer groups that elected to participate. Any program to remove abuses or secure equitable treatment of all parties was pretty sure to be defeated by the unregulated operations of handlers or producers not covered by a marketing agreement. Marketing orders provided the means of extending uniform opportunities and responsibilities to (and enforcing them upon) the entire market, rather than certain handlers only.

Once an order is put into effect in any market, it becomes the duty of every handler covered by that order to make monthly reports to the Market Administrator as to all milk handled by him. These reports must show weights and tests of milk received and the uses for which it was sold.

Handlers must keep adequate records and documents to verify all such transactions and uses. The Market Administrator compiles the reports of the handlers and computes the minimum prices class and blended that must be paid by handlers under the order. These compiled figures show the actual flow of milk through the market channels and permit constant observation of the actual operation of the market, and analysis of results of its several provisions-- information notably lacking in the absence of a marketing order.

The system of Federal market orders with its progressive refinements, has now been working and steadily expanding (see attached table and maps) for more than a quarter-century. Fluid milk markets, to the number of 81) have been brought under Federal "regulation" in the best sense of the term. This is not complete or arbitrary control but regularization under marketing orders whose terms are initially proposed by the producer groups, with modified proposals by handlers or competing cooperatives) with public hearings in which all interested parties are heard in advance of the drafting of the final order. Since World War II, intermarket and intra industry relationships and problems have required increased consideration.

What has here been created is a truly unique marketing institution) neither quite free nor fully controlled but heavily conditioned" by both private and public mechanisms and policies. Our report will describe its major features and analyze their results in terms of impacts on the several interested groups) so far as they can be identified or strongly inferred from available statistical data and present understandings of economic principles. Out of it will come such conclusions and recommendations as the committee shall arrive at.

Table I.--Number of markets, producers, handlers, and volume of producer receipts, Federal order markets, selected years, 1940-61

Year	Number of markets	Number of producers <u>1/</u>	Number of handlers <u>2/</u>	Milk received from producers by handlers regulated under Federal orders	Receipts of milk from producers by regulated handlers as a percentage of all milk delivered to plants and dealers
	Number	Number	Number	<u>1,000</u> lb	Percent
1940	17	1/ 99,386		1/ 9,095,359	3/ 19.3
1945	26	123,161		13,209,100	19.2
1950	39	156,584	1, 101	18,659,790	25.1
1955	63	188,611	1,483	28,948,067	31.8
1956	68	183,830	1,486	31,377,533	32.8
1957	68	182,551	1,889	33,455,338	34.0
1958	74	186,155	1,962	36,355,658	36.5
1959	77	187,576	2,197	40,149,083	39.8
1960	80	191,235	2,257	44,812,259	43.2
1961	81	194,497	2,309	48,802,113	4/ 45.4

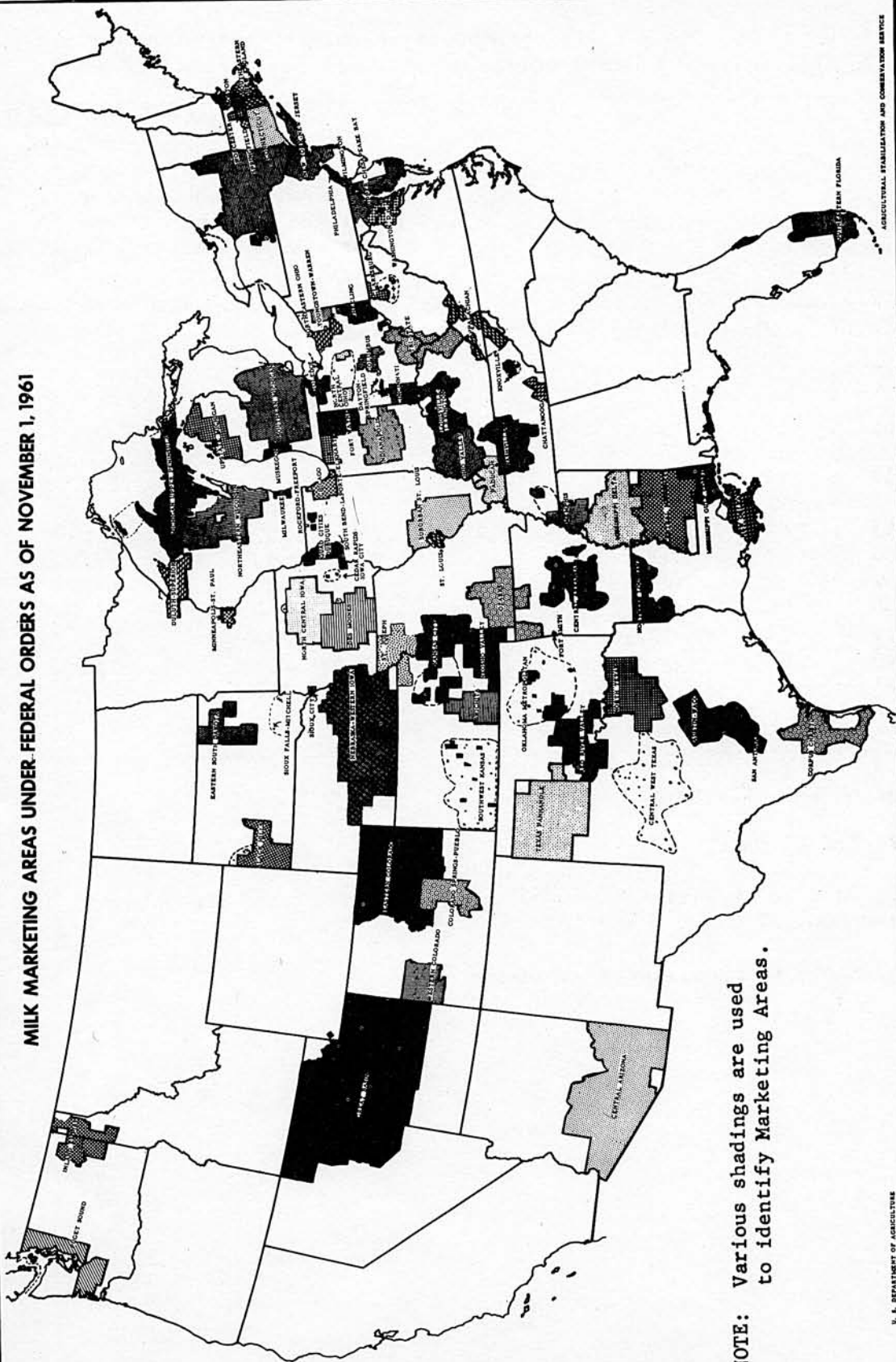
1/ Average for year.

2/ End of year.

3/ Data for 6 markets: Boston, New York, Chicago, New Orleans, Omaha-Council Bluffs, and Toledo.

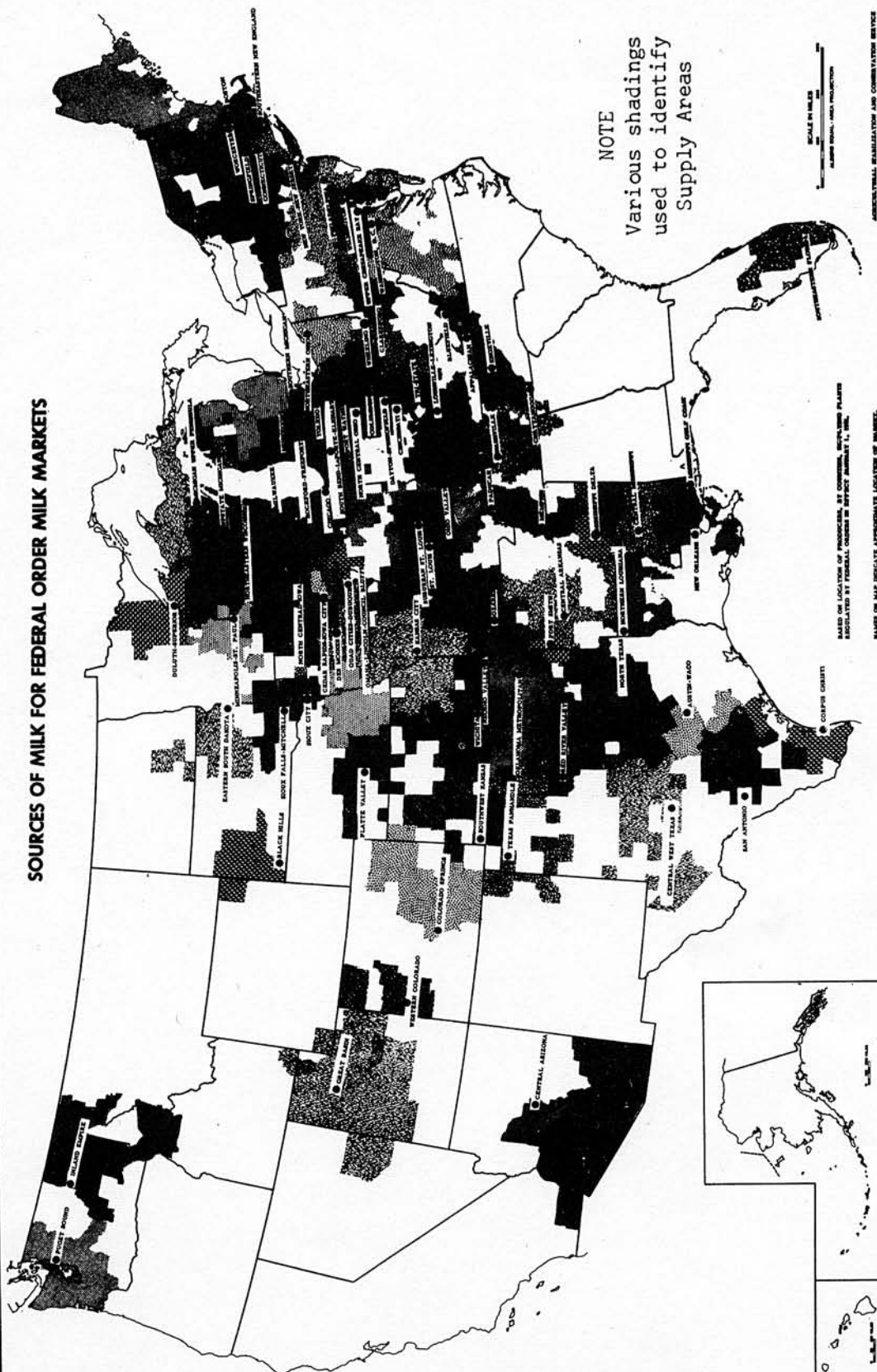
4/ Based on preliminary estimate.

MILK MARKETING AREAS UNDER FEDERAL ORDERS AS OF NOVEMBER 1, 1961



NOTE: Various shadings are used to identify Marketing Areas.

SOURCES OF MILK FOR FEDERAL ORDER MILK MARKETS



The Concept of Administered Prices - The first proposition in this analysis is that fluid milk prices are one species of a large genus referred to more and more commonly as "administered prices." Its habitat spreads out over a wide area between the theoretically automatic prices of very small-scale (or atomistic) competition in a predominantly free market with many buyers and sellers at each stage of the marketing process and the wholly controlled prices (with much control also of production and consumption) of an autocratic government set-up. Administered prices are neither emancipated from the laws of supply and demand nor can they be defiant of those laws. The phrase does not imply mystical beneficence (like the Invisible Hand of laissez faire economic theory) or diabolic coercion (like the edicts of a communist or a fascist dictatorship). The term is simply descriptive of the way business is (and has to be) done in highly centralized industries like steel and automobiles-.and likewise in fluid milk markets under modern conditions of numerous large-scale commercial organization, official sanitary requirements, and modern facilities for transportation.

The distinctive feature of administered prices is that the price maker has a significant ability to determine or influence the flow of supplies and often the differentiation of products, or related services, and that he adopts a price "policy." That is, he sets up goals of unit price and/or over-all profits and then adjusts his supply operations toward the attainment of that price-profit objective.

The degree of supply control available to the agricultural cooperative, however large its membership, is slight indeed compared with the control of output exercised by great industrial corporations in many lines. The

cooperative executive must administer in available demand channels whatever supply of milk his hundreds or even thousands of individual and independent farm proprietors decide to produce (with their managerial judgment overridden by the random impact of weather conditions, disease or pests). He has no control and little influence over non-member producers or other cooperative associations. But associations of producers can formulate and implement a policy of allocating product between different uses - i. e. "classified pricing."

The ingenious methods that have been devised to deal with this free-wheeling supply situation and related distributor issues will be examined in some detail in Part II of this report, under "The Classified Prices" and "Pooling and Producer Settlements." Under the milk marketing order system, the Secretary of Agriculture, through the Milk Marketing Orders Division becomes an important participant in the process of milk price administration. The nature and limits of the participation are the essence of the problem which the Secretary assigned to this committee for evaluation and recommendations.

First a brief look at the goals or purposes which were espoused by producer groups or early cooperative managements; and some preliminary evaluation of those objectives in the light of economic analysis. Were they congruent with the public interest? Or have they been suitably modified by present laws or suitably directed through pragmatic regulatory procedures?

Our specific frame of reference here is to the subsection 608c (18) on Milk Prices contained in the Agricultural Marketing Agreement Act of 1937 as amended. Though encrusted with numerous ambiguities and anachronisms

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such as generally accumulate on a statute which deals with controversial economic matters, it shows a core of loyalty to the economic doctrine of supply-and-demand equilibration and the social criterion of “the public interest.” Since the self-help efforts of dairy farmers antecedent to the passage of the Agricultural Adjustment Act and the Marketing Agreement Act were directed toward the administration of group supply vis a vis metropolitan demand, we may well begin with a brief look at the purposes that animated them and the goals they sought to attain.

What Cooperatives Undertook to Do - The history of the agricultural cooperative movement in the United States shows clearly that these associations arose as an attempt to ameliorate the income situation of their members--mainly small farm proprietors. Dairy farmers attributed their difficulties primarily to three factors: (a) they were dealing individually as small producers of a highly perishable product in a market generally dominated by a few large buying units; (b) their milk, even though it met minimum market standards, varied considerably in quality, and in quantity it was subject to wide seasonal variations; (c) these conditions made them vulnerable to severe price cuts by dealers at flush seasons (or even partial or temporary loss of market outlet), and enabled dealers to reap most of the profit from supply shortages while the farmers had to bear most of the penalties of market surpluses.

The early cooperative bargaining associations pioneered several procedures for coping with problems of this sort. They had, in the hard school of practical experience, picked up considerable rough-and-ready understanding of the mechanics of the market or the economic principles

relating ends and means therein. They were well aware that if supply tended to outrun demand at a prevailing level of prices, competition among handlers engendered merciless cutting of prices to producers, and that competition among producers to retain as large as possible a share in this market led them to accept these hard bargains. Similarly, when supplies were short, producer groups would try to seize the opportunity to force prices up as high "as the traffic would bear." The handlers defended themselves against price enhancement by scouting around for cheaper milk wherever they could find it. The end result of this cold war was frequent demoralization of the business of providing an adequate and dependable supply of high quality milk to the ever-growing metropolitan markets. A stable peace or at least peaceful co-existence was demanded under the slogan "orderly marketing" of milk.

To attain this end and to raise the incomes of their members, the fluid milk cooperatives launched a two-pronged program. First, they sought to improve their bargaining power by amassing a significantly large volume of supply and putting it in the hands of skilled sales executives equipped with appropriate physical and financial facilities. Second, they devised concepts and practices of "classified" pricing to the dealer according to the use to which his milk went and of "pooling" returns to members so that all would share equitable in both the higher returns from fluid milk and the lower returns from "surplus" uses. But they could not fully enforce the classified price system because they could not prove dealer utilization in the absence of an effective audit

of handler records and because they could not get participation of all handlers or all producers.

As a means of getting dealer acceptance of their program and improving members' supply position behind their marketing organization, the cooperatives developed extensive programs for improving the quality of their products, grading and assembly, and in some cases processing of "surplus" milk. They sought better service to dealers as well as higher returns to their members.

These efforts of cooperative milk producers have brought impressive results, some of which will be considered in Part II of this report. But here it should be noted that, behind the handsome facade of this "tall, opaque word" orderly, there appeared from time to time to be a lurking desire among some groups to build up such bargaining power as would enable the cooperative to dominate the price-making process and raise prices for their group above a true competitive level. It is not the assigned task of this committee to describe or evaluate the degree of concentration of economic power that cooperative associations can or should exercise under the Clayton Act, the Capper-Volstead Act, and various court decisions (including the recent ruling of the United States Supreme Court that they are not exempt from the provisions of anti-trust law).

But, in searching for general economic principles that can serve as criteria or guidelines in the future development of the marketing order system, we must consider what cooperative structures and practices promote healthy competition and which, if any, have the purpose and effect of fostering monopolistic power. The marketing order system both underwrites

and circumscribes the administrative powers of the cooperative associations. Since it undertakes to make milk marketing orderly and equitable among all factors in a given market and between related markets, the Secretary must decide (a) what structures and practices that have grown up between producer and handler organizations in any given market shall be accepted for inclusion and enforcement in a Federal marketing order, (b) whether these terms of trade are properly related to the basic prices established in the order and (c) which of them shall be modified or abandoned- whether through attrition or summary action.

Our report will make recommendations bearing on these issues.

The Concept of Orderly Marketing - The classical doctrine that unregulated competition would act as an automatic adjuster of both price and production had merit in its day of small-scale business operators. But as the investment required for an improved herd and for better physical facilities has grown, and as the managerial training of the modern dairy farmer has expanded, it has become less useful and indeed impractical. If fluid milk markets are to have an orderly supply, there must be orderly production, and for orderly production--both efficient and remunerative--there needs to be orderly provision for the physical assembly and distribution, for dependable and equitable contract relations between handlers and producer organizations and between these organizations and their individual members. There need also to be orderly relationships as to prices and supplies between different markets

The structures and practices that the cooperatives and handlers have devised and the complementary mechanism of regulation supplied through government milk marketing measures taken together have gone a considerable distance toward this end. But the basic concept of “orderliness” in the economic sense is still not clearly understood or fully agreed to by all parties. The issue has been tackled on several levels. Order has been conceived in the time dimension as related to annual seasons, longer cycles, and secular (i.e., long-run) changes in productive conditions and consumptive demand. It has also been conceived geographically in terms of single market areas, regions embracing several such areas, and possibly even national areas of industry-wide adjustment---including economic adjustment between the two branches of dairy farming, fluid milk and milk for manufacturing uses.

It must be recognized that the objective of orderly marketing espoused by early cooperatives was primarily local. They sought to get away from severe and often unpredictable swings from surplus to shortage of supply within the year and from peak to bottom of a production cycle. They sought to secure a permanent and dependable membership, who would loyally support the policies and programs aimed toward the benefit of the whole group. They sought to build up a vested interest in a desirable market situation and to protect this domain from intrusion by others. They sought to hold prices steady for considerable periods of time and to respond to changed economic conditions such as the general price level, farming costs, pressure of alternative supplies of milk, or the like, rationally and gradually not erratically or abruptly.

From the beginning, such considerations have, in varying degree, entered into the drafting and administration of milk marketing orders. But something further has been emerging...a recognition that the outlook of the Secretary of Agriculture and his aides should not be parochial but industry-wide and national in its scope. The Secretary is empowered and entrusted to develop a system of fluid milk marketing orders, integrated as to their relations with each other and with all the uses into which milk goes, not merely orderly as to their internal housekeeping. He is cabinet minister of the nation's agriculture, pledged to bring it, in the national interest, to the soundest economic adjustment, private and public, that can be worked out.

The Concept of Agricultural Adjustment., It is well to remember that the original statute from which the Federal milk orders system stems was conceived as an agricultural adjustment undertaking. It set up an apparatus for improving the lot of the farmer by helping him in every reasonable way to bring an industry (and its sub-industries) in which productivity was rising rapidly even faster than in the industrial sector of the economy into better equilibrium over time with market demands that are relatively inelastic. The broad goal of improving farm incomes still holds, and the word "parity" still appears in Sections 602 and 608c of the Agricultural Marketing Agreement Act of 1937. But a simple and rigid price formula based on the mathematical ratio of two general price indexes tracing back to the economic conditions of 1910-14 has from the start been found unsuitable to the purposes of bringing the fluid milk enterprise of a given area into satisfactory equilibrium---both profitable

and stable -with available demand. A more flexible and pragmatic approach was needed.

In the unique system of free enterprise production and orderly group marketing of fluid milk that we have inaugurated and are still striving to perfect, the golden mean lies between rigorous government control and tooth-and-claw mayhem among partisen groups, often of considerable differences in bargaining power or situation. The Secretary of Agriculture under this unique institution for the rational ajustment of an agricultural sub-industry--what Professor Black called "assisted laissez faire"-- is the moderator of an intellectual process dedicated to promote the public interest.^{2/} This calls for tailoring the master concept of individual competitive enterprise to the diverse and changing conditions of large-scale operation and ever-advancing technology.

Competition As The Way of Economic Adjustment - The enduring essence of what economists and businessmen have learned about the nature of economic equilibrium in the dynamic terms of "growth and stability" (our modern watch words) and about means for attaining and maintaining this double goal may be summed up in the single word competition. Freedom of business enterprise and freedom of movement between markets are the hemispheres of this global idea of competition. With such freedom, producers can embrace the most profitable opportunities they can discover- --or create. Then also, consumers will have access to the best and most

^{2/} For discussion of the meaning of this term in the Marketing Agreement Act, see Part III page 8.

economical source of want satisfaction, distributors will have profit incentives to find the most economical sources of supply and create the most efficient means of reaching them and serving users, and the nation's resources will be allocated to the most desirable uses.

But though the principle of competition as an organizing force remains basic over the ages, the manner of its application changes with the times. In today's situation of highly capitalized and big unit organization, we have graduated from atomistic competition to what, among economists, is now called "monopolistic" competition. It is characterized by partial control by managements but within the "great impersonal power of the market." As stated above under "administered prices," we are dealing in pricing milk under Federal orders--as in many industrial areas--with a situation in which a given supplier organization has sufficient control over volume in its market so that it can exert significant influence on price. This is not monopoly, but is planned competition among organized groups--something very different from blind competition among powerless individuals.

It becomes a matter of public as well as private concern that this process of pricing be so conducted as to maintain the essentials of free enterprise and optimal allocation of productive resources as well as, or better than the "Invisible Hand" was supposed to do under "atomistic" competition. Administered pricing should be the highest expression of the idea of orderly marketing, properly guided by the trained intelligence of production and marketing experts. Such guidance sometimes calls for a

structure of reasonable public regulation pledged to promote "the general interest." As a part of that interest it must realistically recognize the claims of producer groups who have immobile investments in past arrangements even if some of them are, by present standards, ill conceived. Reform must not move so fast toward the achievement of what is regarded as ideal that it itself becomes a factor of economic demoralization.

Marketing agreement legislation sought to guard against such dangers by setting up a system of public hearings when "the Secretary of Agriculture has reason to believe that the issuance of an order" is needed or desired in the market. Details of the order may be proposed by producers or others and supported or contested by any interested party. Obviously, not all such proposals can be either granted or reconciled, and it rests with the Secretary to formulate the final details of the order in terms consistent with the purpose of the Act and see that they are enforced with vigor, fairness, and good judgement, or terminated.

Competition, Ease of Entry, and Justifiable Shelters - With competition as the center pillar of classic and modern doctrines of economic efficiency and optimum allocation of national resources, its corollary has been that there should be open entry of enterprisers into any given line of production and an easy flow of trade between markets. "Free trade" has long been an accepted principle for the efficient allocation of economic resources among countries. But it was never swallowed whole in a doctrinaire sense except by a minority of extreme "fundamentalists" among either economists or businessmen. The truth and practical usefulness of the free trade proposition can best be demonstrated in

negative rather than positive terms. That is, wise public policy must identify and remove or competently police any business structure or practice that so limits ease of entry into a producing or marketing situation as to keep competition among enterprises from fulfilling its normal function of economic adjustment.

Under modern technology and business administration, the quest for efficiency inevitably produces situations which limit the ease of entry to many business areas--including fluid milk. In the industrial field, efficiency demands capital accumulation, managerial skill, and research facilities of a size that often precludes easy entry (or possibly at times even entry at all) by a newcomer. Public policy has recognized this fact at least tacitly and provides or permits arrangements that shelter affected producers to one degree or another short of a real bar to new entrants. At the same time, it is watchful that these shelters be not abused. This is the essence of rational anti-trust policy.

As of today, both the capital needed and the skill required for success in the fluid milk business operate to limit to a considerable extent the ease with which newcomers can enter the business. Within market situations thus somewhat restricted, the role of the Secretary of Agriculture in administering the milk marketing order system would seem to have four co-ordinate and interrelated parts: (a) to establish a structure of prices among order markets, with differentials between differentiated uses suitable to the scheme of classification and other operative features of the several markets; (b) to see that these differentials and operational features do not permit such unpoliced entry

for new producers and "outside" milk as will disrupt orderly operations or inflict confiscatory damage on established producers; (c) not perpetuate or promote uneconomic allocation of productive resources or inequitable market relationships; (d) avoid maintaining or creating a monopoly power that might result in prices inconsistent with the public interest.

These generalizations as to the nature of administered prices) competition between large milk bargaining units, and the unique system of government regulation embodied in the milk marketing orders have concrete meaning only in the light of detailed consideration of the specific and rather complex practices which will be set forth in Part II of our report. But the statement of objectives and principles constitute the orientation within which these analyses and evaluations have been developed

SUMMARY

In brief, then, this committee believes that the Federal milk marketing orders system under the Marketing Agreements Act has the following major objectives:

1. To promote orderly marketing conditions for farmers specializing in the production of fluid milk and thereby improve their income situation at least in the long run;
2. To administer and supervise the terms of trade in defined milk markets in such manner as to equalize the market power of buyers and sellers and attain reasonable competition but not local monopoly resulting in undue price enhancement;
3. To assure consumers that they will have access to adequate and dependable supplies of high-quality milk from the sources best suited

both technologically and economically to supply these demands;

4. To complement the efforts of milk producers' organizations to maintain economic order in their industry, and to bring about the co-ordination of price structures and market practices within and between marketing areas, between fluid and manufacturing segments of the dairy industry; and between milk production and other lines of farming;

5. To secure equitable treatment of all parties--producers, dealers, and consumers, not only within each local or regional market but through out the system;

6. To establish such terms of trade under the orders as will combine maximum freedom of trade with proper protection of established producers against seasonal or other loss of outlets that would tend to demoralize markets and farming plans.

Ancillary to these major objectives of the order system are the Department's efforts, through the several Market Administrator's offices} to obtain a comprehensive and accurate flow of milk market statistics} so that producer organizations and handlers may administer their business affairs in such manner as to best serve the declared purposes of the Act and that the orders may be most effectively and equitably enforced on all parties. These statistics are also an invaluable guide to the Department of Agriculture in drawing up new orders or modifying old ones-... and to market economists elsewhere.

In our judgment} these purposes embody sound principles of modern economic thinking, faithful to fundamental doctrines of free economic enterprise, stimulative competition, and freedom of market movement,

but with the realities of today's technology, large-scale business organization, and the need for industry-wide regional and national planfulness suitably recognized.

Note by the Chairman:

During the early weeks of the committee's deliberations, a subcommittee, under the lead of the Chairman, undertook to draft a brief introductory statement of economic principles and criteria pertinent to the structures, policies, and practices of the milk marketing order system. We sought to arrive at some general consensus in the thinking of these 18 specialists so well acquainted with the history, rationale, and results of the order system in its practical context. After much discussion of this draft material in successive plenary sessions of the committee, and after considerable revision, this orienting statement emerged in the form here presented as Part I of our report. It was formally accepted by vote of the full committee on January 31, 1962.

Meanwhile, all members, organized in three subcommittees, proceeded with their separate analyses of the four subject-matter areas that make up Part II of the report. Both in their draft materials and in the discussions thereon at successive full committee meetings, it became increasingly evident that there were two clearly divergent schools of thought as to desirable ends for the order system to pursue and appropriate means of pursuing these ends.

This divergence within the committee came to an issue on January 31 in a test vote on the adoption of Section 3 of Part II. With the chairman counted out, the vote stood 9 for the section and 8 against. It was then pointed out that other parts of the text, particularly Part III} were more or less at variance with the conclusions of Section 3 of Part II. When Part III came up for action, various textual changes were made and the last 6 pages of the draft submitted to the committee on December 15 were deleted and the present closing pages were substituted.

It was apparent to everyone that the entire report would have to be re-examined and substantially re-written if inconsistencies were to be removed and it was to conform fully to the views of the "majority" of nine members. It was

evident, too, that a comparable job of re-writing would have to be undertaken if the views of the "minority of nine" were to be adequately set forth. No such systematic revisions could be prepared in view of the lack of time and the imminent dispersion of the committee, but all dissents and supplementary comments that were submitted after January 31 have been attached at the indicated places.

It is hoped that this statement of facts will be of help to readers as they encounter inconsistencies in the report or ponder the divergent economic and social philosophies that it reflects. - Edwin G. Nourse

PART II - i

MILK MARKET ORGANIZATION AND PRACTICES UNDER SECRETARY'S ORDERS

The regulatory impacts of milk marketing orders run in two directions. On the one side, they promote economic orderliness and commercial equity through a system of classified prices, applied uniformly to all handlers in a given market. On the other side, they promote orderliness and equity among producers through a system of distribution of total returns to individual producers.

Classified pricing will be considered in Section I of Part II, followed by discussion of methods of defining a marketing area (Section 2). Thereafter, we examine pool structures and settlement practices (Section 3) and how intermarket relations (Section 4) affect and are affected by class prices, settlement methods, and other order provisions. The analyses developed in these four sections furnish the basis for the general evaluation of the order system, along with our recommendations, presented in Part III.

Note by Edwin W. Gaumnitz

I am in accord with the content of Part I of the report, "Principles and Criteria"; with Section 1 of Part II except for the statement appearing on pages II-1-24 and II-1-25 (where I have appended footnotes); and with Part III, "Evaluation and Recommendations" up to page III-28. Otherwise, this report does not represent my views on the assignment given the Committee. My dissent goes to the tone or accent, the substance, and the over-all composition of the report. The broad points to which I take exceptions are those regarding the interpretation of the "public interest" and "marketing control". Minor exceptions are noted at several points in footnotes.

In general summary, my objections to the report are that it fails to set forth clearly the following:

(1) In so-called fluid milk markets under present market structures and in the absence of governmental control, prices of Class I milk are

Part II - i

indeterminate within a considerable range. This is also because of large scale organizations on the part of both producers and distributors. This fact is the basis for the common statement that Class I prices are unstable. The price prevailing at any particular time is dependent on the relative strength of relatively large elements both in the selling and producing phase.

(2) This instability was probably the principal reason for the development of various types of governmental intervention, including that provided by the Marketing Agreement Act of 1937.

(a) While the Marketing Agreement Act (originally part of the Agricultural Adjustment Act) had as its stated objective increasing producer returns to "parity," it was generally recognized that the obtainable objective was that of "stability" rather than artificial increase in prices.

(b) The general "stability" principle was followed in recognition of the fact that artificially high prices would induce additional production on the part of those producers then supplying the market and would also result in added supplies of milk from producers not presently selling to that market.

(c) It was also recognized that the provision of the Act relating to entry meant that there should be no artificial restrictions on entry provided by Orders.

(d) It was evident that Section 18 was in effect a modification of the "parity" objective and meant that prices should be established at levels sufficient to bring forth the necessary supplies and no more.

(3) Within the above limitations the establishment of Class I prices was not too difficult, recognizing, however, that there was a "range of indeterminateness." A departure from prices so determined in the direction of artificially high prices clearly would give the Administrator no basis for making price determinations.

(4) Departure on the high side in establishing prices runs into the danger of attracting additional supplies or necessitates

(a) artificial restrictive devices such as compensatory payments and plant qualification, or (b) some type of producer sales quotas (which are not authorized under the Act).

(5) While such devices as plant qualification, "down classification" and compensatory payments may be justified on a "minimum" basis there seems to be no basis for the use of such devices above such minima.

(6) It is obvious that high prices under fluid milk marketing orders will induce and have induced increased production and offerings within the normal production area as well as from outside sources. The increased supplies resulting from such prices add to the total milk supply for all

uses and are therefore specifically to the disadvantage of milk producers not under protective milk orders.

(7) The Federal price support program affects the returns to producers of all milk and butterfat irrespective of order programs. Basically there should be no criticism on the part of manufacturing milk producers if milk order programs are administered so that prices established under such orders bear their usual and necessary relationship to manufacturing milk prices. It must be assumed that the inconsistencies referred to in the note of the Chairman (page I-23) represent a failure of members of the Committee to recognize the existence of such inconsistencies and also are indicative of a lack of understanding of the issues involved and their significance.

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PART II - Section 1

THE CLASSIFIED PRICING SYSTEM

Classified price plans, i.e., the establishment of a schedule of prices which handlers pay for milk, differentiated according to end product use by the handler may be traced back at least to 1903. Such plans originated when the early system of individual producer and handler bargaining was superseded by collective bargaining with handlers by groups of producers organized into cooperative associations. Since organization of the supply for purposes of developing greater bargaining strength and thus improving the financial status of producers was the major reason for the establishment of cooperative milk associations, the development and spread of the classified price plan of selling milk to handlers closely parallels the growth of fluid milk cooperative associations of producers. They were of paramount importance in its development, its rapid spread during the 1920's and early 1930's and its incorporation into the Agricultural Marketing Agreement Act of 1937.

Classified pricing has, over the last six decades, become the almost universal practice in fluid milk markets.

Purposes of Class Pricing. - In bargaining for prices for their members' milk, cooperatives immediately crashed head..on into the problem of the "surplus" over fluid milk requirements particularly on a seasonal basis. Since milk qualified for distribution as fluid milk in any market must be available at all times in greater volume than what is actually sold as fluid milk in that market, the problem was one of so segregating such surplus or reserve that it would not cause serious instability in the level, and particularly the seasonal structure, of fluid milk prices.

11-1-2

This problem was attacked, and to a greater or lesser degree met, by establishing one price for milk entering fluid use, and another price (or prices) for milk going to other uses.

Price classification was designed to serve several major purposes such as: (1) to facilitate the disposal of seasonal supplies in excess of fluid milk requirements, thereby eliminating their impact on fluid milk prices, (2) to enable all producers to share in the relatively higher prices from the sale of fluid milk; and (3) to reduce the inherent instability of fluid milk prices through assuring uniformity of prices to all handlers. The overriding objective of classified prices in milk marketing orders is to establish a system of prices which covers the total supply of milk of a market in such a way as to assure an adequate amount for fluid use and to establish

a degree of orderly marketing in the fluid segment of the dairy industry. 1/

The key factor essential to the development and operation of a classified price plan in any market is large-scale organization of the supply. Under conditions of small-scale, individual marketing~ the volume brought to the market by any single producer has no demonstrable effect on the price level in that market. Under large-scale organization; however) the volume that the large scale cooperative association administers in the market can be decisive as to the price or prices it can secure from different users. It can adopt a pricing policy and set

1/ Price classification was designed primarily to obtain higher returns for producers. Purpose (1) is secondary; purpose (2) is incorrect. Classified pricing does not provide that all producers "share in the relatively higher prices:W-That is done by pooling, and there have been important examples of classified pricing without pooling. - Leland Spencer

11-1..3

a price "target" in the highest value use and support this price through a strategy of diverting other parts of the supply to lower-valued uses. The closer the volume of supply handled as a unit approaches the total market volume, the more closely the large producer group comes to attaining this target price.

Enhancement of total income from any volume of raw milk supply depends in essence on the opportunities that exist for diverting milk, or so pricing it that it is diverted, from a market in which the organized supplier is a major factor to another market (such as the manufactured products market) in which the organized supply, or proportion thereof diverted to it; is so small as to have no measureable effect on the market price in the latter. Under such large-scale organization of supply, the question immediately arises as to what factors form a logical and effective basis for such differentiation or price classification in the fluid milk market.

Perhaps the major factors which tended to differentiate fluid milk supplies in most local markets from other milk, at least in the beginning, were quality differences, and institutional practices in applying them. Other factors of importance include unit transportation costs, which are much higher on fluid milk than for the product equivalent that can be manufactured from milk, and the volumes of surplus and the uses that can be made of such surplus. All of these factors are important in determining the number of classes in any given market, as well as the size of the price differentials between classes.

II-1.4

An additional important feature of this form of administrative pricing is that it permits the administrative agency to separate effectively the differing demands that exist for raw whole milk. Many products, both agricultural and industrial, can be

used in many ways. Therefore, the demand on the part of purchasers of multiple-use raw products is an aggregate, or composite, of several individual demands. In many cases; the elasticities of these component demands vary considerably from use to use, and this, rather than any difference in the product itself, becomes a basis for differential pricing.

The demand on the part of the handler, for locally produced raw milk, being a derived demand, reflects in part, for each of the alternative products for which it may be used; the quantities of finished product which handlers can sell at alternative prices during any time period and the costs of processing and marketing these products. These demands, however, are strongly influenced also by the availability of alternative-source supplies not under the jurisdiction of the local price administering agency. These derived demands refer to prices that will be paid to a farmers' selling organization by milk distributors in a local market, and are greatly affected by the quantities qualified for fluid use in the market.

Health regulations, transportation costs; and "keeping qualities" are among the important factors that determine how severe will be the competition from "other source" milk. Products locally manufactured from excess fluid milk supplies do not enjoy the same protective advantages

II-1-5

afforded the less concentrated fluid products, and are sold in markets of national scope.

Thus, the elasticity of demand for local producer milk in a milkshed varies directly with the availability of alternative supplies.

Products Included in Each Class.

Two important determinants of the specific pricing plan for milk in any given situation are the number and types of products which are and will be produced from available supplies, and the administrative problems involved in establishing and enforcing multiple-price programs.

Universally; the high-price category (Class I) includes milk used as fluid whole milk and generally includes closely related fluid products, such as skim milk and flavored milk. In many cases it includes fluid cream. Observation indicates a close correlation between the types of products included in the high-priced categories and the existence of conditions that might lessen potential competition from alternative supply sources.

The principal reason for including milk and its related fluid by products in Class I is that because of sanitary requirements, transportation costs, and other reasons supplies tend to be limited to a relatively local milkshed. Further; the consumer demand for these products is such that relatively high prices can be charged without substantially reducing the quantities that will be absorbed by the

market. Together, these factors provide sufficient reason for the inclusion of these products in the high-priced classification.

II-1-6

Furthermore, to the extent to which closely related fluid products may be substituted in consumption for fluid whole milk, the exclusion of these from the same category as whole milk would serve to reduce the degree of inelasticity of demand} since the existence of substitutes for any product has the effect of increasing the sensitivity or responsiveness of buyers to changes in the relative prices of any particular product and of its competitor. For this reason, the successful introduction of a new competitive product, such as sterile concentrated milk, in a local market would be expected to result in an increase in the elasticity of demand for locally produced fluid milk supplies, as well as a reduction in the level of demand.

Passing from Class I to the lowest price classification, it is to be noted that, if the market price structure is to permit the marketing of the entire supply available to a market, price levels for surplus milk sufficiently remunerative to raw milk buyers to assure handling of such milk should be established for the lowest value classification. From this it follows that the group of products included in this lowest price category (as well as the prices established for this class) depends upon the supply of milk in excess of Class I requirements, the products that the local market processors can manufacture from these excesses, and the prices that can be realized for these products. Historically, order prices have been lowest for milk used for the relatively highly concentrated products, such as butter and the so-called "hard" cheeses. The market prices for these products (which influence the prices producers

II-1.7

can charge handlers) are largely determined on the basis of supply and demand forces of national scope) including government outlets under the price support program.

To the extent that excess fluid milk supplies exist in any milkshed; and to the extent that some milk must be used for low-valued products at any or all times during the year, then the maximum price that can be charged for milk in the class in which these products are included is one sufficiently low to assure that it will be handled by the processors of these relatively low-value and low-margin products. From this, it can be seen that the lowest price classification is reserved for those products for which (from the standpoint of the local market) the quantities taken are most sensitive to changes in price, i.e., with highest demand elasticity. This, in essence, is the economic justification for the provision for a separate classification for milk entering butter and cheese uses which exists in many markets which have relatively large fluid supplies in excess of Class I needs.

Since the lowest class category is restricted to products for which the demand for local milk is most elastic, it follows that the products to be included in any possible intermediate classes also depend upon differences in the demand elasticities for milk used in these remaining products. If substantial differences in such elasticities exist, it might then be advantageous from the standpoint of producers to make further class segmentation.

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At the present time, little is known about the elasticity of demand for locally produced raw milk supplies entering such outlets as ice cream, "sort" cheeses, cottage cheese, and the various cultured products. Logically, those would depend in part on the relative profitability of producing and marketing these different products. To a very large extent, however, the demand for locally produced raw milk for these purposes is affected by the prices at which alternative source supplies are available. A discussion of factors affecting the demand for such milk is provided in Appendix A.

The previous discussion has assumed that conditions which affect the demand for and supply of milk are known fairly precisely and, therefore, "appropriate" prices can be determined by the pricing agency. For reasons that will be discussed more fully in later sections, this assumption is so unrealistic that the establishment and pricing of intermediate classes must be approached with very considerable caution. There is such serious danger of distortion of desirable utilization patterns through malalignment of class prices that it may well be in the long-run interest of producers to keep the number of classes to a minimum, even though there may appear to be apparent loss in short-run opportunities.

Like many others, the question of the appropriate number of classes must be answered in the context of the circumstances surrounding the local market. In some densely populated area, total pool supplies never exceed the combined requirements for fluid milk and the bulky, perishable

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products such as ice cream and cottage cheese. In such cases, it appears appropriate to establish a single surplus price at levels consistent with the ability and willingness of handlers to pay for milk entering these uses. At the other extreme, some markets have a year around supply that consistently exceeds the demand for milk for these bulky products and so excesses must be processed into concentrated products, such as butter, cheese, and nonfat dry milk. This appears to call for the provision of, at least, two surplus classes, with the lower at levels which will permit handlers to dispose of all available supplies. An intermediate situation is that in which seasonal excesses over market demand for milk and the bulky, perishable commodities exist. In this latter situation, at least two courses of action are available. On the one hand, there may be seasonal variation in the number of classes. Alternatively, a single surplus class may be used but the level of the price for this class varied seasonally.

Class I Milk Pricing. - As stated in Part I of this report, the objectives of the Federal milk marketing orders system include: The promotion of orderly marketing

conditions for farmers specializing in the production of fluid milk and safeguarding their income situation; the administration and supervision of the terms of the fluid milk trade in metropolitan markets in such manner as to equalize the market power of buyers and sellers and attain reasonable competition but not local monopoly; assurance to consumers that they will have access to adequate and dependable supplies of high quality milk from sources best suited

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both technologically and economically to supply these demands; to maintain economic order in the dairy industry and coordination of price structures and market practices within and between metropolitan areas, between fluid and manufacturing segments of the dairy industry, and between milk production and other lines of farming; and the attainment of equitable treatment of all parties--producers, dealers, and consumers. Attainment of these objectives would mean that the structure of fluid milk prices would bring about an "adequate" (though not excessive) supply of wholesome milk to consumers in the several markets at all times.

Formulas for determination of Class I prices, named (as uniform minimums) in the several orders are arrived at by the Department on the basis of factual and analytical materials developed in the public hearings) through the reports made to the Market Administrators' offices; and from other sources. In Section 4 of Part II and in Part III we recommend some strengthening of the role of the Department in influencing the level and the relationships of class prices within and between markets.

In recent years; all markets under Federal milk regulation have used a "formula" method for determining Class I prices. The term "formula" denotes a basis) more or less fixed) for "automatically" making changes in prices to be paid by handlers for milk.

Though differing in details) these formulas are of two main types.. those relating fluid milk prices to manufacturing milk price levels and those based on "economic indexes." The former usually includes either or both the prices paid for manufacturing milk at specified plants and the current prices received from the sale of dairy products, such as

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butter, nonfat dry milk, and cheese. The latter, or economic type index, relies primarily on movements of measures of general economic activity and consumer income, and may include indexes of cost factors such as feed prices and farm wages.

Interest in the use of economic type formulas to price Class I milk was stimulated in the postwar years by the fast-changing situation with respect to prices

in general and to dairy prices in particular--- and especially the marked fluctuations in manufacturing milk prices. In sharp contrast with the situation in manufacturing milk markets) however, fluid milk markets are generally not strictly limited by product prices because there is no highly integrated national market for fluid milk. As a consequence, there is a somewhat lesser degree of sensitivity in the level of Class I prices than exists for prices established for surplus classes.

In any event) the results of formula calculations do not pretend to reflect all of the forces of supply and demand which focus on a particular market, and the specific components are actually of secondary importance. Thus, fluid milk pricing formulas cannot be accepted as exact indicators of "proper" price levels. The formulas must be considered as devices which are useful in determining the time and direction for price changes but as requiring continuing study and modification.

The success of a particular formula can only be judged on a pragmatic basis--a formula is "good" so long as it "works all right." "Good" and

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"bad" will have somewhat different connotations for producers, distributors, and consumers, but over the long run, these diverse value judgments would probably reduce to some definition in terms of supplying the market at adequate returns to producers and fair and reasonable costs to consumers.

"Supply-demand adjusters," which serve to increase Class I prices when the amount of surplus milk in a market declines and to decrease such prices when surpluses increase markedly have become standard provisions in most Federal milk marketing orders today. Such adjusters are mechanistic "evaluators" of the basic price structure.

They rest upon the logical foundation that, if the percentage of surplus is increasing beyond normal limits, there is a strong presumption that Class I prices are too high, and conversely that they are too low if the percentage of surplus supplies is decreasing. These variations in supply have been reflected in schedules, differing from market to market, that provide for increases or decreases in the Class I price when surpluses fall within various percentage ranges.

The committee strongly supports the general philosophy of supply demand pricing, although short-time changes in either market receipts or utilization may not be good indicators of the long-run situation. Moreover, these mechanical supply-demand adjusters do not accomplish the same results in all markets under present conditions. Some markets operate with individual-handler pools. others operate with "pool plant" requirements and other order provisions that may curb entry to some degree, so that pool receipts are not a good indication of the impact of prices

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on the available milk supply for the market. For this and other reasons, the mere formal provision of supply-demand adjusters is not sufficient to insure an "adequate); but not excess supply for all markets.

However, an "ideal" system of open, nationwide pools for Federal order markets could be coupled with appropriate supply-demand adjusters. If this were done, the free selection of markets by producers or handlers would provide an excellent indication of appropriate intermarket price relationships, while the aggregate of receipts and sales would be very useful in judging the Whole level of Class I prices throughout the Federal order system. The use of such open, nationwide pools would introduce a considerable amount of competition and free choice in milk pricing. Even with a system of governmentally administered prices, such provisions would give some play to free market forces and so provide useful guides for the administrative agency.

Certainly, where the marketing areas are contiguous and the supply or distribution areas overlap, there is a basis for considering the receipts and Class I utilization for the combined marketing areas in establishing a supply-demand adjuster, rather than for the individual markets on a separate basis. At best, experience with these adjusters as they have been administered has been that they have tinkered with price.

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supply relationships within and between markets but they have not served as effective tools for reducing persistently excessive supplies.

A third type of "automatic" price adjuster is directed at seasonal disparities in supply. Many Federal orders provide for a pricing system which results in relatively low prices to producers during "flush" production months and relatively high prices during the "short" season, as a means of encouraging more even production throughout the year. The importance of this device has somewhat diminished in recent years.

Seasonal variations in the price received by producers presumably encourage added production in months when supplies are normally low, while tending to discourage production during the flush season. This is supposed to be desirable--largely on the ground that leveling off the "peaks" and the "troughs" would permit more economical and efficient use of manpower, transportation and plant facilities for processing. However, in modification of the presumption of "desirability", there is evidence that changing technology, such as the adoption of pipeline milkers, corral-type feeding operations, and bulk farm tanks, is influencing production practices in a way that has the effect of decreasing seasonality. Therefore, extreme care is needed to make sure that the normal pattern of seasonal variation does not

become uneconomically distorted as a result of the special price incentive plan that is used. Further, the need for seasonal pricing patterns is not uniform from market to market, and variation may disrupt intermarket price competition. Also, there are substantial questions concerning the magnitude of the

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"costs" commensurate with those associated with programs designed to "level" production. X

Transportation Differentials. - The principle of location economics and that of providing substantially equal raw product costs to all competing handlers (both of which we accept as desirable criteria) requires that different prices for Class I milk be established for various locations within any milkshed. The differences between these prices for a given interval of distance from the market center (or "milage zones") are referred to as "transportation differentials." In general, we subscribe to the theory that these transportation differentials be closely related to actual transport costs.

In addition, we are concerned with maintaining as high a degree of efficiency as possible in the organization of the milkshed. This can only be achieved where the fluid milk requirements are obtained from areas immediately adjacent to the market, so that surpluses will be processed into the more concentrated manufactured dairy products in the outlying areas of the milkshed, thus minimizing total transportation costs.

We recognize that procedures which provide transportation differentials exactly equal to differences in actual transportation costs may be inconsistent with the objective of minimizing total transportation expenses, since such a system tends to make the handler indifferent to the location of producers of his fluid milk supply.

Proposals have been made to overcome this inconsistency by various means which may be described as "tilting" the transportation differential

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schedule in such a way as to provide a premium for fluid milk supplies which are obtained from relatively nearby sources, with a penalty on the procurement of milk from distant areas.

While the committee agrees in principle with these procedures, there are dangers associated with "built-in distortions" in the pricing system due to administrative errors which might result in uneconomic quantities of milk production in relatively high-cost nearby areas. Also such proposals assume that the extent of the geographic area required to serve fluid milk needs (the ideal fluid milk boundary) is known in advance. Variations in both the supply and demand of milk

for fluid purposes make the advance determination of such a boundary difficult if not entirely impractical. Additionally, procedures which provide regulated plants with lower costs for milk from nearby sources provide an opportunity for the existence of premiums to producers over the minimum prices established in the order.

In view of the above limitations, the committee subscribes to concepts which could accomplish the same purpose without incurring the dangers of bringing about organizational distortions through the price system. Some markets achieve this end through pooling procedures and methods. Under these arrangements, each handler accounts to the pool at prices which assume that all Class I supplies are received in the market from the most closely adjacent supply sources available to that handler, irrespective of actual shipping point. This procedure means, therefore, that, if a handler receives fluid milk from a distant plant, while at the

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same time diverting eligible milk from a nearby plant into manufactured products, he still accounts to the pool for his Class I supplies at prices which prevail in the more closely located plant. This does not prevent the handler from making his own decisions with respect to the source of fluid and manufactured supplies, but it does provide a penalty (in terms of the transportation differentials) for making a decision inconsistent with the objective of maximizing efficiency.

Butterfat Differentials. - The problems of pricing milk are made more complex by the fact that the constituents of milk vary because of breed, season of the year, stage of lactation, and feed and management practices. The components of milk are butterfat, solids-not-fat, and water. Milk with different concentrations of these components has a different monetary value to the receiving handlers. In most markets, these differential values have been recognized through the use of a specified number of cents added to or subtracted from the class prices established for a "standard" level of butterfat.

More recently, there has been increased emphasis on the value of the nonfat portion of milk. This is indicated by the fact that sales of fat-containing products have tended to decline relative to those of the products derived primarily from the skim portion, such as "fortified" milk, cottage cheese, skim milk, and nonfat dry milk. An alternative to use of the traditional butterfat differential is to establish separate prices for fat and solids-not-fat. Regardless of the mechanics adopted to handle this problem, the approach to setting appropriate differentials of this type should be based on determination of "realistic" values for the components

II-1-18.

The problem of determining "appropriate" differentials in one of bringing about equality of the "net values--to handlers--of milk of different content. When this equality is achieved) producers are efficiently guided in making their own decisions with respect to breed of cattle, feeding and management practices, and other variables which affect solids content. The relationship in prices between high and low solids content milk, depends primarily on whether SolKS of milk required by handlers are higher or lower than solids in milk received from producers. This, in turn, is largely affected by local regulations which specify whether standardization practices are permissible.

Pricing Surplus Milk. - The primary function of a fluid milkshed is to meet the bottled milk and cream requirements of the market. The seasonal characteristics of production and operational conditions of distribution of these products are such, however, that adequate supplies throughout the year cannot be assured from local sources unless production consistently exceeds demand..

In many respects, the pricing of surplus milk is more difficult than pricing Class I milk. If fluid milk is incorrectly priced, the long range effect may be serious but in the short-run few consequences are likely to be noted, due to the availability of a surplus outlet. On the other hand, if surplus milk is priced too high, it may lead either to "homeless" milk or place an undue burden on cooperatives to dispose of milk that handlers will not take. If it is priced too low, this may have a disruptive influence on the manufacturing milk industry. For

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example, underpricing surplus milk in fluid milk markets encourages manufacturing operators to seek pool status as a means of purchasing milk for less money while being able to return their producers more money at the expense of the pool.

Two general formulas are used in pricing surplus milk. Under the first method, market quotations of end products and yield factors are used to compute a gross value from which a processing allowance is deducted to determine the order price. Other adjustments, such as a seasonal factor, may be included.

The second method is based on an average of prices paid by non regulated handlers for milk utilized in manufactured dairy products. With this formula the competitive pay price is used as a basis and other adjustments may be superimposed upon it. This keeps the surplus price in line with variation in prices paid by nonregulated handlers for manufacturing milk.

The level of surplus prices is very important for other reasons. While pricing surplus milk to avoid "homeless" milk, extreme care must be exercised to price such milk so that (a) surplus handling is not so profitable as to encourage bringing more milk into the market in order to increase handler profits, (b) surplus is not withheld from Class I usage when needed, and (c) unstabilizing effects upon the markets of

producers of manufacturing milk are avoided.

In markets with large surpluses, underpricing surplus milk operates to the significant disadvantage of local fluid milk producers) as well as creating chaotic conditions in manufactured dairy products markets.

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Thus, in setting prices of surplus milk in a fluid market, attention has to be given to prices paid by nonregulated handlers for manufacturing milk for the same use and for prices paid for manufacturing milk in the main producing sections. However, conditions in individual markets may be such that the surplus price must deviate from that paid by nonregulated handlers.

In a regulated market with a marketwide pool, the surplus price is about the only instrument that is available under the order to correct certain pricing inefficiencies or inequities as, they may develop, such as widespread premiums in the country, high handling charges, and difficulties of "short buyers" in obtaining milk supplies, and, on the other hand, difficulties in moving surplus milk and "homeless" milk.

A price for surplus milk which will encourage handlers to accept all milk offered by producers, does not have to be the same in relation to manufactured products at all seasons of the year. This means that there can be (and it is often necessary or advisable to have) a seasonal variation in the surplus price that is superimposed on the other factors in the formula, either the product value minus allowances for cost of processing, or competitive paying price.

While there are various types of formulas that are used in establishing surplus prices, no formula developed has given the right answer all the time. The final judgement in regard to the surplus price must be based on the developments in the market. A formula may yield fairly satisfactory results for a considerable period of time, and

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then yield wrong prices which cause undue hardship to some elements in the market, and, yield windfalls to others. Accordingly, close and continuous attention must be devoted to surplus pricing not only in relation to internal market developments, but also in respect to relations between surplus prices in adjacent fluid milk markets and national manufactured dairy products markets.

Price Relationships and Utilization. - While evaluation of the price structures in Federal order markets is, in the main, deferred to Part III, it is desirable that certain Class I and dairy product price relationships, as well as trends in

utilization in order markets be examined here.

A striking change in price relationships in the dairy industry in the last two decades has been the rise in Class I prices as compared with the price of milk used in manufactured dairy products. The prices of milk for manufacture in the late 30's and early 40's were low enough to clear the market with practically no Government aid, whereas during recent years the price of manufacturing milk has been enhanced by Government purchases of cheese, butter, and nonfat dry milk under the price support program. The margin between Class I prices and prices paid producers at condenseries has about doubled since the early 40's. It was roughly stable from 1940-46, showed rapid increases during the late 40's, and increased moderately in the 50's.

During the first part of these two decades there was also a marked rise in blend prices under Federal orders in relation to the condensery price. In the last 5 years the blend-condensery margin averaged over

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twice as high as the margin in the early 40's. In the last dozen years there has been a tendency for the Class I-condensery price margin to widen, while the blend-condensery margin showed little change. This indicates that more recent increases in the Class I price, as far as the producer was concerned, tended to be offset by increasing surpluses.

The rise in Class I prices in relation to the condensery price has varied greatly by areas and markets. In general) Class I prices in the middle West, in and near Wisconsin and Minnesota, rose relatively little in relation to the condensery price, while in eastern markets there has been an increase in the margin between Class I and condensery prices.

While relationships between the level of Class I prices and changes therein and the utilization of milk in a fluid milk market are difficult to isolate and measure, broad guidelines to judgement as to the economic soundness of price structures may be set up.. One of these broad guide lines is the proportion of a market milk supply that is used in Class I (fluid)' use, although it is recognized that factors other than price may have considerable effect upon utilization.

In a number of markets} in recent years, surpluses over Class I requirements have been very large and are growing larger. Some markets exhibit a somewhat better balance between Class I sales and fluid milk requirements, and in rare instances the Class I percentage has increased.

These relationships have obtained during a period of years when the total sales of fluid milk have, for the most part, showed a rather consistent increase, which no doubt has been associated with a rapidly

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growing population and, in the main, a high level of prosperity and employment. Also, during the last several years there has been a consistent expansion in consumption of fluid milk under the School Lunch Program, the Special School Milk Program, and the Military Milk Program. Currently, these programs account for about 3 billion pounds of fluid milk per year, or roughly 6 percent of total fluid milk consumption.

Thus, the consistent tendency has been for surpluses in most markets to increase, or at the least not to decrease, in percentage terms. The total volume of surplus has increased markedly. This is clear evidence that the milk price level has been higher than necessary to bring forth adequate supplies, as the joint effect of the price support and the Federal order programs. This suggests that the pricing policies and practices under orders have not reflected realistically some important technological developments in production and in transportation and other distribution costs. 2/

2/ It is important that there be set forth here the long-run consequences of (a) establishing Class I prices at levels higher than those necessary to call forth an adequate supply, and (b) thus using the device of price classification for enhancement of producer income to levels which "overreach the bounds permissible if there is to be long-run stability and orderliness in the national fluid milk market" (quoted from Part III, page 24) .

These consequences are:

(a) Higher prices to consumers, with consequent smaller volume of fluid milk consumption.

(b) Supplies at higher levels, resulting in larger surpluses because of increased supply and reduced consumption.

(c) The development of (1) more vexing problems in handling surplus, (2) excess capacity, particularly in surplus handling, (3) uneconomical expansion of production in high-cost areas } (4) capitalization of such enhanced income in increased land values and other costs, and (5) additional surpluses of manufactured dairy products to the detriment of the producer of manufacturing milk and butterfat.

Such policies of price and income enhancement spawn programs designed to perpetuate or even enhance the degree of price and income enhancement currently prevailing, as is clearly evidenced by the market limitation and production control scheme proposed by the "majority of nine" as set forth in Part II, Section 3. - Otie M. Reed

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Milk supplies in Federal order markets have increased for several 3/.

a. There have been an upward push in milk production generally, due to the rapid application of scientific knowledge and to advances in technology and dairy farm management.

3/ We cannot agree that the summary statement entitled "Milk supplies in

Federal order markets have increased for several reasons" correctly describes the subject matter. Milk supplies in Federal order markets have increased for two cogent reasons. First, there has been an upward trend in milk production generally, and secondly, an increasing percentage of the total milk supply is being marketed through handlers subject to Federal orders.

The conversion of manufacturing grade milk to market milk represents an industry trend not peculiar to Federal order areas. When relative prices, market stability, and the increase in numbers of orders, taken with the widening of marketing areas is considered, it would be strange if milk supplies in Federal order markets did not show an increase.

Point (e) is particularly irrelevant to the issue of milk supplies in Federal order markets. Where a market wide pool is effective the rational producer will respond to his estimate of future blended prices. It will not make any difference to him in his production and marketing decisions whether his estimate of blend prices result from a relatively low Class I price and high Class I utilization or from a high Class I price and a relatively low Class I utilization. Having determined upon his blend price estimate, he then plans his production accordingly. To suppose that producers consciously attempt to maintain a given share of Class I sales for themselves under uniform pricing intrudes an economically nonrational element in the decision.

It is possible---indeed there is some evidence to show--that under an open base system producers often over estimate the value of their bases, and therefore, tend to produce more during the base making period than the monetary returns from their subsequent bases justify. If this is the case, however, the solution lies in the elimination of the base plan. This may be done because other measures may be substituted for rectifying seasonality which do not require producers to estimate the future value of base quantities.

The comment (point f) relative to the demand for fluid dairy products has a very insignificant effect on the amount of milk delivered to Federal order markets. To the extent that sales might be depressed, the effect would be a decline in the uniform price and this should discourage, not encourage, the delivery of milk.

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b. In a number of markets there have been significant shifts of reserve milk supplies from State-regulated and unregulated markets into Federal order pools.

c. In some areas there has been rapid conversion of manufactured grade milk to market milk under Federal orders.

It also should be noted that while supplies in Federal order markets have increased, there are many reasons why fluid milk markets must carry larger reserves than in former years. They are necessary to allocate supplies for fluid milk use equitably among handlers as the markets have become larger and plants more widely disbursed. Furthermore, the 5-day bottling week, the growth of distribution through supermarkets, and the widening of distribution areas from individual plants require larger reserves if consumers are to be supplied in accordance with their present purchasing methods. The material presented in the paragraph beginning on the bottom of page 26 represents further inconsistencies and goes far afield from the assignment of the committee. In the first instance, it is stated that "...for practical reasons could not be reduced..." There is no evidence to support this statement. Many instances can be cited where Class I prices have been reduced. Neither is

there any basis for the statement differentiating between order prices and the prices established under the support program. The statement regarding price policy is without foundation. The objective of the Federal order program is stable marketing conditions, not "raising the incomes of farm people to a level of parity with other groups." Although the Federal order program does enhance producer incomes through enforcement of classified pricing, income enhancement for all producers is provided by Congress through the price support program. The statement regarding supply control is gratuitous and not germane at this point. Furthermore, the last sentence of the paragraph implies that the "iron law" of supply and demand has been applied, or has been advocated throughout the report. This statement is clearly in conflict with various facts and conclusions stated elsewhere. The net effect of this paragraph seems to be an admission that the standards of the Act have not been applied. It implies that the standards could not have been applied and that they should not have been applied. - Judson P. Mason, Gordon M. Cairns)
James L. Reeves, Edwin W. Gaumnitz.

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d. Due to increased market security and greater assurances of stable remunerative prices there has been encouragement of expanded milk production under Federal orders.

e. The distribution of payments to producers in Federal order markets in the form of blended prices has deprived them, as individuals of an opportunity to benefit by adjusting their output to the needs of the market for fluid milk, and made it necessary for each of them to expand production in order to maintain their relative position in the market.

f. In the face of these developements the demand for fluid dairy products has been subjected to a number of depressing influences which have prevented the growth of demand from rising in proportion with population growth.

Prices for fluid (Class I) milk have not been reduced rapidly enough and for practical reasons could not be reduced sufficiently in accordance with the supply-demand criteria to fully offset these influences favoring increased milk supplies in Federal order pools. It would be unreasonable to expect the Department to effect supply control in Federal order markets through market price to a greater extent than has been done with respect to manufacturing milk or other agricultural products. Nor would such a policy be consistent with the stated objective of raising the incomes of farm people to a level of paxity with other groups. Moreover, while supply control by means other than market price undoubtely involves serious difficulties, it would clearly be

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inconsistent and unequitable to subject market milk producers and other farm groups to the iron law of unfettered supply and demand, while other groups) including organized labor and much of the industrialized world are given more

favorable treatment.

Classified Pricing and Market Coordination. - A distinctive element introduced into fluid milk marketing by the advent of Secretary's order is coordination of the structure of prices. Classification is a basic tool toward that end, and the procedure of public hearings and supervision by the Department provide the means of skillfully establishing and subsequently adjusting class prices in the separate markets each studied in its relation to adjacent markets and the wider market system.

The operation of an administered price system requires that some means be provided to identify the milk to be pooled, and that all milk in the marketing area be regulated. If unregulated milk could enter a regulated market without being subject to partial regulation, the class price system would be rendered ineffective. This has been overcome by various approaches, one being the assessment of compensatory payments on unregulated milk disposed of for Class I purposes in a regulated marketing area. The rate of this payment, in some cases, has represented the full difference between the Class I and surplus price. In other instances, it has represented the difference between the Class I and the blend price. In either case, the rate of payment has generally been subject to the same transportation differentials as fully regulated milk. The rate of the compensatory payment is an administrative matter that must take into account the facts involved.

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Milk subject to another Federal order should not present difficult problems of this nature if the prices and other order provisions for the several markets are properly related. Even so, adjustment of some sort may be required to offset transportation differentials or other factors brought about by the application of provisions of more than one order at the same plant location. The committee is of the opinion, that, even though compensatory payments may serve a necessary function in the order program, they should not be used to unduly bar milk from entering any market, whether from another regulated market, or from nonregulated sources.

Federal orders establish minimum prices which all handlers must pay for milk. Prices negotiated above the minimum levels, however, are found in some order markets. 4/ In the opinion of many people their use is accepted as recognition that the Marketing Agreement Act is designed to supplement cooperative marketing rather than to supersede it. It must be remembered, however, that a cooperative association operating under an order is not negotiating its Class I price in a free market, but in one undergirded by the minimum prices and other provisions of the order within a system of orders. If cooperatives in a given market regard these prices as insufficient and are confident of their ability to maintain a higher (premium) price,

the logic of the situation would be that the order prices are incorrectly established and should be amended.

4/ Mention should be made also of the problem created by the fixing of minimum class prices by State milk control agencies higher than the Federal order prices. This is perhaps the most troublesome of all "premium" situations. - Leland Spencer

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or that the order is unnecessary and should be withdrawn. 5/

Producers having made the decision to negotiate a premium would have to live with the consequences of the higher price level they have negotiated. If the cooperative has misjudged the equilibrium level; and has negotiated prices that are too high, this will so stimulate and added flow of milk as to result in such lowering of the blend price as ultimately to defeat the purpose of the premium. However, the consequences of attracting large surpluses to the market are very difficult to reverse.

Negotiated market wide premiums are attacked by some people on the ground that they are prima facie evidence that producers are exercising monopoloid power under the aegis of the order. This would be true if the order as administered becomes an instrument for the exclusion of milk from other producers qualified to compete for sales in the premium market. Any such situation should not be allowed to persist, but it is argued that, for a time, negotiation of a premium may be the best way of testing whether the order price correctly reflects true supply and demand conditions over an appropriate competitive area. The prospect of translating the adverse evidence of such a test into corrective action is slight.

Furthermore, since the negotiation of a substantial premium in a major market may facilitate, or force, other markets in the same area to make similar adjustments) thus, it may become a widely disturbing influence.

5/ In discussing this subject, we do not consider appropriate handling charges for services performed within the category of a marketwide premium. Unless cooperative associations collect fees for services performed, they, in fact, realize less than the minimum prices specified by the order. Neither do we consider higher payments to producers delivering premium quality milk, high volume, or milk with other desirable characteristics as marketwide premiums. - Gordon M. Cairns)
Gordon C. Laughlin, Judson P. Mason, George 'N. Pederson, James L. Reeves.

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Since the existence of Federal regulation facilitates the use of negotiated premiums by providing the framework within which they can be secured, it is particularly incumbent on the Secretary to see that there is free access of qualified milk to the premium market, that the order system does not become a shelter for

monopoly and that the Federal order minimum prices are not unrealistic. In markets where substantial marketwide premium exist, it suggest that new hearings should be held to review the level of the Class I price. If after such a hearing and conclusions, negotiated prices still persit, it raises the question whether the compensatory payment, allocation, or plant qualification provisions of the order should be modified to permit greater freedom of access to the market. In fact, it may raise the question as to whether a Federal order should be continued.

Classified Pricing and Price Supports. - Federal orders are devices for orderly marketing, not mechanisms of price support as such. How ever, they possess price enhancement potentialities in common with the dairy price support program. Fluid milk prices in most orders are superimposed on manufacturing milk prices which in turn are directly linked to the support level for manufacturing milk.

The price support program has had the effect of increasing prices to producers above the levels they otherwise would have received. Such boosting of producer price levels on a national scale has a direct effect on fluid milk producers by increasing (a) the price of surplus milk, and (b) Class I prices in those many instances where those prices are tied to manufacturing milk prices under the orders. Thus, the price support

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program tends to remove class price structures of orders from the realm of supply-demand economics to a greater or lesser degree. Certainly, the surplus problem cannot be divorced from the price support program. While this is the case, as was indicated previously, the margin between Class I prices and manufacturing milk prices has increased markedly. Thus, in addition to price enhancement effects of the price support program, there is the price enhancement effect of increasing prices for fluid milk relative to prices for manufacturing milk.

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Appendix by David A. Clarke, Jr.

Factors Affecting the Demand for Locally Produced

Milk For Manufacturing Uses

Some insight into the nature of demand for milk for alternative products can be obtained through the following hypothetical situation. Let us assume two alternative product combinations--one involving the production of 40 percent cream and nonfat dry milk, the other reflecting an ice cream mix---cottage cheese operation. Approximately the following quantities of product can be obtained from a hundredweight of milk of 3.5 percent milk fat content:

From a cream-nonfat dry milk operation:

Cream (40 percent milk fat) - 8.521 pounds

Nonfat dry milk - 8.110 pounds

From an ice cream mix-cottage cheese operation:

Ice cream mix - 20.272 pounds

Cottage cheese - 11.745 pounds

We will further assume the following prices for these products:

Cream - 32 cents per pound

Nonfat dry milk - 13.75 cents per pound

Ice cream mix - 16.5 cents per pound

Cottage cheese - 12.5 cents per pound

By applying the above product yields to the respective product prices, it can be seen that the value of cream (in a cream--:powder operation, is about \$2.73. The value of the nonfat dry milk adds \$1.12 to this amount for a total of \$3.85 as the combined value of the products manufactured from this milk. By deducting from this an estimated processing cost of 60 cents per hundredweight of milk, we arrive at an estimated "net value" of \$3.25.

When we consider the value of products from the ice cream mix-cottage cheese operation, however, we note that the value of ice cream mix is about \$3.34, while the returns from the sale of cottage cheese amount to \$1.47 or a total of \$4.81. By again deducting from this an estimated processing cost of 60 cents per hundredweight of milk, an estimated "net value" of \$4.21 is determined. Taken alone, the above information suggests that the demands for milk for these two purposes might differ. To the extent to which the assumptions made concerning product yields, f.o.b. plant-product prices,

and processing costs are realistic, alternative profit opportunities in the manufacture of these different product combinations are indicated. Based on this

difference, some might argue that processors can "ill afford" to pay higher prices for raw milk going into ice cream and cottage cheese than for that entering the cream nonfat dry milk processes.

Once again it should be stressed that the demand for raw products from local milksheds for any particular use depends only in part on the amount of the return which processors can expect to receive from the manufacture and sale of the finished product. Certainly, no milk will be purchased for any given use at prices which will not return the raw product cost plus the expenses associated with processing and marketing the finished product (including a return for normal profit).

To further demonstrate the point that raw product demand on the part of processors is only partially determined by profitability, let us make the following further assumptions. In order to produce the approximately 20-1/4 pounds of ice cream mix that can be obtained from a hundred weight of 3.5 percent whole milk, more than 2-1/2 pounds of milk fat are required. In addition, a little more than 2 pounds of nonfat solids are necessary. The 11-3/4 pounds of cottage cheese will involve slightly less than 1/2 pound of milk fat and about 2-1/2 pounds of nonfat solids. We further assume that the processor of these products has the alternative of obtaining the milk fat and nonfat solids requirements from sources other than locally produced whole milk supplies. For example, the milk fat can be obtained either in the form of cream or sweet cream butter from alternative sources. Similarly, the nonfat solids needs can be secured in the form of condensed skim milk or nonfat dry milk. At prices, for example of 32 cents per pound of cream (as given above), or equivalently 64 cents per pound of sweet cream butter, and with alternative source prices for nonfat solids of approximately 14 cents per pound, the combined fat and solids requirements for these products can be obtained in the amounts required to manufacture the equivalent of one hundredweight of 3.5 milk for about \$3.00. If the added cost of reconstituting these "dry" ingredients does not substantially exceed 25 cents, the ice cream mix cottage cheese manufacturer will find that the "alternative cost" of using ingredients other than raw milk supplies is quite closely related to the "net value" of milk when used for the production of cream and non fat dry milk. On the basis of the above assumptions, the demand for milk for ice cream mix and cottage cheese purposes would be virtually non-existent at prices substantially in excess of the \$3.25 level indicated in the above hypothetical example since the "demand" for any commodity, including that for raw supplies of milk by processors, refers to the schedule of quantities that will be taken at alternative prices.

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The above argument indicates the limited desirability of attempts to initiate class plans with large numbers of classes in the hope of "exploiting" differential profit

opportunities in the manufacture and sale of different types of products. This basically arises from the fact, mentioned earlier, that the elasticity of demand for a product and the existence of substitutes or alternatives are closely related. The greater the possibility for substitution, the larger the degree of elasticity. To the extent that alternatives, either in the form of obtaining outside supplies or of moving manufacturing facilities to other areas, are available to processors of many types of products under similar circumstances, this would likely have the effect of approximately equal demand elasticities, in the long run at least, for raw product in the several uses. Because the gain, either from the standpoint of maintaining market stability or from the standpoint of enhancing producer returns, depends upon the existence of substantial differences in demand elasticities for alternative products, the probable similarity of demand for these alternative uses suggests that it would not "pay" to make further class segmentation. A further element in this argument is the fact that multiple-price classifications are both more difficult and more expensive to administer and would, therefore, serve to limit the choice of class numbers to a relative few.

The appropriate number of surplus classes--under a class price system--is closely related to the number of products for which demand differs. This is, primarily, a question of the extent and degree to which alternative products satisfy the same uses or needs, whether by consumers or by handlers.

Although there is a relative lack of substitutability at the consumer level for alternative types of dairy products, there is a much higher degree of competition at the processing level. In many instances, the finished product of one process may become an "ingredient" for another product. Thus, condensed skim milk may be used for the production of ice cream or, alternatively, it may be further processed into nonfat dry milk. Fresh cream may be used directly in the manufacture of ice cream (or other fat-containing products), or it can be manufactured into butter or plastic cream.

Processors of many types of finished dairy products find themselves in a position of having alternative source of raw product ingredients. A manufacturer of ice cream, for example, has a requirement for a specified amount of milk fat and solids-no-fat. These requirements may be obtained by the purchase of whole milk from producers, in the form of cream and condensed skim milk--either separately or premixed to specification--or, alternatively, they may be secured in the form of sweet cream butter, plastic cream, or frozen cream from storage. The nonfat solid alternatives include nonfat dry milk and dry buttermilk.

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The existence of this variety of alternative possibilities to satisfy market

demands seriously complicates the problem of pricing surplus milk in local fluid milksheds. This is primarily due to the difference in the extent to which it is possible to "control" prices for raw milk supplies utilized in the manufacture of these alternative "intermediate" products. The so-called "wet" ingredients (cream, condensed skim milk, and ice cream mix) are relatively bulky and therefore expensive to transport. For this reason, these types of ingredients are commonly produced from local supplies--frequently from the excess over fluid milk and fluid cream requirements. Since these supplies are derived from the local "pool," the milk utilized for these supplies logically falls within the class-price structure for the particular market involved. The "dry" ingredient alternatives (butter, plastic cream, and nonfat dry milk), on the other hand, are more highly concentrated and can be shipped at low cost over long distances. Furthermore, few if any sanitary or other institutional barriers exist to impede trade flows for these products. Thus, milk entering such uses is subject to only a limited degree of price control through local market mechanisms.

In considering the problem of the appropriate number of surplus classes to be used in the price structure for a local fluid milk shed, therefore, two questions must be answered. The first of these is, "What is the nature of the demand for the alternative products for which the total milkshed supplies may be used?" The second question then becomes, "Are these demands significantly different from each other?" Both of these questions must be answered in terms of the availability of substitutes. These substitutes include those which directly compete with milk and dairy products at the consumer level as well as those which compete to fill the requirements of final product manufacturers.

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PART II - SECTION 2
DEFINITION OF MARKETING AREAS

Federal regulation of prices paid producers for market milk in the United States has developed over a period of nearly three decades in the form of separate orders for many local or regional marketing areas. While this system of regulation was expanding to include 81 such areas with a population of 92 million, great economic and technological changes were taking place. In this dynamic situation it was inevitable that serious problems relating to the definition of “Marketing Areas” for purposes of regulation, and to inter-order relationships, would arise. The present difficulties in this sector also are traceable in part to the natural insistence of local groups of producers and handlers that orders be fashioned primarily to improve conditions in the particular areas for which they are issued without much concern for their effects upon others..

The definition of the marketing area is one of the most important terms of a Federal milk order, since it is the primary means of identifying the milk that is to be priced and pooled. The Act authorizes the issuance of orders for either production or marketing areas. In fact, orders to regulate the marketing of fruits and vegetables are issued under the same Act for specified production areas. It is significant also that in Section 608(c) (11) (B) of the Agricultural Marketing Agreement Act, orders pertaining to milk were made an exception to the general requirement that orders—“shall be limited in their application to the smallest regional production areas or regional marketing areas. . . which the Secretary finds practicable. . .” Thus the Act has imposed no direct limitation on the extent of marketing areas as defined in Federal

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milk orders. However, the Act is interpreted by the Department to require that milk marketing orders be issued for marketing areas in which the conditions of demand and supply are reasonably homogeneous. Although Federal milk orders

are issued for specified marketing areas, they regulate the pricing of milk from farms and plants associated with the market wherever they may be located. The "orderly exchange" of milk, which the Federal order system is designed to promote, begins when the milk leaves the farm, even though this may occur as much as a hundred miles or more from the marketing area as defined by the order.

Changing Conditions Affecting the Extent of Marketing Areas

Marketing areas for purposes of regulation under Federal milk orders are defined by the Department primarily by tracing the outlines of distribution areas served by competing handlers. Other factors such as sanitary regulations and organization of producers supplying the market are considered. But relatively little attention has been given to competitive relationships in the procurement of milk.

In the early years of the Federal milk order program, the usual extent of territory served by milk dealers from a given center was much smaller than at present. Certain developments that have progressed rapidly since World War II, have caused these milk distribution areas to be extended much more widely. Among these influential developments have been the steady increase of urban population and spread of suburban areas; the building of fast arterial highways; increasing use of mechanically

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refrigerated trailer vans and delivery trucks; bulk handling of milk from farms to plants; increasing volume of milk distribution (wld processing) by super market chains; use of light-weight paper containers in place of glass bottles; consolidation of processing plants into large volume units capable of using modern labor-saving equipment efficiently; and progress toward unified or reciprocal milk inspection systems.

In consequence of these significant changes, the distribution areas of many handlers have been extended to embrace secondary distribution centers in the production area which supplies the market as well as the suburban territory

adjacent to the primary distribution center. Marketing areas defined in recent orders generally reflect these changed conditions. In some instances, however, it seems that marketing areas have been defined (for the purpose of regulation) without sufficient consideration of the need for coordinating producer prices throughout a production area which supplies two or more adjacent or closely related distribution centers.

There is evident need for expanding and consolidating many of the marketing areas that were defined too narrowly in the light of present conditions. This is a difficult task because it frequently means that certain groups of producers or handlers are deprived of special advantages to which they have become accustomed. Nevertheless progress is being made. There are at least ten instances in which orders for adjacent marketing areas have been merged.

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In appraising what has been done, it must be recognized that the Department has to administer the Federal order program under democratic procedures specified by the Agricultural Marketing Agreement Act. It cannot act arbitrarily but must try to obtain the best compromises possible, often confronted with strong pressures and resistances on the part of groups with conflicting views and interests. Such pressures have been the more difficult to resist because many provisions of the Agricultural Marketing Agreement Act are broad and indefinite, allowing for a wide range of interpretation.

Metropolitan Market Complexes

The need for defining marketing areas on a broader basis and for expanding or consolidating those areas which are too small under present conditions is most obvious in the case of large metropolitan markets. In terms of milk volume, number of producers, number of handlers and number of consumers affected, such markets represent the major part of the entire fluid milk industry of the United States.

A large metropolitan market normally consists of a major city

surrounded by a number of smaller cities and suburban areas, which draw their milk supplies from the same milk production area. Moreover, within the production area for the metropolitan market are usually found many secondary or satellite distribution centers which compete with that market for their milk supplies. The recent technological and other

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developments previously mentioned have tended to bring the several distribution centers in such market complexes closer together.

The several parts of the primary market and the secondary distribution centers of a metropolitan market complex are closely linked by economic and institutional factors such as:

1. Their dependence upon the same milk supply area, in which producers and plants associated with the several distribution centers of the market complex are interspersed.
2. Surplus handling facilities that provide for the balancing of milk supplies with fluid sales and for economical utilization of reserve supplies.
3. Marketing organizations, pasteurizing-packaging plants, and distribution systems that serve one or more of the secondary distribution areas as well as the principal city and its suburban territory.
4. One or more cooperative bargaining associations whose membership is spread over most or all of the supply area for the entire market complex and that represent producers in both primary and secondary distribution areas.

The several parts of a metropolitan market complex are so closely interrelated that it is difficult to bring about orderly marketing and equitable treatment of all parties unless the entire market complex is regulated by one order. Yet there are instances in which the marketing areas defined by Federal orders have excluded parts of the primary market as well as secondary markets of the market complex.

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Instances of piecemeal regulation. The Philadelphia marketing area, for example, excludes substantial parts of the primary market of which that city is the hub. Before it was expanded by order amendment in 1957, the New York marketing area embraced only about two-thirds of the total population of its metropolitan district. Chicago and St. Louis are other prominent examples of orders whose marketing areas were so defined as to exclude substantial segments of their respective primary markets. Differences in sanitary standards were a factor in the decision to issue separate orders for component parts of some of these metropolitan markets.

Moreover in defining the marketing areas to be regulated under most of the earlier orders for large cities secondary distribution centers lying within the production area of the regulated market were not included. The milk supplies directly associated with the excluded portions of the market complex remained unregulated or were priced and pooled under separate Federal orders, or by state milk pricing orders. Some examples of this are the metropolitan areas of Boston, New York, Philadelphia, Cleveland, Detroit, Chicago and St. Louis.

What has usually happened in the development of Federal regulation for a large metropolitan market is that a Federal order for the major distribution center was issued first, to meet a pressing need for price stabilization. Minor or secondary distribution centers, often representing a substantial part of the overall market complex, were excluded.

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from the marketing area defined in the major order. More often than not this was done at the insistence of producers and handlers directly interested in the secondary distribution centers. On occasion, also, cooperative associations of producers have thrown their influence against a suitably comprehensive definition of the marketing area to be regulated, in order to avoid a bitter internal controversy.

In some instances, state milk control agencies and other political groups

have resisted the inclusion of market segments that should logically have been included in a comprehensive milk marketing area for purposes of uniform regulation.

Such pressures as these, together with the reluctance of the Department to take a strong stand on such matters and the lack of suitable, well established criteria for defining the marketing areas to be regulated, resulted in the issuance of many orders of too limited scope. And finally, the requirement that each proposed order (with its defined marketing area and other provisions) be approved by a two-thirds favorable vote of producers who would be directly affected, has often dictated a decision to define the marketing area more narrowly than would be logical or desirable.

Effects of piecemeal regulation. Where parts of a metropolitan market complex have been excluded from the order for the major market in the group, a disproportionately large share of the total milk supply for the entire market complex usually became priced and pooled under

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that order. This resulted in relatively low fluid utilization and in blended returns to producers lower than those received by other producers in the area. On the other hand, it was often the case that relatively high percentages of the more limited supplies associated with the distribution centers excluded from regulation by the major order were utilized in fluid form. Where these milk supplies became regulated by separate Federal orders or by state milk pricing orders, the producers usually received higher blended returns than their neighbors and other producers similarly situated whose milk was priced by the order for the major market. On the other hand, where the milk supplies excluded from regulation under the Federal order for the major market were left unregulated, the producers often received flat prices as high or higher than the uniform prices determined under the major order. Nevertheless the net cost to the handler of milk used in his fluid sales was nearly always less than he would have had to pay for Class I milk under an order.

The usual experience has been that when the Federal order for the major

distribution center became effective it helped to stabilize producer prices throughout the entire market complex and its production area. Thus, even though the producers whose milk was directly priced and pooled under the order for the major market were dissatisfied and realized that they were not being treated equitably, there was a great deal of inertia to be overcome, as well as strong resistances on the part of the favored groups and their spokesmen, before the marketing area defined in the Federal order for the major market could be expanded to a proper coverage.

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These experiences emphasize the importance of insisting upon a proper definition of the marketing area before a Federal order is issued. Once an order has been issued for a marketing area that is too narrowly defined, especially in the case of a metropolitan market complex, it is likely to be difficult to correct the error.

Whether parts of a metropolitan market complex are regulated by different orders or some parts are left unregulated, the results of such divided or incomplete regulation are inconsistent with the declared policy of orderly marketing and with the principle of equal application of law and regulation. It has been said that "there is not too much difference in the operation of a combined market program or two separate orders with major provisions closely related." In actual experience, however, it seems to have been impossible to coordinate the provisions of separate orders for different parts of a metropolitan market complex well enough to avoid serious difficulties such as those mentioned in the foregoing discussion and further elaborated in the section on Intermarket Relationships.

Suggested Procedure for Definition of Marketing Areas In the course of its deliberations the Committee formulated a suggested procedure for defining or redefining the marketing areas whose milk supplies are to be priced by Federal orders. This suggested procedure, with particular application to metropolitan markets, involves

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four steps, as follows:

1. Identify the principal city whose milk supply and that of closely related distribution centers is to be priced by the order.

The principal city is a well defined, readily identifiable, political unit which constitutes the hub or core of an extensive urban area.

The boundaries of this metropolitan market which will be a major component of the marketing area defined by the order are to be determined in step No.2.

2. Determine the extent of the primary metropolitan market, including besides the hub city, its suburban areas and contiguous or adjacent urban centers that have strong economic and institutional ties to the principal city.

The metropolitan market thus determined (subject to further expansion in steps 3 and 4) is likely to be somewhat more extensive than the marketing areas defined in accordance with earlier procedures in which the extent of route systems of competing handlers was the principal determinant. For example, under the proposed new procedure urban centers adjacent to the principal city and strongly linked to it by the economic and institutional factors heretofore mentioned (items 1, 2 and 4 - page II -2 - 5) would be included in the

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marketing area even though not served by route systems of handlers also serving the principal city and its suburban areas (item 3 - page II-2-5)

3. Trace the boundaries of the regular production area for the primary metropolitan market identified in step No.2 (as a necessary preliminary to step No.4).

This production area will normally include all counties (excluding

non-contiguous or remote areas) in which are located plants or dairy farms that have been associated with the primary metropolitan market.

(a) by health department approvals, (b) by shipments of fluid milk or (c) by other economic and institutional factors previously mentioned (page II-2-5)

4. Locate all the principal urban centers that lie within the production area as determined in step No. 3j extend the bounds of the primary metropolitan market as determined in step No.2, to embrace these urban centers and the intervening territory

The entire area thus outlined will constitute the marketing area whose milk supply is to be priced by the order. The intervening territory mentioned in step 4 may include small municipalities and rural areas that in themselves are unimportant. It is essential, however, that they be treated as part of the marketing area because they are strongly linked.

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to the primary metropolitan market economically as well as by distribution patterns and other institutional factors. To exclude them from regulation would result in troublesome differences in cost of milk to competing handlers.

On the other hand, some minor distribution centers and rural areas in the more remote parts of the production area may be excluded from the marketing area as determined by the foregoing procedure. Relatively weak linkage of these peripheral areas to the distribution centers within the marketing area and the high cost of order administration in relation to potential benefits may justify the exclusion of these small-volume distribution areas from regulation.

Situations undoubtedly will arise in which the suggested procedure does not indicate clearly whether a particular distribution center on the periphery of the market complex should be included in the marketing area to be regulated by a given order. The alternatives will be to include such a distribution center under the order for another market, issue a separate order for a marketing area which

embraces this distribution center, or leave it unregulated. The decision in such cases should be made by the Department on the basis of the four factors previously mentioned (page II-2~5) and possibly others which determine the degree of relationship of the distribution center in question to one marketing area or another.

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Among other considerations it is undesirable to define a Federal order marketing area in such manner as to give any one milk inspection agency control of access to the pool.

Orders for smaller markets. Many of the marketing areas that are or may become regulated by Federal milk orders are much smaller and of more simple structure than the large metropolitan markets hereto fore described. They may also be comparatively isolated from other distribution areas in the sense that their supply areas do not overlap nor are they served by distribution establishments that also distribute milk in adjacent or nearby markets. Nevertheless such marketing areas can properly be defined by the same procedure that has been suggested for metropolitan market complexes. Probably in most such cases, steps 3 and 4 of the suggested procedure will result in little or not extension of the marketing area beyond the scope defined in steps 1 and 2.

Application of the Suggested Procedure

The Committee suggests that the procedure heretofore outlined be followed both in defining the marketing areas to be regulated by new orders and in reappraising and revising the marketing area definitions of existing orders. Hearing notices issued for proposed new orders and for proposed expansion of marketing areas under existing orders should specify for consideration areas broad enough to give assurance of meeting the requirements heretofore indicated. Final determination of the proper

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scope of the marketing area can be made only after evidence on the matter has

been presented at a public hearing, but the marketing area as ultimately defined cannot extend beyond the limits specified in the hearing notice. This is a matter in which the Department may well exercise strong influence and leadership.

The exercise of leadership in this direction will of course not be without its problems. For instance, an order cannot be issued under present procedure without approval at a producer referendum. A proposed area that meets requirements heretofore indicated may not be approved if it conflicts with the vested interests of too many of the area producers. Conversely, some groups might feel compelled to submit evidence to justify inclusion of all territory proposed, even that outside the scope of our recommendations. However, the Committee prefers that the Department cope with these types of problems as best they can rather than issue orders with marketing areas that are too narrowly defined.

Some groups have urged that no additional territory be included in a marketing area to be regulated by a Federal milk order without the consent of the producers involved whose milk was not previously priced and pooled under that order. The Committee believes that such a requirement would be improper and unacceptable, however, since the scope of regulation under an order is a matter of concern to all producers who contribute to the milk supply for the entire market complex. The courts have, indicated clearly that no legal basis exists for separate approval

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by the newly affected producers of proposed extensions or consolidations of marketing areas. 1/ In this as in many other affairs of modern society, individual preferences and minority interests must give way to the requirements of equity for the entire group whose welfare is significantly affected.

The Committee recognizes the fact that marketing areas might be defined too broadly as well as too narrowly but so far unduly large marketing areas have not been a serious problem. The Committee believes that the procedure suggested herein will help to avoid the creation of marketing areas that are too extensive as well as others whose coverage is too limited.

Finally it is suggested that the Agricultural Marketing Agreement Act might well be amended to establish more clearly and firmly the policy that the marketing area defined in each Federal order should include the entire market complex associated with the principal city or cities whose milk supply is to be priced by that order. 1/ Such an amendment would place the Department in a stronger position to exercise constructive leadership in this matter and to resist pressures from both industry groups and political interests toward limiting the scope of regulation too narrowly to insure equitable treatment of all producers in the supply area for the market.

1 / *Benson and New England Milk Producers' Association v Schofield et al* 236 Fed. (2) 719 (1956). No application was made for appeal of this unanimous decision to the U. S. Supreme Court.

2/ While ascribing to the general objectives, we cannot agree that amendment of the Act for this purpose is desirable. The Secretary has sufficient authority to exercise his leadership. Amendment of the Act could transfer the initiative from cooperatives and other industry groups to the government. - Judson P. Mason, James L. Reeves, Gordon M. Cairns, George N. Pederson, Gordon C. Laughlin, Edwin W. Gaumnitz.

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PART II - Section 3
POOLING AND PRODUCER SETTLEMENT

Orderly marketing of fluid milk is a reasonably well established objective under Federal orders. In the sense that marketing and pricing have been regularized and producers and distributors have observed the rules of the game, orderly marketing has been accomplished. Although disruptive and even chaotic local market conditions occasionally develop, producers in order markets are usually shielded from the short-run impact of such handler competition.

Yet, this can be deceiving;. perpetuation of orderliness is not automatic. It takes work. Specific terms of orders which comprise the regulatory system have themselves been important factors in shaping the structure, operational efficiency and rate of technological innovation in milk production and marketing. Penalties for failure to comply with established regulation have been significant in assuring orderliness. But mere absence of disorderliness for protracted periods does not necessarily assure that economic efficiency is being accomplished within individual markets or for the system as a whole. Any administered marketing or regulatory system may impede or promote innovation and adoption of improved technology in the long run. Short-run stability and orderliness may involve public cost in terms of loss of long-run efficiency. Furthermore, certain regulatory devices established for ease and convenience of administration can magnify this problem. The quantitative

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significance of such short and long-run impacts of regulatory practice may be impossible to measure. Nonetheless, such qualitative evidence as is available should not be ignored.

Orderly marketing has been sought through rules which establish or support (1) uniform class prices to handlers, (2) uniform prices to producers with provisions for established differentials, and (3) in most markets, adjustments in payments between handlers as necessary to accomplish (1) and

(2).

Elimination of price differences between handlers for milk used in the same class eliminates one of the prime incentives for disorderly marketing. This arrangement eliminates the buying advantage which some buyers could achieve by pitting producer against producer or by refusing to Participate in the negotiated pricing Plan.^{1/} This arrangement equalized the cost of milk to handlers and implied that handlers could compete as much as they wished based on distribution efficiency but that this competition could not lead to lower pay prices for milk, and that distributors could not compel farmers to finance the cost of excessive competition.

1/ While agreeing with this statement, it should be noted that under the present situation the emphasis has merely been shifted to pitting producer against producer by edict in that preferred and protected producers under one order are now concerned about protecting the advantage attained under that order against those producers who receive the benefits of a second order. Both groups, however, seek to protect themselves against all other producers such as manufacturing milk producers. It should be noted that less than 200,000 producers deliver to handlers regulated "under" orders, while there are a total of about 1,000,000 farms from which milk or cream is sold. It is certainly difficult to square this statement with the objectives of equity so nicely stated elsewhere and to which lip service is given throughout the report. - Edwin W. Gaumnitz

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Arrangements for paying producers uniform prices---subject only to stated adjustments for volume, grade, and location---presumably eliminate the major disruptive effects of widely varying producer prices. Minimum producer prices assured that handlers could encourage producer shifts mainly through payment of premiums. 2/

Basis and Present status of Pooling

Key provisions of the Act dealing with methods of settlement are 608c(5) B, C and F. These provide for payment to producers for milk delivered to handlers through pooling. Also, they permit authorized cooperatives to modify their payment procedures to allow blending of net proceeds from all

operations over all members. Two basic types of pools are authorized and operative: one type (individual handler) blends returns among producers delivering to the same handler; the other (market-. wide) blends returns among all producers delivering to all handlers in the market. Careful reading of the Act suggest that within its broad formulation there is room for innovations and modifications in pooling arrangements. It appears, however, that few variations of significance from traditional methods have been attempted. Time has seen a gradual reduction in the proportion of handler pools to marketwide pools (see Table 2). 3/ In December 1950, 10 of the 39 regulated markets, or 27 percent, had individual handler pools; in December 1961, 14 of 81, or 17 percent, had individual handler pools.

2/___ It should be recognized that sizable quantities of milk are shifted from handler to handler and market to market by cooperative associations upon the basis of the judgment of the cooperative associations rather than that of individual producers. - Judson P. Mason, Gordon C. Laughlin, George N. Pederson

3/ This sentence and the succeeding one, while factual are misleading in that they fail to note that very few Federal order markets have shifted from individual handler to marketwide pools. It also makes no mention

Market wide Pools				Individual handler Pools		
Year	Producer receipts	Producer Class I	Percentage of receipts used in Class I	Producer receipts	Producer Class I	Percentage of receipts used in Class I
	1,000 lb.		Percent	1,000 lb.		Percent
1946	11,419,779	3,686,226	32	2,988,349	2,264,966	76
1950	15,860,218	8,943,546	56	2,799,572	2,056,296	73
1955	24,710,947	4,694,751	59	4,237,120	3,337,104	79
1957	29,311,451	8,020,531	61	4,143,887	3,318,168	80
1961	44,296,350	6,325,027	59	4,505,763	3,510,714	78

Producer receipts in markets with specified type of pools and number of markets with specified type of pools								
Market wide pools					Individual handler Pools			
Year	Number of markets with M-W pools ^{1/}	Percent of all Federal Order markets	Producer receipts	Percent-age of Producers receipts for all markets	Number of markets with I-H pools ^{1/}	Percent of all Federal Order markets	Producer receipts	Percent-age of producer receipts for all markets
	Number	Percent	<u>1,000</u> lb.	Percent	Number	Percent	<u>1,000</u> lb	Percent
1946	22	73	11,419,779	79	8	27	2,988,349	21
1950	29	74	15,860,218	85	10	26	2,799,572	15
1955	46	73	24,710,947	85	17	27	4,237,120	15
1957	51	75	29,311,451	88	17	25	4,143,887	12
1961	67	83	44,296,350	91	14	17	4,505,763	9

Table 2

^{1/} Numbers apply to pooling arrangements in effect at the end of the year.

The law does not specify the criteria to be used in choosing between types of pools. The Department of Agriculture has not published a set of criteria. The rationale for the type of pooling arrangements used in orders has been set forth by the Secretary only in the promulgation and amendment decisions issued by the Department. Type of Pool 4 /

Under individual handler pools, the use values of milk handled by the handler are "blended" and distributed separately to the producers who supply milk to that handler only. Under such circumstances, producers delivering milk to different handlers in a given market may receive different prices for their milk due to differences in utilization as between handlers.

Such blend differences can give some handlers a strong competitive tool in the form of higher blend prices. These handlers will be able to attract preferred larger volume producers or will be able to attract producers with seasonal production patterns closer in accord with their needs. This would reduce their blend prices and put them under some competitive pressure to drop off their less satisfactory producers.

of the fact that in the newer Federal order markets there were no strong cooperative groups with any degree of history or significant influence in the area. It is reasonable to expect that newly formed producer cooperative bargaining associations would espouse marketwide pools if for no other reason than the fact that incomes of such organizations would be bolstered by the compulsory check-offs on non-cooperative members under the guise of "equal service" performed by the Market Administrator's office. Thus the statements shed little light on the merits of individual handler vs market wide pooling. - Edwin W. Gaumnitz

4/ Intermarket aspects of pooling are discussed further in Section 4 of Part II.

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Conversely, handlers with a low Class I utilization who pay a below average blend price will be under some pressure to reduce the amount of milk they receive from producers to bring their blend into a closer relation-ship with their competing handlers. This pressure will lead them to decline to receive milk from producers who are less satisfactory from the handler's standpoint by virtue of

location, seasonal pattern of production, quality, or any other factor. Of course, some hold this to the credit of the individual handler type of pool.

It may be seen, therefore, that individual handler pooling encourages handlers to exercise a strong degree of supply control with respect to the local fluid market. In handler pool markets where a producers' cooperative becomes a handler by attempting to find a market for surplus local producer milk, it soon becomes apparent that performing this service for the market places the cooperative at a serious competitive disadvantage. Under such conditions the cooperative will quickly petition for a change to marketwide pooling.

The historical development of marketwide pooling appears to have been a logical extension of association pooling. Prior to use of Federal orders, producers in most markets were organized into one or more bargaining associations for purposes of negotiating with handlers over matters of price, milk supply, and other things. A major objective, regardless of pooling arrangement, was uniformity of prices to producers. If the cooperative had sufficient control of the milk to require handlers to remit to the association at class prices for milk delivered by members, the

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association pooled such payments and made payment to members and uniformity---among members---was achieved. If the association operated on a check-off basis---that is, negotiated prices but the handlers paid producers directly and collected dues on a check-off for the association, there were two general methods of operation. First, the association, on the basis of reports from handlers, figured a pool price to producers and instructed handlers the price to pay its members. Equalization of monies among handlers was necessary to correct for differences between value in use and payments to producers for each handler. Second, the association would negotiate uniform class prices to handlers but each handler would compute the uniform price to his producers on the basis of his utilization of their milk. Where handlers were quite similar as to their uses of different classes of milk and as to the distribution--or the association's control --of the surplus, the individual handler pools achieved a measure of uniformity.

The Act providing for Federal orders recognized these forms of market administration. The marketwide pool with a producer settlement fund for the equalizing of handler accounts goes directly to the objective of uniform prices to producers whether association members or not. Individual handler pools in this sense are anachronisms. To the extent that they result in different levels of payout to producers supplying different handlers, they provide the incentives for lower paid producers to move their supplies to higher paying outlets. However, such shifts

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are frequently difficult or impossible. Moreover, it is easier to move money than milk--and often more conducive to orderliness and marketing efficiency.

The introduction of equalization of producer returns altered the competitive relations among handlers in a significant way. Handlers with high utilization no longer were able to exercise control over producers through the high blend prices they were able to pay. Handlers having relatively lower Class I utilization, who formerly had been somewhat disadvantaged, now found their competitive relationship to other handlers a less serious problem.

Marketwide pooling has also served to reduce the producer identification with individual handlers and to minimize the incentives for making "deals" between producers and handlers at less than order prices. It also affords cooperative associations an opportunity to prevent loss of markets for their members during periods of surplus or for other reasons. 5/

Seasonality and Pooling

Methods of producer settlement, specifically provided for in the Act, are designed to promote orderly marketing by evening out production of

5/ These statements regarding marketwide vs individual handler pooling ignore the advantages of the association of producers who produce in accordance with buyers' requirements being associated with such handlers. The statement also fails to point out that in markets with individual handler pooling surpluses are generally less, order producers receive higher per unit prices, and retail milk prices are lower.

The general tone of the report seems to be that there is something sinister about individual producers or a cooperative association of producers using their or its best efforts to secure returns rewarding them for meeting the requirements of individual handlers. - Edwin W. Gaumnitz

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milk over the seasons.^{6/} Production leveling devices have two basic purposes; first, to assure an adequate supply during the normally short supply season, and second to reduce or eliminate disruptive surpluses during flush seasons. A valuable by-product of production leveling would be more efficient operation of fewer facilities for the disposal of reserve supplies on a year round basis.

Efforts to modify seasonal variations in production through seasonal variation in class prices, particularly Class I, were discussed in an earlier section of this report. Inasmuch as handlers in some markets do not favor seasonal variations in the Class I price, the so-called "take out and pay back" plan was developed. ^{7/} Under this plan, a deduction is made during the months of seasonally high production from the uniform price to producers and the sums representing this deduction are added to the pool, and thus to the uniform price, during the months of seasonally low production.

A third device developed by cooperatives and continued under Federal orders is the base-excess plan. Under this plan a producer earns a base equal to his production during designated short supply months. This

^{6/} This statement implies that the methods of producer settlement provided in the Act are designed to promote orderly marketing by evening out production seasonally. Factually, the statute provides that various methods of settlement may be used; the statute certainly does not indicate that the Congress judged that evening seasonal production was necessarily a desirable objective. - Edwin W. Gaumnitz

^{7/} There are many other reasons which sometimes require class I pricing without seasonal variations in the differentials, most important of which is the need to maintain proper intermarket price alignment on a month by month basis. The seasonal pattern of milk production is not uniform from market to market. - Judson P. Mason, Gordon C. Laughlin, George N. Pederson

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base then becomes his claim to a prorata. share of total base milk during the part of the year during which producers are paid on base---either the flush months or, in some markets, the year round. When the bases are closely in line with Class I sales, the base price tends to reflect to producers the full premium of Class I prices over surplus prices and the full difference becomes the incentive to the producer to level out his production or at least to earn a larger base by increased deliveries during the base-forming period. If bases far outrun Class I sales, which is the situation usually experienced, the base price is diluted, the incentive for production leveling and further expansion of bases is proportionately reduced.

All three devices have reportedly had a place in achieving a reduction in the seasonality of production in the areas where they have been applied. Their effectiveness should be carefully evaluated and their analysis statistically subject to critical review.

The basic purposes for production leveling set out in the beginning of this section were: first, to assure an adequate supply during the normally short season and second, to reduce or eliminate disruptive surpluses during flush seasons. Regulation under Federal orders directly removed the disruptive effects of seasonal surpluses, even if the surpluses themselves continued. The only remaining primary purpose is to provide an adequate supply in the short season. 8/

8/____ Since the report states that seasonal production leveling devices are not needed in order to eliminate or remove disruptive effects of seasonal surpluses and since the only remaining primary purpose is to provide an adequate supply in the short season,"It clearly follows that base rating or base excess plans have no place in markets which have an adequate supply in the short season, except for such effects as they may have, if any, upon contributing to efficiency in production and marketing through leveling out seasonal variation in production. - Otis M. Reed

assumed that production during normally short seasons is more costly than at other seasons. If this is so, production in excess of market requirements in the short season is uneconomic. Production leveling for its own sake is not desirable.

One consideration may modify this conclusion. A valuable by-product of production leveling was noted in that level production required fewer plant facilities to process reserve supplies on a year round basis. A balance here must be struck between the costs of production leveling on the many farms involved as against the cost of providing and operating plant facilities necessary to take care of seasonal peaks and low periods . It is entirely possible that it would be less expensive to provide plant and storage facilities than to force production leveling on the farms .9./

Pooling in Relation to Needs of the Market

Pooling practices are usually thought of as the set of mechanical arrangements used to distribute proceeds from handlers among producers. While this is the immediate goal, any given pooling plan must be viewed relative to its effect on size of pool. Key issues here involve the

9/ The question that arises from this sound modification of conclusions previously stated is whether, in the institution of seasonal pricing programs, studies necessary for striking the "balance" referred to do in fact form the basis for the inclusion of such programs in markets which are adequately supplied during the short season. It is quite doubtful that such studies exist, and if this is the case, such plans must have been instituted either on faith, or non-statistical hortative testimony, or for other reasons not disclosed in this report. Thus, this report, after having eliminated the basis or justification for base-excess plans to a very large degree, clearly evades the issue as to why their use is continued in markets having an adequate supply in the short season.- Otie M. Reed

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evaluation of producer rights to the pool and the continual modification of pooling processes whereby they recognize technological changes in production and marketing.

Market Rights of Producers. - The crux of the issue lies in the

previously-stated general order objective: "To establish such terms of trade under the orders as will combine maximum freedom of trade with proper protection of established producers against seasonal or other loss of outlets that would tend to demoralize markets and farming plans." Payment plans must reflect in returns to established producers the provisions defining the marketing area And formulas for class pricing. But who are "established producers"? It is here that a whole family of equity problems is decided implicitly or explicitly.

The pooling process results in the establishment of uniform prices to producers. They need no other reason for a unique interest in equitable settlement or blending methods.

Federal orders do not specify market rights of producers as such. The power to order and promote orderliness in marketing tends to promote a notion of rights among participating members. The pool itself implies some definition of market value which is a right of the producer. Seasonal base plans, further buttressed by compensatory payment and down allocation provisions to protect regular producers, suggest the acceptance of the principle of market rights in Federal orders. Else where we have accepted the notion of prior rights of established producers as essential for orderly marketing.

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Such market rights as are created, however, are not absolute or permanent. Producers must continue to meet health requirements. Producers must find a handler who will accept their milk and continue to meet conditions specified by him. The pool plant provisions are continuing market tests of performance and the benefits of orderly marketing require such performance. Producers must "earn" bases through performance in markets with base-excess plans. Such rights as are created are not recognized in the courts as marketable. It is widely accepted, however, that being "on the market" is a valuable right.

How do we provide "proper protection of established producers" under conditions of rapidly advancing dairy technology in both production\and marketing? Is there such a thing as a "market right"? Does a producer have a

"right" to a market because he is close to it as compared to the producer who is distant? Does he have a "right" to it because he supplied it "during a representative period of time"? Does he have a "right" to a market because he produces milk of a specified quality--even if substantial part of that milk is used in products which do not require that quality? Does his alter ego, the manufactured milk producer, in fact, have a prior "right" to that market'?

Basically, there are no "rights" other than those which can be established and held. The conception of rights must be reappraised continually in the light of changing conditions. What now is "proper" protection of established producers? 10/

10/ A companion question is: Does "proper" protection of established producers justify the establishment of price structures and marketing devices which are a factor of major importance in the development of large surpluses of milk which must be used in manufactured dairy products to the detriment of the manufacturing milk producer, or, if the latter is assumed to be "protected" by the price support program, contribute materially to the costs of such program? The answer is a resounding and emphatic no, yet this has taken place to a material degree. (See Price Relationships and Utilization, Part II, Section I, and Are There Still Elements Of Disorder? Part III.)----Otie M. Reed

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The objective is to provide orderliness in 'milk markets. Orderliness cannot be achieved by maintaining the status quo to the extent that pressures from the "outs" cause the system to break down. Neither can orderliness be achieved by allowing the competitive forces of completely free trade to place the considerable investments of the "ins" in jeopardy without provision for transition.

Rights created by Federal orders may be minimal, but they do indeed buttress the notion that established producers have certain prior rights in the market. The network of organizational control embodied in the order adds up to market rights with limited value. Regular producers are protected from the transient onslaughts of dumping by outsiders. Take out and pay back plans and

base-excess plans, ostensibly designed to influence the seasonal pattern of deliveries, constitute devices for differentiation among producers in the division of total market returns to producers. Producer rights have been assigned to volumes delivered during given seasons.

Extended Use of Producer Bases in Order Markets. - Base plans have been traditionally used for their effect on seasonality of production. Yet, their effect on size of pool has been recognized. Extended use of producer bases in order markets as here discussed emphasize this latter use 1/ 11

1/ 11 The only specific reference to the effect on size of pool of base plans is contained in the section entitled "Seasonality and Pooling," wherein one primary purpose of production leveling devices, including base rating or base excess plans, is "to assure an adequate supply during the normally short supply season." In most milk production areas, it is probable that an increase in supply during the short season would be associated with an increase in total production on an annual basis. Another clue as to "effect on size of pool" of base plans is to be found in the state

II-3-15

Such base plans have often been confused with quota plans which prohibit sale of milk. 12/_The discussion here does not anticipate such prohibition of sales, but rather, develops a two-price payout plan as a natural development in modern pooling methods. 13/

ment that "if bases outrun Class I sales, which is the situation usually experienced (underscoring added), the base price is diluted, the incentive for seasonal production adjustment is reduced" Here the inference, is that production under base plans is so large that they are markedly inhibited in reducing seasonality of production, and that they have had little if any influence on adjusting supply to market requirements. Thus, they have been used heretofore either to increase production during the short season, or, where this is not the goal, they have not been used to bring, or at least have been unsuccessful in bringing, production into adjustment with Class I needs, and in fact may have been responsible for increasing production relative to fluid requirements.

Therefore, the statement "Extended use of producer bases in order markets as here discussed emphasize this latter use" is entirely misleading, since the "extended use" is to stop the development of surpluses or even reduce them,

a purpose directly contrary to the purposes for which have been used under milk market orders. - Otie M. Reed

12/ I cannot recall a single instance in all the agricultural legislation since 1933 which "prohibits" the sale of any agricultural commodity from farms in the United States. All legislative programs, to my knowledge, which have been designed to reduce marketings from individual farms have involved some form of remuneration for reducing production, such as under the original Agricultural Adjustment Act¹ or penalties assessed against production or marketings in excess of acreage or market allotments, but these never prohibited sales in excess of such allotments. - Otie M. Reed

13/ "Two-price" plans, i.e., plans under which producers receive a higher price on their share of the market and a lower price on their production or marketings in excess of this share, are an integral part of Federal agricultural legislation designed to limit production or marketings. This is accomplished by a non-recourse loan procedure, with sale of non-loan volumes at the market price, or by assessing penalties for volumes marketed in excess of allotments so that the return on such excess marketings is lower than on market allotment volume. Thus, extended use of producer bases in order markets, the program proposed in this section, if adopted will become another in the congeries of production and marketing restriction programs now in effect under existing Federal law. - Otie M. Reed

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National surpluses encompassing the total dairy industry have drawn attention to national supply management plans. This discussion of producer bases in order markets does not deal with this problem nor make recommendations for its solution. Such would lie outside the assignment of the committee.

However, Federal orders face a problem which lies in two almost overwhelming factors contributing to a widening gap between production and consumption. First, the dairy industry at all levels is in the throes of a technological revolution without precedent. Second, dairy product consumption is being discouraged by a complex of factors very difficult to overcome.

Producers in Federal order markets have delivered more milk in every month since May 1956 than in the corresponding month of the previous year.. Reserve, or excess supplies of milk from state regulated and unregulated markets have shifted into order pools. Rapid conversion of manufacturing grade milk to

market milk has occurred in some areas.

This dilemma focuses attention on three features of Federal order markets. First, relative stability of returns to producers under an order offers farmers less uncertainty than is true for those without an order or possibly other farm~rs in alternative enterprises. Price and income hazards are materially reduced under orders. This is an inherent result of stabilized or "orderly" marketing which no one would want to

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undo. but which must be recognized as a factor in, attracting milk to order markets . 14/

Second, throughout most of the period since the Korean War, milk prices have been maintained at higher than supply..demand levels through support purchases of products and widening Class I differentials. Up to one-half of the milk under some orders is used for manufactured products. "Public interest" has failed to dictate to the Department of Agriculture or others that dairy farmers should be exploited by letting prices sink to their supply-demand level 15/

Third, the price problem in order markets has been compounded by the side-effects of blend pricing. The class prices are carefully set individually, and then averaged or "blended" into uniform producer prices.

14/ True--but proper recognition of this factor would point to some reduction in milk prices compared to those received by farmers "without an order" or in "alternative enterpriaea." In fact, however, fluid milk order prices have increased materially relative to prices of manufacturing milk in many milk order markets. (See Part II) Section 1.) - Otie M. Reed

15/ It can be stated with equal emphasis that "public interest" has failed to dictate to the Department of Agriculture or others that (a) consumers should be exploited by being charged prices so high that supplies far in excess of their fluid milk needs are forthcoming, or (b) that manufacturing milk producers, although protected to a greater or lesser degree by the price support program, should bear the onus of being responsible for the large surpluses and high costs of the price support program, when in fact.the huge surpluses in fluid milk markets contribute materially to such costs. This is true despite the fact that about 6

percent of total U. S. fluid milk sales are subsidized under the Special Milk, School Lunch, and Military Milk programs. - Otie M. Reed

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The implication of this procedure is to offer a producer--already under the influence of supported prices--the opportunity to deliver surplus milk to the oversupplied market at the average price rather than at the surplus price. Moreover, in order to maintain his share of Class I returns, the producer must increase his deliveries along with his neighbors.

Present regulatory arrangements tend to place inadequate responsibility on individual producers for checking the growth of market surpluses and inadequate penalties for supplying the market through time with milk in excess of needs. Indeed, it seems incongruous to focus so much attention on protecting local markets from incursions of surpluses from other areas and simultaneously adopt such ineffective measures for checking the growth of surpluses in production of regular producers. It seems obvious that steps which will prevent the further development of surpluses from whatever source, local or otherwise--are basic to improvement of producer incomes. 16/

16/ There is here the clear inference that "penalties for supplying the market through time with milk in excess of needs" are presumed by proponents of this plan to be needed. Hence, proposals to establish such "penalties" clearly envision action that will halt the development of surpluses or reduce them. This clearly envisions application of procedures which will control production--production control--irrespective of what the sponsors of such proposal call it. - Otie M. Reed

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Specific terms of base plans may be combined in a wide variety of ways to accomplish given objectives for a particular market. In view of this, the Committee feels that the details of such proposals should be decided in the usual hearing procedures for amending individual orders. Consequently, it would be inappropriate for it to make detailed recommendations for specific base plans. However, a general procedure is now described for handling bases. Many

variants or alternatives might be better suited to particular market conditions.

Producer hundredweight bases reflecting each producer's share of Class I sales in some recent period could be established. This aggregate of bases could be defined to include the 10-20 percent daily excess normally needed in most markets. There would be no prohibition against marketing milk produced in excess of base.

The handler obligation to the pool and a market blend could be computed as presently. However, for each producer the Class I price could be applied to base milk as a deduction from the pool. The remaining value of the pool would be divided by the non-base milk to figure a surplus price. This price would then be applied to the non-base milk of each producer. At any given time, this arrangement has the advantage of placing the burden of surplus supplies directly on each producer. Each knows his base and for some temporary period is assured of Class I price for it. But in addition, each additional hundredweight yields a lower uncertain return.

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Usual adjustments for test and location could be applied to both base and excess milk, although it seems reasonable that these adjustments might be applied in a differential manner so as to discourage producers from supplying the market with additional surplus.

The difficult problems involved in base programs begin to show up in connection with adjustment of producer bases. Many producers will wish to expand the size of their marketings. Some will wish to acquire initial bases and begin to serve the market. Some will wish to sell their farms or retire. It is largely in connection with how such provisions are handled that base plans can be thought of as being tight or loose. If market entry or expansion of base by present producers is too easy, the program will shortly serve no useful purpose. On the other hand, it is generally agreed that the producer discipline should not be any more severe than necessary to accomplish the program objectives, and that program costs in terms of individual producer restraints should be periodically re-examined in relation to program accomplishments and goals.

Several key and interrelated questions about bases must be answered.

- (1) To what extent should bases be considered the property of individual producers, and in this connection, what, if any, restraints should be placed on transfer of such bases in whole or part?
- (2) By what procedure, if any, should changes in Class I sales be reflected in bases?
- (3) What means should be provided to handle the requests of outside.

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producers for a base, and the requests of established producers for enlarged bases? (4) Should limits be placed on the aggregate base which anyone person or business can hold, and should there be occupational or other restriction on who can own bases?

Clear-cut, easily understood rules must be established and followed. Efficient program operation and understanding may be jeopardized by excessive administrative requirements. Except for minimum restraints, base holders could be permitted to transfer bases among their number or to new producers in whole or in fractional Parts under established rules.

Two among the many alternative procedures for base transfer are discussed.

1. Except for minimum limitations on ownership, producers might transfer bases in whole or in part among themselves. For pooling purposes, this transfer would be accomplished only when registered with the market administrator.

At the end of each year the market administrator would determine total Class I sales including approved reserve. In addition, he would determine shipments of base milk during the year. Class I sales thus determined would be allocated pro-rata over shipments of base milk and new annual bases for each producer would be allocated accordingly. In this way, individual bases would be changed each year by the market administrator to reflect changes in total Class I sales for the market. Increases or decreases would accrue fully to existing base holders.

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New producers could acquire bases by buying them separately or by purchasing a farm with a base.

Individual bases would expand or contract with the Class I market or by transfers among individual producers.

2. A procedure which is less stringent, but which might be adequate in some markets is as follows: For all producers, bases would be recalculated and reassigned each year to reflect recent marketings. A new producer might for example, have one-third of his production considered as approved supply in figuring his base in the first year, two-thirds in the second year, etc. For established producers in any given year, the base percentage could be the proportion that Class I sales plus necessary reserve is of approved supply. To determine the producer base for a given year, this percentage would be applied to his approved supply for the preceding year. No more than one-third of any increase in production of a regular producer in a given year could be considered as an addition to approved supply for purposes of computing a new producer base. Thus, it would take three years for a production increase in one year to receive full credit in figuring producer bases.

As indicated, these base making procedures are set out merely as illustrations of the myriad ways of gearing the supplies of a market to fluid milk demand.- 17/

17/ It is necessary to study the means by which broad and vaguely stated goals are to be achieved under a regulatory system such as fluid milk orders if there is to be full understanding of the basic nature of any proposed program.

While the base-and-excess-pricing system supported by half the committee in this report (the majority was 9 to 8 since the recorded chairman was nonvoting) is put forward in a beguiling fashion as merely

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Under several circumstances producer base plans might usefully be

adopted to solve the twin objectives of bringing local milk supplies into better balance with local market needs and reducing the contribution of

a logical extension of existing practices in order markets (see paragraph 6, Part III), the examples given as to base-and-excess pricing plans plainly visualize restriction of production. The means to accomplish this, as disclosed by description of methods, are by use of what commonly are called "fixed" or "closed" base-and-excess pricing plans. This fact is readily ascertainable from a careful reading of the two examples given. Also, as has been noted in previous footnotes, the proposal is not a "logical extension of existing practices" but is directly contrary in desired effect to existing base and excess pricing practices under milk orders. The position of the U.S. Department of Agriculture in respect to "fixed" or "closed" base and excess plans, such as are recommended by the bare recorded majority in this report, is set forth in a publication entitled Class III Milk in the New York Milkshed: VI--Economic Analysis of Class III Pricing, Marketing Research Report 466, Agricultural Marketing Service, USDA, page 45, as follows:

"Perhaps the best known device to limit total milk supplies is the 'base and surplus' plan with closed base.^{24/} Under this system, a base quantity is established for each producer. Any milk produced and marketed' in excess of this base quantity is designated surplus milk and receives the lowest class price. Base and surplus provisions of Federal marketing orders have been used to provide incentives for limiting seasonal fluctuations in production. The orders have not used closed bases which would tend to limit total quantities of milk produced within a milkshed (and so reduce total volume of pool milk), since the control of production is not permitted under the Marketing Agreement Act. ^{25/}

24/ The effectiveness of such a plan depends upon whether it operates with an open or a closed base. If a new base is earned each year—as in an open-base plan—incentives exist for the expansion rather than contraction of supply. If, on the other hand, the base is set without reference to current production and little opportunity exists for expanding the base through increased production—a closed-base system—the incentive is to restrict production close to the base. In this discussion, reference is made to the closed-base plan quotas.

25/ Agricultural Adjustment Act of 1937 (Public, No. 137-75th Congress--Chap. 296, 1st Session of U.S.C. 674, 50 Stat.249.)"

local surplus to the national milk supply problem. Three problem areas are

described briefly to illustrate how such base plans might contribute to their solution. It should be noted that this grouping of problem areas is not mutually exclusive but is designed to focus attention on different aspects of the general problem.

A. To Avoid Uneconomic Expansion of Market Milk Supplies in Deficit Areas. In a number of markets especially in the South and Southwest local production during the flush season has been adequate for local needs. During the short season milk supplies have been imported from surplus producing areas. Efficient transportation facilities make this feasible at relatively low cost.

In most of these areas conditions of production are such that unit costs are higher than those in surplus areas where production is used primarily in manufactured dairy products. Adoption of new production technology in these deficit areas is leading to expanded output which, in turn, requires new investment in processing facilities to handle seasonal or other surpluses. Because of inadequate volume, surplus handling costs are unnecessarily high and a burden on local producers

. The position of the Department in respect to this matter is much more compelling than exhortative statements contained in this report in justification for recommending adoption of base and excess pricing which statements do not disclose any research findings which would lead to a conclusion contrary to the conclusion of the Department cited above.

From the foregoing, as well as from previous footnotes to the text in this Section 3, Part II, it is obvious that no matter what proponents of this recommended base-and-excess-pricing system call it, it is in fact production control. It is, of course, entirely proper for different people to have different opinions as to programs that should be adopted under Federal milk orders. It is, however, quite inappropriate and quite misleading to recommend a program on the basis that it is not restrictive and that it is not production control when in fact it is. - Otis M. Reed, David A. Clarke

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Appropriately designed producer base plans, could prevent the uneconomic development of such local surpluses and the inefficiently used processing facilities associated with them. In a number of these markets, local

producer groups have petitioned for hearings on base proposals designed to accomplish these purposes. The Department has concluded that base programs which do not permit each producer to earn a base in an unlimited amount each year are not authorized under existing law, unless this interpretation is changed, new legislation will be required to permit their adoption.

B. To Avoid Side Effects of Blend Pricing.

Extended base plans may have an important role in avoiding undesirable effects of blend pricing. Producers receive a blend price which is an average of the class prices weighted by handler or market utilization percentages depending on type of market. The averaging process yields a price which is higher than the price which additional milk contributed to the pool and consequently is a misleading indicator of the value of additional production. Furthermore, each producer knows that even though he does not alter his production, if other producer increase theirs, his share of Class I sales will be reduced. Thus the twin effects of a misleading blend price and the prospect of a reduced proportion of Class I sales through increased production of others reduces the incentive of individual producers to keep supplies in better balance with market needs for fluid milk.

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It has been contended that the marginal costs of milk production are rather low, and even at current surplus prices producers would find incentive to expand output. This may be true. However, this is a matter of degree, and it seems reasonable that the response to the spread between marginal cost and blend price will be greater than to the spread between marginal cost and surplus price. In addition, the uncertainty with respect to share of Class I sales assignable to each established producer is an incentive to produce at a high rate merely to maintain his present share of the market since other producers will be following the same course. In effect, production of surplus milk may be subsidized with the proportion of Class I sales in the blend price.

Use of an appropriate producer base plan would provide clearer guidelines to individual producers. It would give a better indication of market

needs for fluid milk and in addition, would assign to each producer the lower return for that milk produced by him in excess of his share of market needs, and not obscure it in a blended price and spread the cost over the entire market. In short, it would tend to lead producers into more responsible action in respect to market needs.

If it is true that marginal cost of production on the average are lower than surplus prices, a base plan may not actually stop expansion of output in markets where applied. It seems reasonable, however, that this procedure will reduce producer incentives to further growth of surpluses and inasmuch as there is some variation in individual producer costs, some producers will find it unprofitable to expand

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further. In view of the lack of research data on this point, the Committee urges that steps be taken to provide a better basis for decision and possible action.

C. To Avoid Further Expansion of Market Milk in Surplus Markets.

Relatively large surpluses now exist in a number of important Federal order markets, with little prospect of significant reduction in the near future under present circumstances. In the Mid-west, some markets are surrounded by a sea of milk much of which is produced to supply manufactured dairy product markets. Producer conversion from a manufactured milk to a market milk basis is relatively inexpensive and rather quickly accomplished. Under such circumstances, the administrative problems of enforcement would be very difficult. In such markets} it does not seem feasible to consider seriously the adoption of an extended base program to bring market milk supplies into better balance with local market needs .18/

On the other hand, in many areas in the eastern United States, most milk producers are already qualified and associated with Federal order markets. Here little of the additional surplus likely to be forthcoming can arise from new producers. Most of it will arise from expanded production of those already qualified and associated with a fluid milk market.

18/____ This conclusion is not consistent with the rationale of the extended base plan. The plan is designed to reflect to producers, for additional units of milk offered to the market, no higher price than such additional units will contribute to the total pool value. Blend pricing offers a higher return to producers than the additional milk returns to the pool. Base pricing removes this false incentive to provide additional milk and should apply with equal force either to increased production from present producers or to conversion from factory to fluid. "Administrative problems of enforcement" should not override the principle. Gordon C. Lau.gh1 in

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Producers in such markets may wish, as a group, to take steps to bring a better balance between fluid market needs and market supplies through a producer base program. It might be in the public interest to permit them to take this step inasmuch as much of this area is not able to cover costs on a manufacturing milk price basis and administrative problems are not as serious as those discussed above.

It should be noted finally that adoption of producer base plans in Federal order markets will carry significant implication for other provisions of the orders as well as relationships among the several markets. In order to achieve reasonable uniformity among orders as well as administratively workable and effective proposals, the Department should exercise strong leadership in formulating proposals for producer consideration in individual markets. Integration and correlation of base provisions in contiguous or overlapping supply areas poses no more of a problem than working out pool plant qualifications, compensatory payments and other knotty relationships.

Exemption from Regulation

Historically, exemption from regulation has been given to certain handlers, particularly public-owned processors and producer distributors. Little justification exists today for exemption from regulation and only under the most unusual circumstances, should such exemptions be granted.

Note by J. Robert Strain

The committee recommendation for use of extended bases appears directed toward an economic inconsistency common in the Federal order method of

pricing and blending returns to producers. For producers reacting to the blend price for milk can" logically (from the point of view

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of their individual farm firm) allocate resources and make production decisions for additions to production in excess of fluid milk needs. The inconsistency occurs when such increases contribute only a surplus value to the pool but return a blended value to the producer. This inconsistency will exist to one degree or another at any level of classified pricing (other than where Class I price equals surplus price) as long as a standard or requirement exists that nowhere in the Federal order system should there be more than an adequate supply for Class I needs plus necessary reserves. If the blend were expected to reflect total combined demand for both fluid milk and manufactured milk products rather than Class I needs only, the inconsistency would not exist. But this is not the case.

Since I am not in full agreement with the recommendation regarding the use of extended bases, I make the following exception to and reservations about the general committee report.

I find especially objectionable the recommendation that extended bases be initiated on a market-by-market or piecemeal basis. If the development of surplus milk in the Federal order system is deemed serious enough to warrant a program of this type, then the program should be placed before all order producers for a vote and applied, if approved, in all markets simultaneously if it is to be (a) effective as a deterrent to growth rather than a shifter of surpluses in the Federal order market system, (b) consistent with the thought underlying the recommendations on intermarket relations for treating all order producers equitably, no matter what order they are associated with, or (c) administratively feasible to operate a coordinated national system of orders.

I am further concerned about whether or not an extended base program can or will be administered solely for reflecting separately the Class I and excess values of milk to farmers as a guide to their production decisions. I cannot agree with those who argue that further steps toward completely closed production quotas or marketing allotments would inevitably follow. However, I do have serious reservations about the long-run benefits that can accrue to dairymen if the program is administered so as to depart from a prime objective of stability and orderliness toward one of lucrative returns to dairymen. Such a move can be detrimental to the long-run income position of the dairy industry by its effect on foreign and domestic consumption patterns and by its encouragement of further development of dairy product substitutes, while at the same time short-run

benefits are being capitalized into long run costs of production that require a higher price from the consumer to provide dairymen with the same cost-returns problems they had before the departure was made. - J. Robert Strain

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PART II, SECTION 4 INTERMARKET RELATIONSHIPS

The fact that Federal milk orders are issued for particular markets and that to an increasing extent the regulated markets are in close proximity to one another, often with overlapping distribution areas and production areas, inevitably gives rise to serious problems of intermarket relationships. The practice of varying the terms of the orders from market to market, tends to magnify these problems. Such variance is clearly authorized, and perhaps encouraged, by the wording of the Agricultural Marketing Agreement Act.^{1/} But whether the many differences in order provisions applicable to markets in the same region are justified under present conditions seems doubtful. Interorder problems have been accentuated in recent years both by the increasing number of orders and by the great increase in mobility of milk supplies.

Since intermarket problems arise mainly with respect to orders for adjacent markets, adoption of the policies recommended in the foregoing section for enlargement and consolidation of the regulated marketing areas, especially those which constitute parts of metropolitan market complexes, would eliminate much of the difficulty. But there are many other situations in which improved coordination of the provisions of separate orders may be the more practical solution or may be a necessary step.

1/ Section 608c (11) (A), paragraph C

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The intermarket problems with which we are primarily concerned relate to differences in the cost of milk for similar uses to handlers under different orders and to disparities in the returns to producers in adjacent or overlapping production areas who are similarly situated except that their milk is priced and pooled under different orders. ^{2/}

Coordinating Class Prices in the Orders for Adjacent Markets

Prices for Class I milk. The need for coordinating Class I prices under the several orders so that handlers operating under orders for adjacent markets will have substantially the same cost for milk disposed of in fluid form has been generally recognized. On the whole, this principle has been carried out quite well in the administration of the Act.

The cost of obtaining milk for fluid use from plants under other Federal orders has been an important consideration in establishing and adjusting the Class I price for each of the markets under Federal

2/ While I find myself in substantial agreement with much of the statement which follows, I feel it is seriously lacking in several very important respects. My major criticisms are:

(1) although it is recognized that devices such as down classification of other source milk, pool plant shipping requirements, compensatory payments, and nearby differentials may be used in a restrictive fashion and are important elements in the failure to achieve uniformity in prices to producers serving adjacent markets, the statement appears to imply that such devices have not been used in an unacceptable manner and thus merely raises an admonitory finger, all of which could have been accomplished with much less verbiage;

(2) no criteria whatsoever are set forth by which it would be possible to determine when, or the degree to which, such devices are so restrictive as to contribute materially to the failure to arrive at the goal of uniformity in producer prices under adjacent orders. It is my opinion that failure to develop such criteria detracts materially from the usefulness of this report to the Secretary and his aides. - Otis M. Reed

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regulation. In general, such alternative costs have been regarded as the upper limit for the Class I price in any market. This policy has tended to result in a geographic pattern of Class I prices such that the prices rise gradually from a relatively low level in low-cost, high-production-per-capita locations (such as Wisconsin, Minnesota and Iowa) to a much higher level in the high-cost, low-production per-capita areas (such as Southern New England, Florida, and Arizona). In general this geographic pattern of Class I prices under Federal orders is similar to that of dealers' buying prices for fluid milk described and accounted for on the basis of economic principles in a recent study by The

Agricultural Marketing Service, USDA (Marketing Research Report No. 98, 1955).

Class I prices in the orders for adjacent markets when considered on an annual basis have been closely comparable in most instances. Short-run disparities in Class I prices established by Federal orders for markets in the same region sometimes occur because of dissimilar supply-demand adjustments and the use of different seasonal pricing arrangements. In some instances such price disparities have caused serious dislocations. The ease with which milk can now be moved from farms or plants to a number of widely separated markets makes it essential that prices be coordinated monthly and seasonally as well as on an annual basis. This points to the desirability of using similar seasonal pricing arrangements in adjacent orders and to the application of supply-demand adjustments on the basis of data for regional groups of markets rather than on an individual market basis.

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Prices for Milk in non-fluid uses. The need for maintaining as nearly equal costs as possible to competing handlers for products made from surplus milk priced by different orders is generally recognized. But equal costs of products may not result from similar prices for surplus milk under different orders. Plant handling, processing, and transportation cost as well as the raw product cost in different areas must be considered. These costs may differ widely because of unlike conditions of volume utilization existing plant facilities and feeder-plant operation under which surplus milk is marketed in the several regulated areas. Such differences call for considerable diversity of pricing arrangements and make the task of intermarket coordination more difficult. The aim in each case should be to obtain the highest return possible for the surplus milk without imposing an unfair burden upon cooperatives to dispose of milk that other handlers will not take at the fixed minimum prices.

Coordinating Blended or Uniform Prices Paid Producers

The "Attraction" Theory The Department has taken the position that

differences in blended or uniform prices to producers under different orders for adjacent markets are an appropriate or necessary means of attracting transfers of plants and producers from a market with a low Class I utilization to one with a higher utilization. Such shifting of supplies would be expected to bring about within relatively

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short periods substantially similar blended prices under the orders for adjacent markets. Thus relatively narrow ranges of Class I percentages and of blended prices would be expected to exist among the various orders in a region.

Differences in Class I Utilization. There is abundant evidence, however, that present interorder relationships as to utilization patterns and blended prices do not conform to the "attraction theory." As indicated in the following tabulation (Table 3) utilization patterns differ widely among the orders in some regions. The range of Class I percentages (for the year 1960) was greatest among the Federal orders in the Northeast region and in the Illinois-Iowa-Wisconsin-Minnesota region, in which Chicago is the principal market.

Table 3 . Percentages of pooled milk utilized in Class I under Federal orders in selected regions of the United States, 1960

Region	Number of orders	Class I percentage (weighted average)		
		Lowest		Highest
Difference				
Northeast	10	52	91 (79)*	39 (27)*
Ohio River Basin	11	66	90	24
Michigan-Ohio-Indiana	11	63	83 (79)*	20 (16)*
Illinois-Iowa-Wisconsin-Minnesota	14	45	89 (79)*	44 (34)*
Kansas-Missouri-Nebraska	9	62	84	22
Lower Mississippi Basin	7	89	19	
Texas-Oklahoma	9	73	93 (87)*	20 (14)*

()* With data for handler pool markets excluded.

Source: Derived from data compiled by the Milk Marketing Orders Division, Agricultural Stabilization and Conservation Service, U. S. Department of Agriculture. Several orders that did not lend themselves to regional grouping were excluded from the tabulation.

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In the Northeast region, for example, the percentage of pooled milk used in Class I for the year 1960 averaged 52 percent for New York-New Jersey, 58 percent for Boston, 79 percent for Connecticut and 91 percent for Wilmington. In the Illinois-Iowa-Wisconsin-Minnesota region, the Class I percentages during 1960 averaged 45 percent for Chicago, 53 percent for Duluth-Superior, 79 percent for Milwaukee and Des Moines, 87 percent for Rockford-Freeport, and 89 percent for North Central Iowa. The Class I percentages for other Federal order markets in each of these regions ranged between the extremes indicated.

In four of the seven regions for which the Class I percentages are shown in the table, the highest percentage pertains to markets with individual handler pooling. With such markets excluded, the ranges are somewhat smaller.

It is true that some of the orders with high Class I percentages are relatively new and that differences in utilization may be reduced as time passes. Such adjustments seem to be taking place slowly, however, and it appears that substantial differences may persist indefinitely unless remedial action is taken.

Logically, the percentages of pooled milk used in Class I should vary from a relatively low level under the orders for the high-production, low-price areas of the North Central region to very high rates in dairy deficit, high-price areas such as Florida, Louisiana, Texas and Arizona.

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Where Class I prices are only slightly higher than the manufacturing value of milk, the market order pools should include sufficient quantities of milk to fulfill all fluid sales requirements together with adequate reserves. If somewhat more milk is included in such pools than is currently required, it will

have comparatively small effect upon the blended returns to producers. In fact, some extra reserves in market order pools for low-price markets should logically be needed from time to time to supplement the regular supplies of markets in the high-cost dairy-deficit areas.

In general, producers in the high-cost, dairy-deficit areas, such as Florida, Louisiana, Texas and Arizona, cannot afford to produce large quantities of milk for manufacture. Milk allocated to such use in the high-cost areas brings little more than is paid by manufacturing plants in the low-cost areas of the North Central states. Consequently, it seems to be a matter of economic good sense that milk supplies under market orders in the high-cost areas be kept in close adjustment to the fluid sales. Economic logic regarding the most efficient use of the nation's resources suggests that these areas should depend on other areas with lower production costs to provide the needed reserves and to supplement the local supplies whenever the latter become inadequate.

This analysis suggests a geographic pattern of "normal" Class I utilization percentages corresponding rather closely to the geographic pattern of Class I prices heretofore described (see pages 1 through '4 of this section). Thus, under present circumstances, the normal Class I

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percentages under orders for markets in the North Central states, on an annual basis, might range between 45 and 60 while in the dairy deficit, high-cost areas about 80 to 95 percent of the pool milk should be used in Class I. If the recent trend toward inclusion under Federal milk orders of a larger and larger part of the milk that is used for production of manufactured milk products should continue, however, this milk should appear in market areas best suited to dairying as a farm enterprise. The high cost areas should continue to be deficit areas with 80 to 95 percent annual Class I utilization but specialized dairy areas under these circumstances would have a lower utilization than was previously mentioned. Ordinarily, however, there should be no more than a few points difference in the Class I percentages under the orders for adjacent marketing areas. Greater differences should be recognized as evidence of barriers to orderly transfers of

milk supplies from the lower utilization pools to the higher ones.

Disparities in blended prices. Since the minimum class prices are, in general, appropriately coordinated in the various orders the wide differences in utilization that exist among adjacent Federal order markets result in substantially different prices to producers who are similarly situated except that their milk is priced and pooled under different orders. In other words the burden of caring for approved milk supplies in excess of the quantities that could be disposed of in fluid sales has been allocated disproportionately to the producers associated with certain of the orders.

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The disparities in blended prices have in some instances been much greater than would ordinarily be needed to induce transfers of milk from the lower utilization orders to the higher. They have caused unfair and disruptive competition among cooperatives and other handlers whose milk is pooled under different orders.

In some instances, for example, high blended prices established under high-utilization orders have enabled the handlers under such orders to attract producers away from cooperatives and other handlers under adjacent lower-utilization orders, while the latter were prevented from competing in those markets and from getting their milk into the higher utilization pools. Thus plant volumes of cooperatives and other handlers under the low-utilization orders have been depleted and cooperative memberships disrupted by unfair competition resulting from discriminatory regulations.

While such differences in blended returns can produce transfers of supplies, the transfer may be disorderly or disruptive and not necessarily the most economical one that could or should occur. For plant volumes of cooperatives and other handlers under the low utilization orders can be depleted and cooperative membership disrupted by unfair competition resulting from discriminatory regulations preventing the plant as a unit from competing in those markets. Furthermore, even when these types of transfers do occur there is no incentive for them to continue in sufficient quantity to equalize blends or remove

the threat of future disruptive and unfair competition once the immediate Class I needs plus reserves have been obtained by the receiving market

II-4-10

Utilization patterns and blended prices in adjacent Federal order markets have not been brought into proper alignment by the normal shifting of milk supplies for two reasons. namely:

1. There have been obstacles to the shifting of milk supplies from one Federal order pool to another which have prevented the utilization patterns and blended prices of adjacent markets from approaching a common level even when the price disparities have been so great as to cause disruptive competition between the handlers for milk supplies.
2. Ordinarily there is no incentive for handlers in a market with relatively high Class I utilization to bring into their pool any milk beyond what is currently needed to cover their fluid sales requirements including a normal reserve. even though a neighboring market may have a much lower fluid utilization. Thus the difference in uniform prices established by different orders in a region does not adequately serve the purpose of spreading the surplus burden equitably among all producers when there is a larger supply in the area than is currently needed.

It is essential that we examine in some detail the order provisions and other factors which may constitute obstacles or barriers to orderly transfers of milk supplies from one market order pool to another in response to differences in producer prices.

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Obstacles to Interorder Transfers of Milk Supplies

Among the order provisions and other factors that have interfered with normal adjustment of utilization patterns and uniform producer prices through orderly transfers of milk supplies from one market order pool to another are the

following: individual handler pooling, pooling requirements, assignment of other source milk to lower classes, compensatory payments, special location differentials to "nearby" producers, sanitary regulations and other institutional factors.

As will be pointed out in the following discussion, each of these order provisions and other factors may serve a useful purpose and be administered in the public interest. On the other hand, each one may be used and in certain instances has been used, to obtain unwarranted advantages for certain groups at the expense of others.

Notice should be taken of the fact that the Agricultural Marketing Agreement Act as interpreted by the courts does not prohibit order provisions which tend to limit the access of milk supplies to regulated marketing areas. The phrase "in any manner limit" which appears in Section bOBc (5) (G) of the Act pertains to products of milk but not to milk itself. Nevertheless, this Committee does not believe it was the intent of Congress to authorize or to encourage unreasonable or discriminatory restrictions on the entry of additional plants or producers to the market pools established by Federal milk orders.

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Individual handler pooling. Under certain conditions individual handler pooling may be preferable to market-wide pooling, but for reasons that will be cited here its place in the Federal milk order system should be a very limited one.

Individual handler pooling is an effective means of insuring high fluid utilization in a particular market. It involves less infringement of free enterprise than market-wide pooling, but by the same token it fails to provide market security for individual producers to the extent that market-wide pooling does.

Even though market-wide pooling has certain disadvantages, this method of distributing payments to producers is an essential feature of the regulatory program for most Federal order markets. Where substantial quantities of milk are handled by operating cooperatives or by producer-handlers, or where there are relatively large surpluses of milk unevenly distributed among the handlers, it would be practically impossible to maintain orderly marketing without market-

wide equalization, unless the Class I price were kept so low as to make the regulation ineffective. The minimum Class I prices fixed by an order mean little to an operating cooperative or to a producer-handler unless these handlers are required to equalize through a producer settlement fund.

Individual handler pooling and market-wide pooling in the orders for adjacent or competing markets are incompatible for two reasons: first, because individual handler pooling tends to cause handlers to

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restrict their purchases of milk and to throw a disproportionate burden of maintaining regional reserves upon neighboring market pool orders; and second, because operating cooperatives under orders with individual handler pools have an economic incentive to move their surpluses into other markets at cut prices.

Only by keeping his milk supply closely adjusted to his fluid sales can a handler under an order with individual-handler pooling place himself in an advantageous position from the standpoint of procurement. If he fails to maintain a high Class I utilization which permits him to pay attractive blended prices, he will find competitors picking off his more desirable producers. The high Class I utilization and high blended returns are, of course, beneficial to the producers who are fortunate enough to participate in them. But this system usually reacts unfavorably upon the producers whose milk is priced and pooled by other orders in the same region.

Practically without exception, individual handler pools have failed to absorb their proportionate shares of the reserve supplies of market milk in the regional areas where they are used. A comparison of Class I percentages for the 14 handler pool orders and the market pool orders nearest to each of them for the year 1960 reveals the following: the simple average of Class I percentages for the handler pool orders was 84.5 percent; the comparable average for 25 adjacent market pool orders was 67.3 percent.

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It is clear that individual handler pooling has a strong tendency to

prevent desirable utilization adjustments among Federal order markets and to maintain unwarranted disparities in the blended producer prices established by the two types of orders.

As indicated previously, individual handler pooling in markets where substantial quantities of milk are handled by cooperative associations may generate unfair competition not only in the markets to which this system applies, but also in others. 3/ Since cooperatives are allowed to pay members the net proceeds of their operations, they have a strong incentive under individual handler pooling to dispose of surpluses in outlets that will yield more than the surplus value. This usually means sales for fluid use in outside markets at cut prices.. 4/

3/ The concept of "unfair" competition as here used should be set forth more fully. Apparently, the term is not used to mean that handlers sell at less than order prices. Rather the reference seems to be to "unfair competition" in that individual handler pool operators do not carry a large surplus. This is "bad", even though the total market surplus in the entire area may be far in excess of that which is necessary. It would seem that the Committee's position should be first, to make certain that the area's surplus is reasonable before trying to force others to increase their surpluses. - Edwin W. Gaumnitz.

4/ Cooperative associations, by law; and with membership approval, can distribute proceeds from the sale of milk among their own members, or retain money for capital purposes without regard to the minimum price provisions of Federal milk marketing orders. Nevertheless, they cannot sell milk to handlers at less than the order class prices and they must account to the pool at full class prices in the same manner as other handlers. A high percentage of cooperative associations are so-called operating cooperatives that have supported the Federal milk marketing order program and although there may be isolated instances where an individual cooperative has sold milk at prices that reflected less than the Class I price, such practice is the exception. I cannot agree with the statement, "This usually means sales for fluid use in outside markets at cut prices". Judson P. Mason

which is accorded the privilege of blending the proceeds of all its sales shall not sell milk or its products to any handler in the market for less than the minimum class prices specified in an order. In practice, however, this requirement has not prevented cooperatives under orders with individual handler pools from selling milk for less than the minimum class prices plus handling, processing and transportation expenses.

Because of the unfavorable effects indicated, the Committee believes that individual handler pooling should be provided for in Federal orders only in special cases where it can be shown that there is a compelling reason and that no serious discrimination against producers or handlers whose milk is priced and pooled by other orders will result.

Requirements for pooling. Each Federal order must contain provisions for identifying the plants and producers whose milk is to be priced and pooled. In handler pool orders the rules for determining coverage are necessary primarily to determine the supervisory and enforcement jurisdiction of the government. In market pool orders such rules are also essential as a basis for computing the uniform price and the necessary adjustments between handlers.

A great variety and complexity of rules for determining the eligibility for pooling of milk supplies from different handlers, plants, and producers is found in the various orders. To some extent,

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such complex systems of pooling requirements are necessitated by the wide variety of conditions to which the orders must be accommodated. It is by no means adequate to provide that handlers, plants, and producers that supply milk to the particular market regularly and no others are to be eligible for pooling. Nevertheless, the Committee believes that all legitimate purposes could be served by more simple and more nearly uniform pooling requirements. 5/

The principle most generally followed in the qualification of supply plants is that pooling eligibility should be determined by actually shipping milk into the market. Thus many orders identify supply plants for pooling in the season of low production on the basis of shipping specified minimum

percentages of their receipts to the market. The shipping requirements for pooling in the season of flush production are usually lower or non-existent for supply plants that were qualified for pooling in the preceding season of low production. It may also be required that the milk from a supply plant be received at a distributing plant which utilized at least half (or other specified part) of its receipts in Class I.

But shipping requirements alone are not an adequate standard for determining the pool status of a given milk supply in all cases. Maintaining stringent performance standards that were satisfactory

5/ In this part of the report the question of plant qualification is raised. Aside from the overall statement, attention is directed to this, page where it is noted that" . . it may also be required. . . Here is recognition that plant classification requirements are exclusionary devices at least under some orders. However, no criteria are suggested. Certainly) it would be reasonable to require that advocates of the use of such devices set up such criteria and request that the department also set up criteria---Edwin W. Gaumnitz

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at one time for a given market on the grounds that there is already more than an adequate supply of milk associated with that market can, over time, as surplus builds, create severe economic problems. Uneconomic movements of milk may be required in order to continue to qualify for the pool. This may result in the shipment of milk with no handling charges or in the necessity for granting other inducements to find handlers willing to take the milk and thus qualify the supply for pooling. But the only alternative for such supplies may be the even more disruptive status of milk without a market or at least without a share of a Class I outlet. Therefore, where the quantity of approved milk available to the market is substantially greater than can be disposed of in fluid sales, it may be necessary to the maintenance of orderly marketing and is likely to be more economical and efficient to have the currently unneeded portion disposed of direct to specialized manufacturing plants.

It goes without saying, however, that only plants which have established eligibility for pooling by past service to the market and whose supplies would be available when needed, as under a call milk provision, should be accorded the

privilege of pool participation without current shipments.

In accordance with this second principle, some orders name the pool plants or provide for their designation under certain prescribed conditions of historical association by shipment or health approval and, in some instances, geographical location. The New York-New Jersey

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order provides for two categories of pool plants, one being the historically associated plants, subject to a call milk provision, and the other, temporary pool plants which must establish eligibility by meeting specified shipping requirements. The call milk provision authorizes the Market Administrator to determine and announce under certain conditions minimum percentages of the milk received from producers to be supplied by each handler for fluid use during a two-month period (when a shortage occurs or appears imminent). Failure to comply with the requirement thus invoked may result in cancellation of a plant's designation as a regular or permanent pool plant. It should be noted that shipping requirements established under the call milk provision may be more exacting and effective than the usual shipping requirements specified in Federal milk orders, whose purpose is merely to identify the plants that are eligible to participate in the pool.

While the incidence of regulation under a Federal order falls directly on the handlers receiving the milk, participation in the pools by producers also is determined indirectly by provisions relating to assignment of classification, and diversion privileges. Such provisions differentiate the milk of producers on the basis of season of entry into the market and previous association with it. Again there are many variations and combinations of these rules.

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The privilege of participating in market-wide pools must be limited to some degree to prevent unfair advantage being gained by handlers and producer groups that have established no proper claim to participation and to protect the market from disruption through occasional dumping by outside shippers. On the

other hand, pooling requirements such as those heretofore mentioned and other rules to insure orderly transfers of milk from one market order pool to another sometimes become unduly restrictive. In some instances, although each of the specified requirements for pooling appears reasonable, the combined effect of the several pooling requirements, other order provisions, and sanitary regulations, is to limit severely access to the pools.

Tight entry rules for both plants and producers are used in some of the smaller federally regulated markets that are associated with or are adjacent to metropolitan market complexes, to exclude milk supplies that are readily available but not presently needed in the market. Like individual handler pooling, such rules are designed to maintain a preferred position for the producers directly associated with the particular markets to which they apply. They account in part for the failure of utilization patterns under adjacent Federal orders to become adjusted toward a common level. 6/

6/ This is certainly clear recognition that under at least some orders "tight entry" provisions definitely have exclusionary purposes. This statement should be noted in conjunction with the conclusion under Section 1, "The Classified Pricing System" (page II-1-21) where it is noted that Class I prices over condensery prices have increased markedly and that surpluses have developed in most markets---Edwin W. Gamnitz

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Assignment of other source milk to lower classes. In practically every Federal order marketing area some milk is sold which is not required to be priced fully and pooled under that order. Such milk may come from a handler or plant that is subject to regulation by another Federal order, or from an unregulated source. In either case there must be a provision in the order to determine how this outside milk is to be classified at the plant of the receiving handler, since this will affect the classification and pricing of the milk he receives from regular pool producers.

In general, the allocation provisions of Federal orders are designed to insure that pooled milk received from local producers will be classified in the higher classes ahead of other source milk. This purpose is accomplished by

requiring that the outside milk be allocated to the lower classes by the handler ahead of his producer milk, with certain exceptions.

Under most orders milk from an unregulated source must be assigned by the receiving handler to the lowest class to the extent that his utilization in that class will accommodate it. The remaining quantity, if any, is allocated to the next higher class or classes in step-like fashion. An exception is that the handler's shrinkage and in some instances a specified additional percentage of producer milk (from 5 to 15 percent) is assigned to the lowest class prior to the assignment of other source milk.

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Milk received from a handler or plant under another Federal order is usually treated in the same manner as milk from unregulated sources, but is given preference over such milk in assignment classification at the plant of the receiving handler. Moreover, under the orders for some markets, which are increasing in number, packaged milk from another Federal order market is given preference over all other milk in assignment to Class I by the receiving plant.

The customary requirement (subject to the exceptions indicated) that handlers in a Federal order market assign other source milk to their lowest use classes is based on the theory that local producers, who supply the market regularly, should be protected from the competition of occasional or irregular suppliers. Such protection appears to be essential to the maintenance of orderly marketing. Here again, however, is a type of order provision that may, if abused, constitute an unreasonable trade barrier and an obstacle to orderly adjustments among the Federal order markets.

Under the usual method of classifying outside milk, a handler can afford to buy such milk only when it can be obtained at a surplus price or when practically his entire supply is used in fluid sales. At this point a conflict of order provisions for classifying milk that moves from one Federal order market to another must be noted. "A handler who buys milk from producers under a Federal order and moves the milk to an outside market for fluid use (or in some cases

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for any use) is usually required to account for it as Class I. Consequently when he sells the milk to a handler in another market, he must as a practical matter charge the Class I price plus an additional amount for handling. (A handler under an order with individual handler pooling might be an exception to this.) But if the second handler is required to account for such milk in a lower class he cannot afford to buy it.

The Committee believes that unregulated other source milk should be assigned first to the lowest classification under an order. In turn, a more liberal and more flexible policy should be followed with respect to classification of milk transferred from one order with a market-wide pool to another. In general, transfers of milk should be treated generously when the movement is from a Federal order market with low Class I use to one with high Class I use for fluid disposition in the latter market. Conversely, transfers from a Federal order market with high Class I use to a market with low Class I use should in general be classified and priced as surplus milk.

Compensatory payments. It is impractical to require handlers who dispose of only small percentages of their receipts for fluid use in a Federal order market to be fully regulated by the order, although some handlers of this type are so regulated. As an alternative to complete pricing and pooling of the milk received by such handlers, other devices are used to insure that their participation in the

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Federal order market does not result in unfair competition or disruption of orderly marketing to the disadvantage of regular pool producers. The provisions for classification of other source milk discussed in the foregoing paragraphs of this statement are one of the means used for this purpose, but this device alone is not adequate. The requirement that other source milk be assigned by the receiving handler to his lowest-use classes, for example, has no effect if the

handler's total receipts are utilized in Class I.

Compensatory payments are sums of money paid into the producer settlement fund of a market pool order by handlers who receive milk from unregulated sources, or in some instances from plants whose milk is priced and pooled under other Federal orders. There is no occasion to require such payments on milk from unregulated handlers which enters Federal order markets with individual handler pools.

A common situation which calls for the use of compensatory payments is the one in which a handler whose business is mainly outside a Federal order market has some route sales within the regulated area. The required payments, except as noted later, apply only to that portion of the handler's receipts which is disposed of as fluid sales in the Federal order marketing area.

Another situation in which the need for compensatory payments arises is the one in which a handler under a market pool order receives milk from a plant not regulated by that order, and disposes

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of such milk for fluid use. If the milk received from producers at the outside plant is not fully priced and pooled by another Federal order the regulated handler who receives it will usually be required to make a compensatory payment. If the outside milk is priced and pooled under another Federal order, it may still be subject to compensatory payments in certain instances.

Compensatory payments or some equivalent device are especially needed with respect to milk that moves from a market with individual handler pooling to a Federal order market with market-wide pooling, to protect the integrity of the pool.

The Agricultural Marketing Agreement Act does not specifically authorize compensatory payments in Federal orders. Such payments have been provided for administratively in accordance with Section 3(c) (7) (D) of the Act which authorizes the Secretary to include in Federal orders terms and conditions incidental to and not inconsistent with the specifically authorized terms, and necessary to effectuate the other order provisions. It is clear that the general

purpose of compensatory payments is to protect the integrity of the pricing and pooling provisions of a Federal order so that regulated milk will not be subject to displacement from Class I use by unregulated milk which may be available at a lower price.

There has been a considerable amount of litigation concerning compensatory payments. The Federal courts that have passed on the

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matter have taken different views concerning the validity of the required payments. In 1952, the U. S. Circuit Court of Appeals, Second Circuit (Kass vs. Brannan), ruled that the required payments violated Section 608c (5) (A) of the Act which provides that prices fixed by the orders shall be uniform to all handlers. More recently, the U. S. Circuit Court of Appeals, Third Circuit (U. S. vs. Lehigh Valley, 1961), concluded that the primary purpose of the payments is to compensate the producers whose milk is displaced from Class I use, and that the requirement of equal prices does not apply as between handlers who are fully regulated under an order and other handlers. The latter decision is now on appeal to the U. S. Supreme Court.

The appropriate method of computing the payments depends somewhat upon the specific purpose intended. For example, if the payments are intended to equalize the cost of regulated and unregulated milk for fluid use, then the amount of payment should be the difference between the class price under the order and the handler's cost for the outside milk used in fluid sales. If the payments are intended to compensate producers for loss of income caused by displacement of their milk from fluid use, then the appropriate payment would be the difference between the Class I price and the surplus price. In some cases either method would give the same result; in others, computations made in accordance with the equal-cost concept would result in somewhat smaller payments.

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With respect to milk received by a regulated handler from an unregulated

source and assigned to Class I, the most common procedure is to compute the compensatory payment as the difference between the Class I price and the surplus price. Under many of the orders, however, the rate of payment in months outside the season of flush production (or when the Class I percentage for the market is relatively high) is the difference between the Class I price and the uniform price. Under most orders provision is made for computing the rate of compensatory payment on the basis of class prices or uniform prices adjusted for location and butterfat, as appropriate to the other source milk.

In the case of milk sold on routes within the marketing area by an unregulated handler, many of the orders provide that the compensatory payment may be calculated either by the method outlined in the foregoing paragraph or as follows:

The difference between the total amount paid by the unregulated handler to his producers and the amount he would have been required to pay for his milk if fully regulated by the order.

This latter method of computation, commonly known as the "Wichita Plan", is objectionable because in effect it sets up an individual handler pool for the unregulated handler, while the

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fully regulated handlers with whom he is competing are required to equalize. , 7/ If the unregulated handler has a higher Class I utilization than the average for the market his producers will fail to bear a proper share of the burden of maintaining the reserve supply.

Compensatory payments based on the difference between the Class I price and the surplus price as applied to unregulated handlers, other than fringe area handlers who have route sales in the regulated area, cannot be regarded as unreasonable, provided that such handlers are given the alternative of becoming fully regulated under the order by meeting requirements that are not unduly restrictive.

How to treat the route sales of unregulated fringe area handlers reasonably, without giving such handlers and their producers an unfair

competitive advantage, is a difficult problem. One way out which would seem preferable to the Wichita Plan, where the unregulated handler cannot be fully regulated, is to compute the amount of compensatory payment on his route sales in the area as the difference between the Class I price and the uniform price, so long as the daily quantity involved does not exceed the daily volume of such sales by the handler during a specified period before the initial date of the

7/ The Conunittee is informed that the "Wichita Plann is not authorized in situations where the unregulated handlers are found to be buying milk in competition with the handlers fully regulated by the order. But difficulties arise when these conditions change.

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order; any increase in such sales would be subject to the usual charge, namely, the difference between the Class I price and the surplus price. Under several of the present orders 300 quarts or 600 pounds of route sales per day are exempted from compensatory payments. Such exemptions would not be necessary or desirable if the suggested base plan were used.

It appears logical that compensatory payments should not be required at times when the market involved has a very high Class I utilization, indicating the need for additional supplies and this policy is generally followed under present orders.

The use of compensatory payments with respect to milk transferred from one Federal order market to another raises somewhat different questions. It has been said that if pricing and other provisions of the various orders are properly coordinated and aligned, transfers of milk from one Federal order market to another should involve no unfair competition or disorderly marketing. The problem is that such coordination and alignment as this statement contemplates do. not presently exist and may never be fully attained. So long as there are individual handler pools in competition with market-wide pools, for example, there will be need for compensatory payments or some equally effective device to prevent unfair and disruptive competition between handlers under the two types of orders and to protect producers under the market-wide

pools from unfair displacement of their milk from Class I use.

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A handler whose milk is priced by a handler pool order may under certain conditions have an incentive to sell fluid milk in another market at less than the full cost as a means of raising his blended returns to producers.

This problem has been a serious one in some situations where market-wide premiums were paid by handlers and where class prices higher than the Federal order prices were established by state agencies. It may also occur in a situation where a handler finds himself with a relatively low Class I utilization and unable to hold his producers at the low blended prices resulting therefrom.

This type of unfair interorder competition is more likely to originate with an operating cooperative (under individual handler pooling) than with a proprietary handler, since cooperatives are not subject to effective price regulation unless they are required to equalize. If such a cooperative, subject to a handler pool order, can dispose of any part of its surplus at a price greater than surplus value, its net returns to members will be increased to that extent.

Thus, cooperative handlers in handler pool markets sometimes have a strong incentive to offer milk for fluid use in outside markets for less than their Class I price plus handling and transportation costs. On the other hand, when cooperatives in a market-wide pool dispose of any part of their surplus at a price less than the Class I price plus handling and transportation costs, they are required to share these sales with the rest of the market through equalization payments based on the full class Prices.

II-4.-30

With respect to milk that moves from a market under a market pool order to another such market, compensatory payments may be a convenient means of correcting for disparities in class prices which arise from dissimilar formula provisions, differences in seasonal pricing arrangements, and differences in supply-demand relationships so long as they are permitted to continue. They

are also a convenient device for assigning outside milk to the surplus of the market to which it moves regardless of the use of such milk by the receiving handler, in cases where the allocation provisions do not accomplish this purpose. 8/

The Committee believes, however, that if its recommendations for consolidation and expansion of orders and for coordinating order provisions to a greater extent are carried out, compensatory payments on interorder transfers of milk will be needed in fewer instances. Consolidating the separate orders for different parts of metropolitan market complexes (and eliminating individual handler pools) under market-wide pools would go far toward reducing the need for compensatory

8/ The reasonable purposes of the use of compensatory payments is well stated. The report implies, though it does not clearly state, that compensatory payments are one of the devices which can be used for exclusionary purposes. That this device, plus others, are used for the purpose of protecting or bolstering Class I prices which are arbitrarily high is clearly indicated by the fact that Class I prices have been and are artificially high with reference to manufacturing milk prices by fifty to seventy-five cents per hundredweight.

A side effect of such a differential for Class I prices would be a reduction in fluid milk sales close to two billion pounds of milk.

The report is lacking in not setting forth clear criteria for the level of such payments--Edwin W. Gaumnitz.

11-4-31

payments on interorder transfers. Closer coordination of seasonal pricing arrangements under different orders and application of both seasonal pricing and supply-demand adjustments on a regional basis would also be significant moves in that direction.

Until such desirable adjustments are accomplished, compensatory payments as applied to both unregulated milk and milk from other Federal orders will continue to be a useful device for the promotion of fair competition and orderly marketing. where properly used, in conjunction with reasonable

requirements for pooling, compensatory payments do not constitute an objectionable trade barrier. 9/

9/ This footnote, although attached to the closing paragraph, is intended to apply to the entire statement on compensatory payments and to convey a more balanced treatment of the matter. In addition to lack of balance and objectivity, the statement is weak indeed in that it carries no evidence of the degree to which such payments have or have not been restrictive, and furnishes no criteria whatsoever as to the level of such payments and method of application which would "not constitute an objectionable trade barrier";

Compensatory payments, in essence, may be described as price barriers, in lieu of any more precisely descriptive term. It is to be noted that the Act specifically permits a "price" barrier to new producers, in that orders may provide that a new producer receive the surplus price in the order for 60 days following his first full month on the market, and after this period he is treated the same as other established producers.

Compensatory payment provisions, however, apply to a handler, and through him to his producers, for the entire time he does not meet the pool plant requirements, thus going far beyond the treatment specifically authorized for new producers by the Act.

The question is not as to the necessity of such regulation but whether the method used (a) meets the requirements of the Act, in respect to uniformity in prices to handlers for milk used

11-4-32

Special location differentials to "nearby producers." Under the Federal orders for the smaller markets which are supplied entirely or almost entirely by direct delivery of milk from the farms, the milk is

in the same class, (b) restricts entry to an unacceptable degree, and (c) does or does not result in discrimination between milk producers.

(a) The Act provides for the classification according to use made of it by handlers, and fixing or providing a method for fixing the price paid by handlers for milk in each use class. It further provides shall be uniform as between handlers.

Compensatory payments should, therefore, assure that the handler pays the same price for "outside" milk used in Class I as he pays for producer milk used in Class I. If he does, the "uniformity" requirement is met, and any objections to compensatory payments must rest upon other grounds.

The price which the handler will pay for "outside" milk will be exactly equivalent to the price of Class I milk fixed under the order only if the procurement cost of the outside milk plus the compensatory payment exactly equals the Class I order price. It actually may be more or it may be less. If more, then the compensatory payment acts as a barrier to entry. If less, then the handler purchasing outside milk has a competitive advantage.

Whether the test of uniformity is met is not subject to generalization. It depends upon the facts surrounding each transaction involved. The only generalization that can be made is that the methods used in computing the compensatory payments do not assure uniformity of class pricing to handlers, and therefore do not assure conformity with Section 8c (5)(A) of the Marketing Agreement Act. (b) whether compensatory payment provisions restrict entry to an unacceptable degree depends upon the point of view of the reviewer, on the one hand, and, in terms of the Act, whether the provisions restrict entry to a degree inconsistent with the supply-demand criteria.

Those who desire to use restrictive devices to limit entry as a tool of price and income enhancement will approve this

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priced at the market and deductions are made by the handlers for the expense of hauling. For markets such as Boston, New York-New Jersey, Philadelphia and Chicago, however, part of the supply is obtained through country plants; allowances are specified for transportation and in some cases for country plant operation. The transportation allowances are graduated according to distance from the market approximately in line with the costs involved. Such differentials usually present no serious problems of intermarket relations.

In addition to the zone differentials, however, the Federal orders for several markets (Boston, Springfield, Worcester, Southeast New England, Connecticut, New York-New Jersey and to a limited extent

feature of compensatory payments. Those who do not believe it proper under

the Act to limit entry will disagree.

(c) Aside from limitation of entry, the most serious question is whether there is discrimination among producers, i.e., "established" producers as defined, and others.

Producers who can find an outlet with a fully regulated handler are entitled to share in the pool. Those who do not have such an outlet, no matter how capable and otherwise desirable as suppliers of the market they may be, are denied the benefits of sharing in the pool. The use value of their milk as marketed by the handler with whom they are associated, is siphoned off and given in its entirety to pool producers. Judged in this context, compensatory payments clearly discriminate among milk producers. They "compensate" established producers for loss of Class I sales, deny non-established producers any benefit which otherwise might have accrued to them from the sales of their handler, and thus rather completely shelter established producers from competition.

While it is granted that all milk entering a market should be regulated, this should be accomplished in a manner that will not amount to discrimination between producers. -----Otie M. Reed

II-4-34

Chicago) provide for the payment of differentials out of pool funds to producers located in specified counties, townships or zones near the principal market.

Precedents for nearby differentials were established during the period of collective bargaining before there were any Federal orders. Various advantages have been claimed for nearby milk from the viewpoint of handlers -- such as more desirable seasonality, earlier and more dependable arrival at city plants, easier and more economical supervision of producers and quality and the possibility of direct hauling from the farms thereby saving the expense of country plant operation. However, the major purpose of nearby differentials apparently has been to compensate nearby producers for sharing market Class I sales with more distant producers in a market-wide pool. This principle seemingly was founded on the belief that in the absence of regulation, a higher percentage of nearby milk would be sold for fluid use.

Producers in areas with a long history of nearby differentials have based their production decisions on them and capitalized their value into land and

facilities. Consequently the differential payments are no doubt regarded by the participants as valuable 'market rights'.

On the other hand, the manner in which nearby differentials are applied has a decided impact on intermarket relationships. Their use and effect may need careful re-examination in light of present conditions of increased mobility of milk supplies. For the payment

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of special nearby differentials out of pool funds depresses the uniform price to producers outside the differential zones and thus tends to limit the extent of the supply area and maintain a higher fluid utilization under an order than would otherwise prevail. At the present time, this effect is so small in some instances as to be negligible. In others, it is very significant.

Under the Boston order, nearby differentials are paid on only about 6 percent of the pooled milk and the uniform price is depressed less than 3 cents - per hundredweight by these payments. Under the New York-New Jersey order, slightly less than 20 percent of the pooled milk qualifies for the nearby differentials and the uniform price is depressed about 6 cents per hundredweight.

On the other hand, under the Federal orders for Worcester, Springfield, Southeast New England and Connecticut, nearby differentials are paid on 65 percent to more than 90 percent of the pooled milk and uniform prices are depressed from about 30 cents to more than 40 cents per hundredweight. In 1960, 90 percent of the pooled milk under the Connecticut order qualified for the 46 cent differential, and 3 percent for the 23 cent differential. The total amount paid in nearby location differentials was equivalent to 43 cents per hundred pounds of all pooled milk and the uniform price to producers outside the differential zones was depressed to that extent.

Thus, the attraction of the high blended price resulting from a high Class I utilization under the order is substantially reduced with respect to producers in the outlying areas.

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In circumstances where a high percentage of milk qualifies for the nearby differentials the producers who participate derive little net gain except for the pool tightening effect of the lower blended returns in the outer zones. Thus, order provisions for nearby differentials of this magnitude can and do effectively limit access to the pools.

To accomplish both recognition of historical patterns in the distribution of funds, and at the same time to minimize the pool tightening effect of an arbitrary nature, nearby differentials could be maintained but varied inversely with the percentage of pooled milk used in Class I. Thus, the rate would be very low or possibly zero when a high percentage of the pooled milk was used in Class I and relatively high when fluid utilization falls to a low level. Such a procedure would tend to modify somewhat the effect of decreased utilization on the prices of nearby producers, and thus protect to some degree their prior market rights and their capitalization of these rights into land values by giving them the advantage of a priority on the share of the receipts from the pool. In other words, their blends would be more stable and fluctuate less widely as Class I utilization increased or decreased. At the same time the access-limiting effect of nearby differentials would be more flexible and would vary according to the utilization in the markets. With low utilization the blend price depressing effects of nearby differentials would be greater and the barrier to additional producers' supplies would be stronger than when the opposite was the case.

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This principle is recognized in the provisions for nearby differentials under the present New York-New Jersey order, but not under the other orders which provide for such payments. In fact, the specified rates of nearby differentials are the same under all Federal orders for New England markets (46 cents in the nearby area and 23 cents in the intermediate area) even though the percentages of pooled milk used in Class I differ widely. In 1960, the range of Class I percentages was from 58 percent in Boston to 79 percent in Connecticut.

Sanitary Regulations. When the system of Federal milk orders was

inaugurated, lists of plants and producers approved by the health authorities of various states and municipalities were useful as a basis for identifying the milk supplies to be priced and pooled under the orders. Thus in many instances municipal or State health authorities found themselves in a position to determine what milk supplies could be pooled under a given order. The situation has changed, however, and health authorities now have much less influence over the composition of Federal order pools than they had during the early years of the program.

The requirements for pooling make it necessary in most instances that the sources be approved by local or State milk inspection authorities. Many of the orders embrace the jurisdictional areas of more than one such agency thus limiting the opportunity of any one agency to control access to the pool. During recent years there

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apparently have been few instances in which sanitary inspection agencies have attempted to restrict entry of milk supplies to the marketing area for other than valid sanitary reasons.

The Connecticut milk order pool is a noteworthy exception to this general condition of freedom from control by milk inspection agencies. The milk marketing area defined by the Connecticut order is completely within the jurisdiction of the State Commissioner of Agriculture and Natural Resources who administers the dairy laws of Connecticut, including the so-called "Connecticut Milkshed Law." This law among other things authorizes the Commissioner to approve new sources of milk supply only when the receipts of Connecticut handlers exceed their fluid sales by less than 10 percent in November or December or by less than 25 percent in other months.

From the viewpoint of milk producers and public authorities in Connecticut this system of regulation undoubtedly has great merit. But from the viewpoint of achieving equitable relationships among producers and handlers under the Federal orders for Connecticut and adjacent areas it constitutes an arbitrary barrier. It accounts to a considerable degree for the high Class I

utilization under the Connecticut order as compared with the much lower utilization percentages for the adjacent Boston and New York-New Jersey orders.

Such extra-order control of access to market order pools should be a matter of serious concern to the Department. As suggested in the preceding discussion of Marketing Areas, one promising remedy

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for such outside interference with a Federal order is to so define the marketing area that it will embrace the jurisdictional districts of more than one sanitary control agency. But this remedy alone may not be adequate in all cases.

Another Institutional Factor

A number of states have milk control agencies which perform different functions at the State level in the regulation of milk in accordance with the various provisions of their respective statutes. In some states the milk control agencies fix minimum prices to be charged for milk by dealers as well as the prices to be paid producers. Where such minimum retail and wholesale prices are enforced successfully they tend to prevent milk from new sources of supply from entering the market, since outside handlers are not allowed to gain a foothold in the market by effective price competition. It should be noted also that with few exceptions the State milk control orders provide for individual handler pooling, which has the same undesirable effects as individual handler pooling under Federal orders.

In a few instances, notably in two markets of Upstate New York and in Virginia, the milk control agencies directly restrict entry to the State regulated markets. The market restrictions in Virginia, together with individual handler pooling, tend to throw an extra burden for maintaining reserves upon the Federal order pools in adjacent areas. On the other hand, restricted entry to the two state-regulated

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upstate markets in New York which have market-wide pools probably has had

relatively little effect upon producers or handlers under the adjacent Federal order. Class I utilization in each of these markets is as low or lower than that of the New York-New Jersey order. Producer Bases

At present none of the Federal orders provides for the assignment of bases to producers for a longer period than 12 months) and new producers are permitted to enter the market without serious handicaps. If this policy were changed, however, and provision made for long term bases (more than one year) a new problem of intermarket relations would arise. It would be necessary to include in each order that provides for such bases definite rules for the assignment of bases to new producers and for transfer of bases from one Federal order market to another. 10/

10/ Proponents of the quota-production control system for fluid milk order markets take the position that their proposal would not restrict movement of milk between markets. This is indeed a naive and misleading view of the matter. Total Class I sales in a market under the proposed system would be allocated to producers regularly associated with that market. How, then, could any milk move, or why would any milk move, when it would not be possible for it to share in the Class I sales in the market, since these are already allocated?

Perhaps it is thought that local producers operating under a quota-production control system would be willing to set aside a portion of the Class I sales for allocation to new producers. Such a willingness on the part of local producers would be incredible. In return for limiting marketings, they will most assuredly demand the total Class I sales in such market as their "market right".

Thus, in addition to the restrictive devices currently used in fluid milk orders which, as is pointed out in this section, inhibit the movement of milk between order markets, the "extended base" proposal would add another and practically insurmountable barrier to the movement of milk between older markets and such markets and unregulated markets. —Otie M. Reed

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Like other order provisions that have been discussed herein, rules for assignment and transfer of bases could be unduly restrictive and have a discriminatory effect upon producers who are not in a favored position. The view of this Committee, however, is that rules for assignment and transfer of

bases should be no more restrictive than is necessary to achieve the minimum objectives of the two-price payment plan as outlined in the foregoing section (Section 3) of this report. 11/

Summary and Recommendations (on Intermarket Relationships)

The increased number and coverage of Federal milk orders, together with the growth of urban and suburban areas and greater mobility of milk supplies, have accentuated the problems of inter-market relationships. These problems involve differences in class prices applicable to competing handlers as well as wide disparities in utilization patterns and in blended prices to producers under orders for adjacent markets. Continuing adjustments will be required to accommodate the changing conditions of production, consumption and marketing.

In general, the Class I prices established by the various orders are well coordinated but there are exceptions mainly of a seasonal or short-run character. More emphasis on regional rather than individual

11/ It is indeed unfortunate that this statement apparently carries no recognition of the bald fact that the "two-price payment plan as outlined in Section 3 of Part II of this report" is utterly inconsistent with and antithetical to the conclusions and recommendations in this Section 4. - Otie M. Reed

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markets in the application of seasonal and supply-demand adjustments would help. Classification and class prices of milk for non-fluid uses have been less well coordinated but this is a complex and difficult problem. The aim should be to obtain for the producers under each order the highest returns possible consistent with orderly marketing and with equitable treatment of both cooperative and proprietary handlers. Differences in conditions and costs of handling and processing surplus milk in the various areas may call for a considerable diversity of pricing arrangements.

The orders have been administered in accordance with the theory that differences in blended producer prices under the various orders would cause milk

supplies to shift from orders with low Class I utilization to orders with higher Class I utilizations. In this way substantially similar utilization patterns under adjacent orders are expected to occur with the blended producer prices under different orders within a region tending to approach a common level.

In many instances, however, these anticipated adjustments of utilization patterns and of blended producer prices have either not occurred or have progressed very slowly. Marked differences in utilization patterns, with corresponding disparities in blended producer prices under Federal orders in the same region, and between orders for closely adjacent markets, have persisted for many years and appear likely to continue. Generally, such disparities reflect inequitable sharing of the burden of maintaining reserve milk supplies for all markets in

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a region. They have also been the cause of unfair and disruptive competition among cooperatives and other handlers in adjacent or overlapping production areas.

Some troublesome interorder relationships have resulted from certain order provisions and of restrictive sanitary regulations that have prevented milk supplies from shifting in a normal or orderly manner from one Federal order pool to another. Even when reasonable freedom of transfer is assured, however, a higher uniform price under a given order will not attract into its pool a proportionate share of the regional surplus when the volume of that surplus happens to be greater than is currently required.

The Committee recommends that the Department give more consideration to these problems in issuing new orders. It should also move "with all deliberate speed" to re-examine existing orders which yield substantially higher Class I utilization percentages and blended producer/ prices than other market pool orders in the same region. The purpose of such re-examination would be to determine what changes should be made to facilitate orderly transfers of plant supplies as well as individual producers between the market pools, as necessary to establish more equitable sharing of both fluid sales and surpluses among all

groups.

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For most situations, evidence of equitable sharing of both fluid sales and surpluses among all groups would appear in the form of geographical stairsteps of utilization and producer blend prices similar to that for Class 1 prices referred to on pages 11-2-2 and 11-2-3. Both would be relatively low in low cost-high production per capita areas, and both relatively high in high cost-low production per capita areas. In markets without location or zone differentials, the net price to producers (price after deduction of hauling) for different markets would be expected to be about the same where the procurement areas overlap. Some variation in prices and levels of utilization between markets within a region might be necessary for this to occur, but in general, blend prices and levels of utilization should tend to seek a similar level both within a given region and on the border lines of adjacent regions. assuming the elimination or curtailment of location differentials that substantially depress the blended prices paid in the outer zones.

In some instances, consolidation and expansion of existing orders for separate parts of metropolitan market complexes. and of other orders for adjacent markets, will be the most appropriate remedy. In many other instances, the more practical solution will be to liberalize order provisions and correct other conditions which constitute serious obstacles to orderly transfer of plants and producers from the orders with relatively low Class I utilizations to those with high utilizations. One of the most clearly indicated steps is to eliminate individual

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handler pooling, with the possible exception of isolated situations in which such pooling is especially needed and will not adversely affect producers whose milk is priced by other orders.

In many instances order provisions should be revised so that plants and their producers whose milk has been priced and pooled under one order can more

easily qualify for pooling under another. Provisions for assignment of other source milk to the lower classes also should be re-examined and where necessary revised to encourage the transfer of milk for fluid use from market order pools with low Class I percentages to those with higher fluid utilization. Assignment of other source milk to the lower classes should not be the rule when the market as a whole is in short supply.

Compensatory payments are a convenient and practical device for dealing with situations in which it is impractical to require that a plant be fully regulated because only a relatively small part of its output is sold for fluid use in the Federal order market. It is true that such required payments might be administered in such a way as to constitute a barrier to the sale of milk by unregulated handlers in Federal order markets, but the Committee doubts that this is the case in many instances. Compensatory payments are not likely to be oppressive if reasonable opportunity is afforded the unregulated handlers to qualify for full regulation. 12/

12/ What is reasonable? Why not develop the criteria? - Otie M. Reed

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If the terms of the various Federal orders were more fully coordinated and liberalized as recommended by the Committee, there would be little need for compensatory payments on milk transferred from one Federal order market to another. Until such coordination is accomplished, however, compensatory payments may be the most practical means of correcting for the disparities in class prices, and of protecting producers and handlers under market pool orders from unfair competition on the part of handlers subject to individual handler pooling.

The uniform prices determined under several of the orders are significantly depressed by payment of special differentials out of pool funds to "nearby" producers. In a few instances, a high percentage of the milk in the market order pool qualifies for such payments with the result that returns to producers in the outer zones are substantially reduced. Aside from the equities

involved internally, such large special payments constitute a barrier to the entry of additional supplies from adjacent production areas and tend to prevent desirable intermarket adjustments. The Committee suggests that the justification for such differentials be reconsidered, especially in the case of areas with high fluid utilization, with particular attention to the impact of these payments upon producers who are ineligible to participate.

In one or more instances access to Federal order markets and to the pools established by these orders is restricted by State or local milk inspection agencies. The most noteworthy example is the State of

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Connecticut whose milk inspection agency exercises complete control over the access of milk supplies to the Federal order pool for that area. Sanitary regulations are not the responsibility of the Department which administers the Federal milk orders. On the other hand, that Department must assume responsibility for any discrimination that occurs through control by particular milk inspection agencies of access to market order pools on the part of plants or producers whose milk is generally qualified for sale as fluid milk.

The foregoing recommendations carried out firmly and persistently should result in much more equitable and satisfactory relationships among the Federal order markets and also between those subject to the orders and others whose milk is unregulated. It is most important, however, that the primary objective, which is equitable treatment of both producers and handlers whose milk is priced and pooled under different orders, be kept clearly in view. Substantial and continuing differences in utilization and in blended producer prices under orders for adjacent markets should be recognized as evidence of discrimination which inevitably leads to disruptive competition. 13/

13/ No evidence has been presented in support of this statement. If the statement is true, the evidence must exist to support such a sweeping conclusion. I think it incumbent on the Committee to furnish such evidence, since exhortations such as this are not very useful to administrative officials, unless buttressed by evidence which can be used as a basis for administrative

action. - Otie M. Reed

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There are likely to be some instances in which liberalization of order provisions, or possible mergers, will not suffice to accomplish the desired objective. In any case where such steps appear necessary to bring about substantially similar utilization patterns and uniform net prices to producers similarly situated under adjacent orders or where procurement areas overlap, the Department should give favorable consideration to a petition for transfer of one or more plants from a lower-utilization order to the higher one for purposes of pooling. Such transfers would be made by the usual process of order amendments on the basis of evidence presented at public hearings. Consideration should be given to the plant location, present or past association with the market, compliance with quality standards, quantities of milk handled, and willingness of the handler to assume an obligation to supply the market when required to do so 14/

14/ This statement appears to indicate that the Committee approves pooling by assignment. The Committee did not act on any resolution concerning this matter, and, in fact, discussed it quite casually and superficially. I can conceive of no more whimsical and arbitrary method of securing uniformity between prices to producers serving different markets. Such uniformity in producer prices under our system of commerce would be secured by shifting milk between markets in response to economic factors. Pooling by assignment would negate and divide income among groups of producers with no economic guidelines whatsoever. We would place our entire system of economic enterprise in milk marketing in jeopardy by the adoption of such methods. Otie M. Reed

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To implement in part its suggestions for improvement of inter market relationships under Federal orders, the Committee recommends the following changes in the Agricultural Marketing Agreement Act 15/

1. Amend 608c (11)(C) by changing the period at the end to a colon and adding "Provided, in the case of milk, such different

terms shall not result in substantial and continuing differences in utilization, or in uniform prices to producers in the same or overlapping production areas but whose milk is priced under two or more orders: And provided further, that the application of the foregoing proviso to orders issued prior to the effective date thereof shall be accomplished with all deliberate speed ."

2. Amend 608c (5) (B) (i) by interpolating after the numeral (i) the words "except as limited by the proviso of paragraph (C) of Subsection (11) of this section."

The general effect of these recommended changes would be to strengthen the position of the Department in its efforts to harmonize intermarket relationships and especially to limit the use of individual handler pooling.

15/ We cannot agree that amendment of the Act for this purpose is desirable. The Secretary has sufficient authority to exercise his leadership. Amendment of the Act could transfer the initiative from cooperatives and other industry groups to the Government. Judson P. Mason, James L. Reeves, Gordon M. Cairns

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Note by C. W. Swonger

There is so much that I find objectionable in Part II, Section 4, of the Committee's report, that I am forced to submit extensive dissent. It is impossible effectively to present nw objections to this section of the report without going into some detail of facts and figures. Besides the narrow regional context in which much of this section is couched,

I object to a number of unwarranted assumptions, inferences, and conclusions, particularly with respect to the effect of nearby location differentials, health regulations, and to some extent, the application and effect of compensatory payments or assignment provisions to milk moving in either direction between Federal order pools.

At numerous points and with minor variations in wording, this section refers to the desirability of achieving similar patterns of utilization and of uniform prices, as though they were the same thing, when in fact they are not. The reason they are not the same is due to the effect of nearby location differentials on the distribution of the proceeds of the pools, and to widely

different variations in the relative proportions of nearby and distant producers.

"Nearby location differentials" are deeply imbedded in the New England orders, and the New York-New Jersey order, and have been justified as a recognition of the historical pattern of prices which existed prior to regulation, or as compensating nearby producers for sharing a part of the fluid milk market which they formerly enjoyed, with producers more distant from the market. The Federal orders did not create such differences in prices, but merely recognized their existence. They have been capitalized into land values, or were in the years prior to regulation.

It is easy to point out that the utilization percentages under the Connecticut order average higher than for New York-New Jersey. The same is also true as between Connecticut and Boston, and by about the same margin. Yet for the year 1961, the simple average of blended prices at the Boston 21st zone was \$4.52, and at the same zone for Connecticut, was \$4.56. The same relationship applied as between nearby producers in the two markets. For December 1961, the blended price to producers in the Connecticut market was 7 cents below Boston, at all zones.

It is true, of course, that there are relatively more nearby producers in Connecticut (or Southeastern New England, Springfield, or Worcester) than in Boston or New York. The Springfield market had a higher utilization pattern than Boston, but blended prices for 1961 averaged 13 cents below Boston. For the same period, blended prices in the New York-New Jersey market (for 3.7 percent milk) averaged 20 cents below Boston, but this was a period when the New York-New Jersey Class III price was running well below Class II prices in New England, and below any level of competitive prices paid for manufacturing milk.

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Apparently nearby differentials are acceptable, if they apply to a relatively small proportion of the milk, but otherwise they constitute an unwarranted "burden" on the pool. In Boston, nearby differentials apply to about 6 percent of the milk in the pool, or considerably less than New York. They apply to a much larger proportion of the milk in other markets of southern New England for the simple reason, as stated, that there are relatively more nearby producers. Yet their effect is the same, in Boston or Connecticut, to establish a particular pattern or relationship of prices, as between nearby and more distant producers, which is identical in both markets. Elimination of the nearby differentials contained in the Connecticut order would aggravate the price disparities in relation to other surrounding markets.

In this connection, the report suggests that "nearby differentials could be maintained but varied inversely with the percentage of pooled milk used in Class 1." Such a system as suggested would result in serious distortion of blended price relationships between markets in New England and New York, both to nearby producers and those located more distant from the market. Reference is made to the uniform pattern of nearby differentials used in New England markets. Any deviation of the type proposed would, for instance, depress blended prices to nearby producers in Connecticut, relative to Boston or New York, and raise blended prices to Connecticut producers in more distant zones, substantially above Boston or New York. It would create price disparities rather than remove them, as between producers similarly located with respect to the market.

If we accept nearby location differentials as a fact of life in New England and New York, it follows that "similar patterns of utilization" would result in wide disparities in "uniform prices" as between producers similarly located with respect to the market, and vice versa. We cannot have it both ways. Of the two, it seems to me that approximate uniformity of blended prices is far more important, and competition tends to achieve this result.

In a more general vein, the geographic boundaries of milk sheds change over time, particularly with changing demands in the marketing areas, and changing relationships in blended prices. Over the last two decades (and mainly in the 50's), Boston gradually "took over" the milk supplies in western Vermont which had formerly been associated with the New York market. It appears inevitable to me that, with growth of population, Connecticut will gradually absorb nearly all of the milk east of the Hudson River in New York. Is this bad? The New York market certainly does not need this milk. And where should handlers in Connecticut be looking for additional supplies, if not in adjacent portions of eastern New York?

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In the discussion of "sanitary regulations," Connecticut is again singled out as a "noteworthy exception" to the "general conditions of freedom from control by milk inspection agencies" over participation in a marketwide pool. No reference is made to New York's health and licensing regulations. Later on it is stated that "restricted entry to the two state-regulated upstate markets in New York which have marketwide pools probably has had relatively little effect upon producers or handlers under the adjacent Federal order," but apparently the alleged restrictive entry to Connecticut is another matter.

Unlike the New York order, neither the Connecticut order, nor any other

New England order, makes any reference to local health approval. It is not the function of the Federal order program in either to support or break down local health regulations. If public health or sanitary regulations are considered unduly restrictive in Connecticut, then relief should be sought through other channels, rather than manipulation of the marketwide pool.

The provisions of the so-called "Connecticut Milkshed Law" are less important than the facts in the case. The fact is that there has been a regular and gradual but rather large expansion of permanently-approved sources of supply (especially of producers) for the Connecticut market, both before and since the inception of the Federal order. The number of producers approved for shipment to supply type (country) plants in the Connecticut pool, for example, increased from 454 in July 1959 (the first month of the period of regular pool plant qualification, following the inception of the order), to 767 in September 1961, an increase of 69 percent over the 27-month period. Although the detailed facts are not readily at hand, I suspect that the proportionate increase in the number of direct-delivery producers shipping to Connecticut from the borderline areas (the only ones where such increases can occur) may have been very nearly as great.

Other "obstacles" cited to the movement of milk include pooling requirements, assignment provisions, and compensatory payments. There may be situations under orders in other parts of the country with which I am not familiar, but in general I think that the treatment of these subjects fails to do justice to the accomplishments of the Department in the establishment of the necessary and appropriate standards to identify the plants and producers whose milk is to be pooled and priced under a given order, and in coordinating the classification and assignment provisions as between adjacent markets.

The statement recognizes that some means must be provided to identify the plants or producers whose milk is to be pooled and priced, and that the principle most generally followed has been based on performance or association

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with the market. With respect to removal of any obligation on the part of specialized manufacturing plants to meet shipping requirements to maintain pool status, this has been taken care of in a number of markets by "group" or "system" pooling. What is meant by "past service to the market," as a basis for pooling, I do not know. How long in the past - 20 years? Heavy reliance is placed on a "call milk provision" to insure that "past service" might at some time be translated into "future service." Since it has never been used in modern times in New York, its mere inclusion in an order does not provide much of a guide to determine association with a market, or for use in the computation of monthly pools.

Turning to the subject of "assignment of other source milk to lower classes," it should be noted that assignment provisions are an adjunct to pooling; an alternative to the use of compensatory payments; and a useful tool to encourage efficient utilization of milk and avoidance of unnecessary freight charges. They also are aimed at insuring that at least the larger, primary markets will attract and carry their own reserve supplies. Yet, we are told that this "is a type of order provision that may, if abused, constitute an unreasonable trade barrier and an obstacle to orderly adjustments among the Federal order markets." The same could be said of any other order provision.

With regard to the matter of conflicting classification and assignment where milk moves (generally in bulk) between Federal order markets, I am not aware as to how much of a problem may exist in other areas of the country. If it is a problem between some adjacent markets, efforts should be made to coordinate the provisions of the particular orders involved.

Back in 1959 we struggled with the problem of conflicting classification and assignment, as between the various New England orders, and I think came up with a reasonable and equitable solution, based primarily on the conditions under which milk generally moves between these markets. The resulting amendments to New England orders (effective September 1, 1960) not only removed the problem as between these orders, but also for all practical purposes, as between the New York and New England orders.

In general, the objectives of the allocation and assignment provisions, applicable to milk moving between Federal order markets, should be (1) to avoid conflicting classification and assignment, as between the originating and receiving markets; and (2) to conform to the economic conditions surrounding such movement, whether for Class I or Class II. Beyond that, we should not seek to impose arbitrary rules, nor should we leave it to the option or whim of the handler.

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Coming back to the early part of Section 4, the report states that "The Department has taken the position that differences in blended or uniform prices to producers under different orders for adjacent markets are an appropriate or necessary means" of allocating milk supplies between markets. With this position I fully agree. No one has developed a system as effective as price to direct milk to the market that needs it most.

The table which follows is intended to show that "utilization patterns

differ widely among the orders in some regions," and as evidence that the "attraction theory" has not worked out in practice due to various "obstacles" to the movement of milk, later described. There is again the equating of "utilization patterns and blended prices," as though they were the same thing, when in fact they are not. The regions listed in Table 1 do not correspond with those for which the Department publishes statistical data, and so it is not easy to identify the markets with the "highest" Class I utilization, which presumably are the worst offenders from the standpoint of "orderly adjustment of milk supplies." My objection is to the indiscriminate lumping together of marketwide and individual handler pools. (There is a partial and incomplete footnoting, purporting to adjust for exclusion of handler pool markets). This single fact accounts for most of the "differences" in Class I utilization shown in Table 1, yet these differences are subsequently attributed to a wide variety of other order provisions besides individual handler pooling.

In the Northeast, the figure of 91 percent relates to the small Wilmington, Delaware, market, an individual handler pool. In the Ohio River Valley, the figure of 90 percent presumably relates to the Appalachian or Bluefield markets, both of which were individual handler pools during 1960. In the "Michigan-Ohio-Indiana" area, the figure of 83 percent refers to Toledo or North Central Ohio, with individual handler pools. In the "Lower Mississippi Valley" the figure of 89 percent presumably relates to Memphis, an individual handler pool. In Texas, the figure of 93 percent apparently represents the Austin-Waco market, an individual handler pool.

At least "individual handler pooling" is given top priority in the subsequent enumeration, as a factor contributing to wide differences in utilization. Apart from the special problems involved in the case of individual handler pools is it true that the "attraction theory" has not worked out in practice? In my opinion, it is not. I have referred to the fact that most of the milk in western Vermont which was formerly a part of the New York pool has shifted to Boston, over the last decade or two. The Connecticut market is gradually absorbing most of the supply east of the Hudson River in New York. One or two handlers from the Southeastern New England market who were short of milk supply have also taken over producers from New York

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Such shifting of supplies may disrupt established plant operations. It may result in changes in cooperative affiliations on the part of producers. Most of the complaint about "disorderly marketing conditions" appears to stem from the fact that the milk moved. Yet the producers' milk moved to the market in which it could command a higher price. Is this bad?

In the "Summary and Recommendations," this section of the report again returns to the subject of "wide disparities in utilization patterns and in blended prices," as though they were identical; and to "restrictive sanitary regulations," particularly in Connecticut. I have already given specific information (in terms of the rapid increase in the number of producers approved for shipment to supply-type plants in the Connecticut pool, and of direct-delivery producers from the borderline area shipping to Connecticut, since the inception of that order; and in terms of blended price relationships between Connecticut and Boston or New York) to indicate how effective or rigorous the alleged "restrictive sanitary regulations" have in fact been. While recognizing that sanitary regulations are not the responsibility of the Department which administers the Federal milk orders," the report asserts that the Department "must assume responsibility for any discrimination that occurs through control by particular milk inspection agencies of access to market order pools" Presumably that "responsibility" could be discharged by annexing Connecticut to the New York market, or by "designating" unapproved plants for inclusion in the Connecticut pool.. With these sweeping assertions, the report would have the Committee recommend that the Department "give more consideration" to these problems" and that it move "with all deliberate speed" to reexamine existing orders which yield substantially higher Class I utilization percentages and blended producer prices than other market pool orders in the same region. If this does not suffice, then pooling by designation should be provided, without regard to performance or association with the market.

The "two small amendments" to the Agricultural Marketing Agreement Act which appear at the end of Section 4 were never discussed in Committee, but were added at the time of final editing of the sub-Committee's report. I object strenuously to using the Committee in this manner to promote the particular interests of the New York market. The changes proposed are based to a substantial extent on a false premise and false identification between "utilization" and "uniform prices," already described at some length in this dissent. I wish to dissociate myself from any such recommendation for amendments to the Act.

The basic concept of the Act is one of "orderly marketing," and from there we move on to such concepts as "allowing markets to grow and develop in an efficient manner," to "coordination in the national interest," and

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other like purposes. "Orderly marketing" requires the maintenance of close uniformity in cost of milk to handlers for the same uses, equity in payment to producers through uniform prices and appropriate differentials, encouragement

of efficient utilization of existing milk supplies, etc.

In my opinion, the Department has consistently sought to accomplish these objectives, and with a very substantial measure of success, in the face of many obstacles thrown up from outside. It has also been diligent in seeking to promote reasonable alignment of blended prices to producers similarly located with respect to the market, again frequently against heavy odds. To me, the latter is not an objective, per se, but a result which stems from the shifting of supplies between markets. If uniformity of blended prices were adopted as the "primary objective" of regulation, it would preclude the shifting of supplies between markets, or the allocation of supplies according to market needs. -

C. W. Swonger

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PART III

EVALUATION AND RECOMMENDATIONS

In the opening section of this report, we observed that the present system of marketing fluid milk under Secretary's orders is a truly unique marketing institution, neither quite free nor fully controlled, but heavily 'conditioned' by both private and public mechanisms and policies. II Though it has some features that resemble the purposes and practices of public utility regulation, it does not allow the Government to intervene in the operational phases of dairy farming or in processing and distribution as Federal agencies do in transportation, communication, and banking operations. On the other hand, for a very large and vitally important industry, it puts in the hands of a Cabinet official a power and responsibility for determining the price level and coordinating the national price structure such as no other Cabinet officer exercises.

These influences of the milk marketing order system in distributive processes have an indirect but significant impact on the production pattern of the industry. The fact of this impact is obvious, even though it is impossible to measure actual results with any degree of precision. In Part II we examined some past and current aspects of this influence of Secretary's orders on production as well as distribution, and noted that proposals are now pending for moving the frontier of the Secretary's influence farther into the area of individual farm

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management and production control. These proposals are of far-reaching significance--directly to the dairy industry but indirectly to other parts of our "mixed system" of private and public economic enterprise, and they will be examined in the closing pages of our report.

The evolution of the present milk marketing system has proceeded through two major stages. For somewhat more than three decades from about

the turn of the century to 1933, groups of dairy farmers in various city milksheds were developing cooperative associations for joint handling of their product and, particularly, for collective bargaining as to its price (or prices). In the slightly less than three decades since passage of the Agricultural Adjustment Act of 1933, this system of cooperative milk marketing, while continuing its internal growth and procedural development, has been complemented by an increasing amount of assistance and what we called "regularization" by the Federal Government through its Department of Agriculture (and to some extent by regulatory agencies of state Governments).

The progress in market organization and practices made during this 60-year period has been impressive. But serious problems, not solved by the cooperatives or resolved by the Department of Agriculture, have accumulated and been repeatedly complicated by technological developments in milk production, transportation, and processing; by business developments in the industry; and by economic developments of national scope. Hence, the time has now seemed to the Secretary of Agriculture to be

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ripe for a re-examination of both achievements and problems and for the exploration of new frontiers of coordinated action, private and public. The objective should be to protect and strengthen our tradition of free individual and group enterprise and at the same time enable the industry and the public to benefit from the efficiencies and orderliness of national policy-making in the public interest.

The members of this committee felt deeply the challenge presented to them by the request made by the Secretary that they undertake such a study. From a variety of academic backgrounds and operational connections, they had acquired fundamental respect for the distinctive characteristics of this dualistic system, broad familiarity with its complex and changing problems and far-flung interrelationships, and a high opinion of the competence, devotion, and good sense with which, in the main, it has been administered by both its private and its Government personnel. In this closing section of its report the Committee

presents its general appraisal of the milk marketing order system in its current state of evolution and some recommendations (pro and con) as to features of the present system which should be retained and strengthened, abandoned, modified, or replaced by new devices better suited to present and prospective conditions.

The term "appraisal" by its very nature connotes some element of criticism unless it be assumed that the system under review has operated perfectly, measured by criteria of economic efficiency and

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public interest. In such adverse conditions as we feel called upon to make, we have no desire to be captious or unsympathetic to the difficulties encountered or unmindful of the results achieved and further improvements still in progress. But we believe that the service we can render to the Secretary, to the industry, and to the public will be in proportion to the frankness with which we, severally, state our criticisms and the vigor and independence with which we suggest ways of betterment. We feel that the report we are submitting is enriched rather than weakened by the inclusion of a number of individual or group dissents or alternative views.

Scope and Method of Our Study

This committee was not set up to conduct voluminous and complicated research in the many aspects of milk order operations. It was not supposed that it could measure quantitatively the results of the various regulatory tools contained in the orders and thus the precise over-all impact of the orders on market stability, prices, production, and sales. Our task, as we conceive it, has been to review broadly the operation of market orders, the problems encountered, the methods used in efforts to solve these problems, and the extent to which market orders have achieved their stated purposes or are adapting suitably to changing circumstances.

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The complexity of the order system has compelled us to limit our report to what we regard as major issues. Many detailed but often important features have had to be omitted or merely alluded to in passing--- such as the transition to bulk tank handling, qualification of cooperative associations, hearing procedures and scope and character of orders, accounting requirements, trade practice regulations, relation to state milk regulatory agencies, and the like. We have in particular had to avoid administrative problems--even though they often are intermeshed with economic issues.

Though the work of the committee has been primarily in the realm of composite judgment rather than quantitative research, this does not mean that its qualitative findings are without value. Quite the contrary. Qualitative judgments, objectively arrived at, can be of great value in reaching decisions as to (a) what the order program has achieved toward the purposes envisaged in the Agricultural Marketing Agreement Act of 1937, (b) whether it has had a significant degree of success in relating and integrating the orders into a national system of regulation, (c) whether, in pursuit of the purposes of the Act, regulatory or trade practices of questionable nature have developed, (d) whether fundamental problems of economic adjustment in milk markets and dairy farming have been partially or wholly solved or merely glossed over and patched up, and (e) deciding whether evolutionary development along the lines of the last 25 years should be continued or whether more drastic changes in goal and method are now called for.

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Part II of our report discussed the major features of cooperative milk marketing practice and of the Government's relation to or participation in those practices. Considerable evaluation of Particular features of the milk marketing order system under Secretary's orders was included, and recommendations were made with reference to quite a number of specific issues. Many of those points will be picked up in this concluding part of our report, not in mere summary but in a general evaluation of ends to be sought, methods used, and of both desirable

and undesirable consequences that appear to follow from alternative policies or practices. We seek in Part III to bring our discussion to a sharper focus on the overriding issues that confront market order policy and administration as we face the future. This involves 'restatement of the basic objectives sought and the extent and character of the Federal Government's role in trying to reach them.

Goals of the Order Program

The goals sought by fluid milk producers and espoused by the Congress in the Marketing Agreement Act of 1931 centered on the attainment of "orderly marketing." In particular, the system was designed to cope with the problem of price-depressing "surpluses," in order that farmers' incomes might be protected against periodic slumps or persistently depressed levels. The target of income maintenance or enhancement toward which the good offices of the Federal Government were to be directed had been defined in the original Agricultural Adjustment Act as "parity" of farm with non-farm prices or, more specifically,

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the ratio of prices received by farmers for their products to the prices paid by them for farm supplies in a base period 1910-14. This "parity" target is still to be found in the Agricultural Marketing Agreement Act of 1937, but in the section of that Act devoted to milk marketing orders, substantially different criteria are set up.

Section 8 (c) 18 establishes the principle of economic (or supply-and-demand) justification for the specific price minimums used in the several orders. Prices so established are supposed to reflect actual conditions of user demand for milk in its various classes vis a-vis cost and other supply factors. By striking a balance between consumers' ability and willingness to pay for milk and its products and producers' ability and willingness to produce within some range of prices, this system would assure consumers of fluid milk an "adequate" supply of milk (of quality guaranteed by sanitary regulations) at all times, without surpluses that would "demoralize" dairy farm operations.

The supply-and-demand criterion of fluid milk pricing is, in effect,

paraphrased and amplified rather than compromised by the other phrase of Section 8 (c) 18 (and elsewhere in the Act) which stipulates that order prices shall reflect and promote "the public interest."

Planned or rationalized competition as expounded in Part I goes far toward safeguarding the long-run prosperity of both producers and handlers and would most economically meet the needs of consumers. It would not rest upon a grant of government power to any group to exploit other groups but

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would tend to reconcile conflicting claims. Public interest considerations often have dictated some modification of the supply-demand criterion in practical application. The enabling legislation does not at any place authorize supply restriction as a means of enhancing milk producers' incomes.

It is the judgment of this committee that the price "parity" formula, however tenable in 1933 (in a "temporary emergency" act) is economically unsuitable for fluid milk. It has in fact been superseded in the order program by the "public interest" criterion, implemented by supply-and-demand pricing ..1/ We shall refer later to

1/ The concept of the "public interest" as used in the Marketing Agreement Act and other Federal statutes is a modern development or application of the traditional objective stated in our Constitution: "to promote the general welfare." Use of the expression "public interest" in the Agricultural Adjustment Act of 1933 and its repetition in the Marketing Agreement Act of 1937 was clearly intended to allay any fear in the minds of Congressmen, editors, or the general public that these measures were class legislation which could be used to the detriment of other segments of the economy.

It had come to be widely recognized that farmers had been peculiarly disadvantaged after World War I by price declines which were more severe and persistent in the case of farm products than for industrial products. The preamble to the 1933 Act--repeated in the 1937 statute--declared that such demoralization of agricultural markets "impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and...affect transactions in agricultural commodities with a national public interest. . ." Though the Congress did not spell out any definition of "the public interest" that they premised as a criterion of policy under the Act, the

clear implication of the reference to "agricultural assets which support the national credit structure" and to the impairment of "the purchasing power of farmers" is that the national public interest could not be fully secured if the interests of agricultural producers were neglected. "Parity". was the watchword.

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the implications of price "parity" in the price support program for certain dairy products and the collateral impact of these supports on fluid milk prices. But the evaluations' and recommendations presented by the Committee in Part III are in the context of an administered price, relatively open market, and public interest objective for the milk marketing order system. These criteria interpret the original and lasting goal of "orderly marketing."

But a second component of the public interest concept was also clearly set forth in the Congressional "declaration of policy" (Sec. 602) v.iz, the consumer. It was declared to be "the policy of the Congress. . . (2) to protect the interest of the consumer by (a) approaching "parity" by gradual correction of the current level at as rapid a rate as the Secretary of Agriculture deems to be in the public interest and feasible in view of the current consumptive demand. . . and (b) authorizing no action. . . which has for its purpose the maintenance of prices above the level which is declared to be the policy of Congress to establish "ie., Parity" The statesmen of 1933 and 1937 were thus mindful of the principle laid down in Adam Smith's Wealth of Nations in 1776, "Consumption is the sole end and purpose of all production, and the interest of the producer ought to be attended to only so far as it may be necessary for promoting that of the consumer."

Finally, there is a third category of economic interest that must be recognized and reconciled with producer interest and consumer interest to make a complete expression of the public interest. This is the interest of "the trade"--distributors and processors, who perform an intermediate function between producers and consumers, serving both. While the interests of these middlemen were not so explicitly referred to in the policy declarations of the Marketing Agreement Act, their participation in public hearings prior to the promulgation of an order and their right of petition for modification of such order or their exemption from it clearly implies that their interest is a co-ordinate element in the public interest.

Naturally, producers want as high a price as they can get, consumers want as low a price as possible, and middlemen want as generous profits as their handling margins can be made to yield. But it is contrary to the public interest to have prices so high that they exploit the consumer and restrict his use of

essential food elements; and equally against the public interest to have prices so depressed as to impair the operative efficiency or the living standards of the producer. Similarly, it runs counter to the public interest to have distributing and processing

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Has Orderly Marketing Been Achieved?

It goes without saying that complete and perfect orderliness in the disposal of fluid milk in all 81 order markets has not been achieved. That would not be possible, or indeed desirable, in a dynamic enterprise market blessed with and disturbed by both technological and institutional changes. But the Committee is unanimous in the conclusion that the order system, over its time span and over

charges so high as to exploit either producer or consumer or so low as to impair the middleman's ability to provide adequate facilities, keep step with technological progress, and give the best of service to both his producer and his consumer clients.

In the last analysis, the interests of producer, consumer, and handler are not antithetical but in fact mutual. It is not in the long-time interest of producers to price milk so high as to stifle the sale of substitutes, or of farmers in a particular market to price their milk so high as to unduly attract milk from other areas, or so to stimulate production in their own market as to pile up surplus, particularly in relatively high-cost areas. A prime criterion for either an individually competitive or an administered price structure is that it shall promote most efficient allocation of all productive resources. The public interest criterion applied to the order system by the Marketing Agreement Act calls upon the Secretary of Agriculture to bring the three economic functions of the milk industry--producer, consumer, and handler--into the best commercial equilibrium attainable (i.e., dynamic stability) through optimum allocation of the nation's resources.

That this broad and equitable public policy was to be carried out within the market structure and with major reliance on the price system rather than on subsidies and controls was equally plain. Section 608 (c) of the Marketing Agreement Act (Milk Prices) instructs the Secretary of Agriculture to "ascertain the parity prices of such commodities" as a bench-mark for any prices under his regulation. But if, on the basis of evidence adduced at a public hearing, "The Secretary finds that the parity prices of such commodities are not reasonable in view of the price of feeds, the available supply of feeds, and other economic

conditions which affect market supply and demand. . . he shall 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."

The legal as well as logical interpretation of this public interest criterion in the marketing order system is that it should not tolerate supply restriction in collective bargaining structures or practices nor should the policies and activities of the Department of Agriculture buttress or undergird such extra-competitive or anti-competitive arrangements.

E.E. Vial, Edwin G. Nourse, David A. Clarke, Jr., Judson P. Mason, Edwin W. Gaumnitz, Gordon M. Cairns.

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its still expanding geographical coverage, has encouraged and promoted more orderly conditions in the fluid milk market which it serves than would have prevailed without it.

First, the ideal of orderly marketing has been given a more precise meaning and a broader frame of reference. It is no longer a vague and somewhat negative slogan of protest against seasonal gluts and local shortages. It has become, or is becoming, a positive rationale of producer incomes and handler prices skillfully engineered through a blending of economic principle and market strategy. Not unmindful of the peculiar problems--even needs--of local communities and different temperaments and capacities among both leaders and rank-and-file participants, it now embraces a nationwide system of fluid milk markets which increasingly conditions and is conditioned by other business groups for whom the same commodity is not an end product but a raw material.

Second, for the effectuation of these broad and economically sophisticated objectives, the order program supplies an increasingly effective implementation. It complements the business skills of distributor executives and cooperative officers with a central strategy agency, dedicated to the public interest. In the open hearings antecedent to the issuance of an order, every group interest directly or even indirectly affected by the outcome of the order is given opportunity to argue its case and to marshal its expert witnesses from the ranks of businessmen, economists, lawyers, or whatever. A transcript (often voluminous) of each hearing is subjected to review

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by the professionally trained staff and the widely experienced officers of the Department and a recommended order submitted to the Secretary. Subject to review of exceptions entered by the interested parties, and to acceptance in a referendum of milk producers, the order is promulgated by the Secretary and its supervision turned over to a market administrator under direction of the Department. An important function of the administrator's office is to receive and verify regular monthly reports from all handlers, which disclose full information on their receipts, utilization, and paying prices for milk. These data give a constantly widening and deepening factual record of how the nation's fluid milk market is operating--an essential basis for analytical studies and progressive refinement of the marketing order system.

In the judgment of this Committee, this apparatus of pragmatic and disciplined ordering of the affairs of an agricultural sub-industry conforms in its essential features to the best modern standards of "orderly" agricultural policy and program--the counterpart of "scientific" management in industry.

Following a course that was both administratively astute and intellectually becoming in the exploratory development of a novel regulatory agency, the Department has, over these first decades, proceeded with considerable restraint in the formulation and amendment of marketing orders. It has not taken a position as proponent on any

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substantial provision of an order as it moved through the public hearing stage and have subsequently developed their recommendations within the limits of the record made at the hearing.

But now expansion of the Federal order program and the growing interrelatedness of orders have developed a greater need for uniformity and consistency. Local problems and desires can no longer be considered solely on the basis of local situations, but also as they fit into and affect decisions and conditions in other markets. To this extent, the scope of decisions which

emanate from a local public hearing must be circumscribed. The reconciliation of viewpoints and of needs can be accomplished to some extent through regional hearings and broader participation of representatives of different areas in local market hearings; but also by more active participation of the Department in the development of proposals for consideration at hearings.

We believe that, with the wide experience now accumulated, a somewhat more positive role of leadership and (in a very circumspect sense) discipline should be exercised by the Department. In some cases the Department should be the protagonist for provisions in the order which, in the wide experience of its staff, would best serve the stated purposes of the Act. Such procedure should lessen or remove the delays and frictions incident to formulating an order consistent with adjacent orders and with the system as a whole.

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Are There Still Elements of Disorder?

Having said all that we have about the achievements of the order system, we must proceed to note, however, that not all of its results are to be entered on the credit side of the ledger. Not all factors leading to instability and disorder have been corrected. A number of structures or practices which have been accepted in Federal order markets or introduced into them have tended toward disorder in the long run if not immediately.

Clear evidence of a failure of the order program to achieve real economic order for the fluid milk industry is to be seen in the large and in many instances persistent volume of "surplus" milk. As noted at several places in Part II, during recent years surpluses over Class I requirements in a number of markets have been large, and they are growing larger. Other markets exhibit a better balance between Class I sales and fluid requirements, and in rare cases there has been an increase in the Class I percentages. 2/ In many instances, when an order was first instituted in a market, surpluses were small,

2/ The implication that this difference has been caused by uneven application of Class I pricing policy is not justified. The differences in utilization are largely the result of factors other than the level of Class I prices. The statement as it appears fails to recognize the principle of regional

differences in utilization that is explained in Part II, Section 4 (page7-8), or that milk supplies for some Federal order markets have been restricted by certain order provisions such as individual handler pooling or by health department regulations.

In my opinion, the report gives too much emphasis to the problem of negotiated market wide premiums, while failing to mention (in Part III) the problem of conflict between State milk control and Federal order pricing, a very serious difficulty in one or more prominent instances. Leland Spencer.

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but as the order operated over time, surpluses in the pools increased markedly. In most markets, after a period of order operation, the rate of increase in surplus has slowed down or has ceased, but at relatively high levels of surplus 3/

3/ In this and other passages of the report, reference is made to the "large and still rising volume of surplus milk." This statement sometimes refers to the obvious surplus in total national milk production, dramatically evidenced by the enormous stocks of dry milk and other dairy products in CCC storage.

But more often "large and growing surplus" refers to the marketing order system and a surplus of milk deliveries in excess of Class I usage. Statistics for the program as a whole, however, do not support the idea that the amount of surplus is rising in relation to total requirements. They show 58.9 percent of producer deliveries utilized in Class I milk in 1950 and 61.1 percent so used in 1961. This can hardly be interpreted as a "growing" surplus in order markets--though they would, of course, show individual differences. It is a high surplus, but due to many factors other than the order system.

The program has experienced growth through the issuance of new orders, expansion of existing marketing areas, and attachment by supplies of milk competing for available outlets. As a result of this growth, more milk is being priced under Federal orders each year, but the proportion of surplus milk has not grown. Since larger reserves are now needed to accommodate the industry under modern conditions of largescale processing and distribution practices, a more desirable balance has been attained.

Some passages in the report might seem to criticize the Federal order program for "attracting too much milk," whereas other passages suggest that performance requirement for participating in the pools are unduly restrictive. But the growth of the program and the volume of milk attached to Federal orders does not indicate that the pools are, in fact, unduly restrictive. The record indicates to us that the Department of Agriculture is succeeding fairly well in balancing the varied interests under conditions in which determination of the incidence of regulation is becoming more difficult,

due to the technological changes taking place in production, procurement, and distribution of milk. - Judson P. Mason, James L. Reeves.

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The growth of this excessive supply has occurred during a period when the total nonfarm consumption of fluid milk has been on an almost uninterrupted upward trend, due to population growth and, in postwar years, to a high level of employment and general prosperity. Further more, the subsidized school lunch and military milk programs of the government have accounted for a substantial fraction of fluid milk sales in the last several years. Although there are differences of opinion as to the degree to which Secretary's orders have contributed to the development of surpluses in fluid milk markets, it is abundantly clear that they have not been accompanied by a relative decline in surplus over fluid milk requirements.

Also, it is to be remembered that, during this period of governmental price support for milk and butterfat, the Class I prices under the orders, and in many markets the uniform prices to producers, have shown a marked increase in the margin between such prices and manufacturing milk prices.

Another element of disorder in price and production relationships results from the negotiation of premiums above established Class I prices in a number of markets. Such premiums introduce an element of instability both within the marketing area affected and in inter market price relationships.

Other elements of instability remain, or have developed in connection with the pricing of lower class milk. They have become more complex as surpluses have increased and as more of the milk

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supply of the country has come under the order system. This development increases the importance of great care to assure, on the one hand, that the interests of fluid milk producers are advanced and, on the other hand, that markets for producers of manufacturing milk will not become mere dumping grounds for surpluses in the fluid milk segment of the industry. The Committee

feels that the Department is moving to keep this problem area under close review and more continuous adjustment, as evidenced by the major hearings that have been held recently to review lower class prices in a number of markets operating under orders. 4/

Provisions of orders which are designed to affect the seasonal pattern of production also present vexing problems. The Committee has lacked for the time and resources necessary to conduct the type

4/ Criticism of pricing policy under Federal orders which is strongly implied in these paragraphs is, in my opinion, unwarranted. It also is inconsistent with conclusions stated in Part II, Section 1 (pages 24 to 27). After pointing out that milk supplies in Federal order markets have increased for several reasons the Committee then said: "It would be unreasonable to expect the Department to effect supply control in Federal order markets through market price to a greater extent than has been done with respect to manufacturing milk or other agricultural products. Nor would such a policy be consistent with the stated objective of raising the incomes of farm people to a level of parity with other groups. Moreover, while supply control by means other than market price undoubtedly involve s serious difficulties, it would clearly be inconsistent and unequitable to subject market milk producers and other farm groups to the iron law of unfettered supply and demand, while other groups, including organized labor and much of the industrialized world, are given more favored treatment." I believe this is the correct view. Leland Spencer.

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of analysis required for specific conclusions and recommendations concerning them. The Department interprets the use of base rating provisions of the Act as being permissible only for the purpose of influencing the seasonal pattern of production not restriction with the purpose of price enhancement 5/ hence a number of questions arise in relation to base rating plans and other seasonal producer pricing plans and adjustments employed in a number of milk market orders.

Perhaps the major question is whether, in view of the production and processing situation found in any given market, a modification of the seasonal pattern of production is desirable in terms of efficiency in the production and marketing process and really contributes to more orderly marketing. This is

indeed, a complex problem and it is to be doubted it has received the specific and detailed research attention needed, either from local market groups or Government.

The institution of base rating or other seasonal adjustment programs raises a number of problems. Such programs can be so drafted as to limit entry to a greater or lesser degree. They may, depending on several factors, be associated with a changed level of annual production. Rules for modification of bases from year to year may raise serious questions of equity among producers.

5/ Under rulings of several successive Secretaries of Agriculture and opinions of the Department's legal counsel. - Edwin G. Nourse

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It is the judgment of the Committee that seasonal production adjustment plans, whether intended to be effectuated through base rating or price adjustment provisions of orders, be carefully reviewed in order to ascertain whether they (a) are geared to the development of a seasonal pattern of production needed to promote production and marketing efficiency and more orderly marketing, (b) maintain equity among established producers, (c) do not unduly restrict entry of producers seeking a market, or (d) interfere with the alignment of prices from market to market.

As the milk marketing order system has evolved and become more widespread geographically, problems of pricing and pooling milk in adjacent marketing areas have become more important and complex. The coverage of each order as to the plants and producers whose milk is to be priced and pooled as established in many of the earlier orders was too limited to meet the requirements of present conditions. In recent orders the marketing areas have been defined more adequately, and progress is being made toward the expansion and consolidation of those areas which were previously defined too narrowly, but much resistance is encountered from groups that wish to retain their special advantages. Continuing and persistent efforts by the Department as well as by industry groups will be needed to bring about the additional marketing area adjustments that are called for by urban expansion and rapid economical

transportation.

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While better coordination of the provisions of separate orders and greater ease of transfer from one market order pool to another would help, it is clear that the problems arising from piecemeal regulation cannot be fully solved in this way. The Committee believes that the procedure for defining marketing areas suggested in Section 2 of Part II, would help to insure marketing areas of adequate scope, and at the same time serve as a check against unwieldy expansion.

As authorized by the Agricultural Marketing Agreement Act, the Department has accepted or approved a wide variety of provisions in the several orders. In general the initiative in formulating these provisions has been left to local industry groups, more particularly to the milk producers' cooperative associations in the different areas, subject to the limitation of a skeleton frame work of over-riding principles and policies. Within limits, flexibility in adapting order provisions to local conditions and desires is proper and commendable. It is apparent, however, that advantage is sometimes taken of the opportunity afforded local interests to devise regulations that will give them a favored position to the detriment of other producers and handlers. The Committee feels that the Department bears a heavy responsibility to protect the interests of all groups affected by an order, not just those whose milk is priced and pooled by that order.

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The main problem of intermarket relationships involves impediments to the transfer of milk supplies (more especially shipping plant supplies) from one market order pool to another. These impediments have resulted in wide disparities of Class I utilization under adjacent orders. In consequence, even though Class I prices have in general been carefully coordinated, there have been substantial and continuing differences in the blended prices paid producers under such orders. The Committee recognizes the propriety of regional

differences in utilization and prices in the form of geographic patterns that are related to differences in economic conditions. On the other hand, it believes that substantial and continuing differences in utilization and in producer prices under adjacent orders are discriminatory and that they are inconsistent with the basic objective of orderly marketing. In some instances the differences in producer prices are obscured by the payment of high "nearby" differentials out of pool funds, but this merely compounds the problem rather than solving it.

Among the order provisions which sometimes restrict entry into the marketwide pools unreasonably are: pool plant qualification requirements, assignment, of outside milk to the lower classes, compensatory payments, large deductions from pool funds to pay special location differentials to nearby producers, and individual handler pooling. Each of these provisions, with the possible exception of the two last named, is essential or serves a constructive.

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purpose in the various orders. It is only where these regulations are misused with the effect of conferring unwarranted advantages upon certain groups to the detriment of others that they are to be condemned.

The Committee questions whether the special location differentials for "nearby" producers now provided for in several of the orders are justifiable under present conditions especially where high percentages of the pooled milk are used in Class I. It therefore recommends that the justification for such differentials be re-examined, and that where appropriate they be either reduced or eliminated. 6/

Individual handler pooling, though possibly desirable in certain isolated situations, appears to be incompatible with marketwide pooling which is an essential feature of most Federal orders, and tends to defeat the basic purpose of uniform returns to producers. The Committee recommends that this method of pooling be provided for or continued only in exceptional cases where it appears to be especially needed and where it will not tend to cause unfair discrimination against producers or handlers in other markets. 7/

6/ My extensive dissent to much of the material contained in Part II, Section 4, extends also to the three preceding paragraphs. - C.W. Swonger

7/ While agreeing that there is much to be said in favor of marketwide pooling, the report clearly recognizes that it has weaknesses. Until some of these weaknesses are eliminated and Class I prices approach more nearly a supply and demand basis as interpreted in Part I, I cannot join in wholesale condemnation of individual handler pooling. - Edwin W. Gaumnitz .

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In the future, the assignment to producers of long-term bases (i.e., longer than one year) may become a factor in intermarket relations. To avoid undue restriction upon entry to the market order pools, provision should be made in such base plans whereby new producers can acquire bases without unreasonable delay or expense and whereby bases established under one Federal order can be transferred to another on equitable terms. 8/

In general, the Committee favors a policy of relatively free entry of qualified milk supplies to Federal order markets and to Federal order pools. At the same time it recognizes the need for reasonable restraints to insure orderly adjustments and to protect the producers and handlers whose milk is fully priced and pooled from unfair or disruptive competition on the part of handlers and producers who are not subject to such regulation. It is the Committee's view that the Federal orders should be designed and administered to function as closely interrelated parts of a national system of price stabilization rather than to create or preserve special advantages for local groups to the detriment of others. 9/

8/ do not know of a more effective way to seal off a market from the entry of new plants or producers.. If this is not the intent, then why talk about such a proposal? - C. W. Swonger. .

9/ In one or more instances the access of plants and producers to Federal order pools is controlled and restricted by state or local milk inspection agencies. Such extra-order control is undesirable and should be neutralized or eliminated by the Department. - Leland Spencer.

Optimum Administrative Policies Under Existing Law

Reviewing the somewhat fragmentary evaluations and recommendations as have been already set forth, it is evident that, on the several controversial issues of class pricing, pool settlements, and market definition and interrelationships, economic analysis does not yield categorical verdicts of "right" or "wrong", absolutely good or unequivocally bad. It can, however, distinguish between short-run and long-run consequences of given policies or practices. It can likewise distinguish between local or partisan interests and the public interest. Moving from relatively restricted but by no means insignificant practices to issues of broad policy and basic principle, we offer six propositions, summarized from Part II.

(1) We believe that local income enhancement in combination with dairy price support levels established has been allowed to overreach bounds permissible if there is to be long-run stability and orderliness in the national fluid milk market. For the real success of the order system it is incumbent on the Secretary of Agriculture and his aides, and indeed incumbent on producers and distributors, to exercise all the objective judgment and analytical ability at their command to establish prices at levels which will truly reflect the public interest and supply-demand criteria laid down in the Act. Serious results follow if prices are maintained materially above these levels. Besides encouraging greater production than needed to furnish the market with an adequate supply and the

adverse effects that this enlarged volume of surplus has on producers of manufacturing milk, the result is higher prices to consumers and lower volume of sales of fluid milk--at a time when' per capita consumption is already being adversely affected by other factors.

(2) We believe that the trend toward enlargement of old orders, merging of smaller into larger market areas, or broader definition of new order markets should be encouraged. This would facilitate more effective adjustment to

technological and commercial changes, accomplished or now in process, and would be continuously guided by Department studies and administrative decisions. The special interests of local groups and the personal preferences of individual leaders should not be allowed to cramp the public interest any more than results from limitations on the authority of the Department laid down in the law or than producers effect through the hearing and referendum procedure.

(3) We believe that it was the clear intent of the Congress that Secretary's orders should provide public assistance to the private enterprise system rather than superseding it. But when free collective bargaining by strong cooperative associations results in negotiated marketwide premiums substantially and persistently above the uniform prices established in the order, an ambiguous and dangerous situation confronts the order system. Either the Class I price in the order is too low or the premium price too high by an "open market" standard.

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It may be argued under a rechanistic theory of market behavior; that, if free collective bargaining results in over-pricing, the process will be self-correcting. But, experience shows that, with the less-than-completely-free market conditions provided by the Secretary's order and with dairy price supports, monopoloid distortions of the market and intermarket price structure may persist indefinitely. This would defeat the basic purpose of the order system to achieve as fully and promptly as possible a national milk price structure that would be internally consistent, serve consumers needs, and promote optimum allocation of the nation's productive resources. We, therefore, recommend that, in markets where negotiated marketwide premiums (or higher-than-order prices imposed by state agencies) exist, the Department institute hearings to review the level of Class I prices and any limitations on free access to the market. If, thereafter, such premiums still persist consideration should be given to suspension of the pricing and pooling provisions of the order.

(4) We believe that market "rights" should be recognized but administratively safeguarded against abuse contrary to the public interest or the

like interests of other producers. (a) Our analysis and argument throughout Part I and Part II have been consistently in terms of open market (large-unit organized) competition as an equilibrating principle. This subsumes the "right" of consumers to have their milk provided from the cheapest source

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(quality policed), and the "right" of new suppliers to enter any market that they find financially attractive in the light of their production and transportation costs (from time to time reduced through technological or commercial changes). (b) We recognize also the "right" of established producers, with relatively heavy fixed capital investments under modern production techniques and quality standards, to be protected against short-run seasonal or other raids into the market which they normally and regularly supply. But we do not recognize a right of such producers in a dynamic society to prevent indefinitely such changes in market supply as are legitimately based on cost differentials. We believe that the Secretary's aides are in effect "masters in equity" charged with the duty to conduct studies and make determination of structures or practices under orders which tend to infringe either of these "rights," the manner and time schedule at which any exclusionary devices should be removed from the shelter of the order, and whether this correction can be effected through the "friendly persuasion" of the Department or whether it calls for hearings on an amendment to the order proposed by the Government itself or as a last resort, their suspension from the orders. This recommendation is in conformity with the principle of "competition and justifiable shelters" stated in Part I and also in our recommendation made earlier in Part III for a more positive role for the Department.

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(5) We believe that certain current order provisions, such as pool plant requirements, compensatory payments, down-classification of milk from sources outside the pool, and base-rating plans are useful and in certain situations essential provisions for promoting orderly relations between priced

and unpriced milk and between markets. However, they also harbor possibilities for abuse. This would be true if they become the means by which certain "insiders" can gain or maintain an unduly favorable position as against other producers or handlers qualified and desiring to enter the Class I market or to shift between regulated markets. This imposes on the Department an obligation to exercise its influence, vigorously but without autocratic power, to circumscribe and safeguard the use of such restrictions on the free market movement of milk. 10/

(6) We believe that, in general, technological and commercial development presage an expansion of milk supply at least as fast and probably faster than any foreseeable expansion in demand at about present price levels. Hence, the problem of price-depressing surpluses will not go away but must be dealt with sooner or later in some more definitive manner. 11/ Insofar as surpluses are widespread in both Federal order markets and manufactured milk producing

10/ While agreeing with this general statement, it is my conclusion that the use of these devices, however "useful" they may be, have been almost, if not completely, prostituted to protecting unreasonable and indefensible Class I prices. The theory may be defensible, certainly the usual application cannot be. Edwin W. Gaumnitz.

11/ While I agree with the content of the first sentence, I could not accept the second sentence if "more definitive manner" implies that price as a regulator has been found wanting and must be relegated to a minor position, although it is clear that relatively high Class I prices in order markets have been maintained for several years. Edwin W. Gaumnitz

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sectors, a general solution of this problem probably cannot be achieved by adoption of base and excess pricing in order markets alone. Attempts to solve the problem of growing national milk surpluses probably should not be approached on this kind of piece meal bases.

However, to the limited extent that such programs contribute to a slowdown in the rate of growth of surpluses in order markets they will (1)

reduce the pressure of excess supplies on prices of manufactured dairy products, (2) bring about more satisfactory producer prices in these order markets, (3) forestall uneconomic investment in surplus disposal facilities, and (4) reduce a major element of local market instability.

The philosophy that milk prices have been and should be the principal organizer of economic activity in the dairy industry has been amended by the requirements of practical democratic statesmanship and substantial evidence that prices, alone, leave much to be desired as guides to decision-making in milk production and marketing. Milk prices are simply one species of a whole genus of forces acting on milk supplies and markets. Placing primary reliance on such prices as guides to achieve satisfactory performance of the dairy industry is probably too great a burden to place on a single economic factor and reflects an optimism unwarranted by the available evidence about the responsiveness of economic units to its

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influence in the real world. 12/ In practice it has been necessary to supplement the guiding influence of price with numerous other guides to producers or handlers in order to achieve market performance consistent with the public interest.

In face of the apparently growing inadequacy of measures hitherto used, the Committee urges that serious consideration be given by the Department to use of more direct and sharply defined measures to achieve a better balance between fluid milk market supplies and demand. More effective base and surplus pricing practices offer some promise and represent a logical extension of existing practices in order markets. Adoption of such measures, when and if necessary Congressional authorization is secured, should proceed cautiously through the normal hearing procedures. (But see footnotes in Part II, Section 3.) Leadership should be exercised by the Department in assuring that these order changes necessary to achieve internal consistency as well as conformance with general Department policy will be achieved.

12/ It is difficult to see how the Conunittee could arrive at the conclusions set forth in this sentence and the second one preceding it. The first sentence seems to imply that "practical democratic statesmanship" is now the principal organizer of economic activity in the dairy industry, and that placing primary reliance on prices as a guide is too great a burden. Second, there is no' evidence throughout the report that the Standards of the Act with reference to price have been applied for at least the past ten years. Edwin W. Gaumnitz, Otie M. Reed.

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(7) We believe that the Secretary must exercise care to avoid short-run partisan positions in the interests of fluid milk producers as may run counter to other dairy intere sts of the general economy, or the long-run interests of the fluid milk producer himself. Tradi tionally the order program has dealt most directly with market milk problems. The growing inter relationships between the market milk and manufacturing milk segrents now mandate extreme care to avoid arbitrary decisions in the market milk sector which may work hardships on the manufacturing sector. Moreover, modern marketing conditions bring handler interests and handler problems more and more often to the core of orderly marketing issues.

The Secretary is empowered and entrusted to develop a system of orders; integrated as to their relations with each other and to all the uses into which milk goes, not merely orderly as to their internal housekeeping. He is cabinet minister to the nation's agriculture, with equal obligation to all farmers.

(8) The Agricultural Marketing Agreement Act gave broad discretionary power to the Secretary. Administrative considerations such as ease, economy and feasibility appear to have played a major role in shaping the policies and directions of some aspects of the order program. Defining marketing areas, granting exemption from regulation, establishment of compensatory payments as well as the specific payment rates, and curtailing the detail of market examinations and analyses prior to promulgation hearings appear to be examples

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of where considerable influence of administrative convenience considerations

have been felt.

The Secretary must be vigilant to be sure that administrative considerations are put in proper perspective with other factors and not allowed to override issues of principle.

To provide a better basis for current policy decisions as well as appraisals of the consequences of past decisions, research undertakings of the Department should be expanded both in Washington and in local order markets and also by State institutions and private research agencies. The growing body of statistical data on current and historical operations of orders is a welcome and necessary underpinning of such research. 13/

13/ An Addendum - At many places in the course of the report (particularly Part II, Sections 3 and 4), members of the committee have appended numerous qualifying footnotes or outright dissents. As a result, it is quite possible that some readers might "fail to see the woods for the trees." It therefore seems desirable to the "Minority of Nine" alluded to in the Chairman's note on page 23 of Part I to join in a summarizing statement of the broad differences in factual analysis, economic philosophy, and social values that distinguish their position and recommendations from those of the Majority of Nine. .

The closing section of Part III (Evaluation and Recommendations) that was submitted in the course of the December and January meetings of the committee was captioned "The Big Pending Issue." That issue was characterized as a choice between (a) continuing the low-pressure, educational, analytical, and pragmatic policies and

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practices of the marketing order system as it has been evolving vs. (b) a change of pace and indeed of direction which, its proponents allege, would cope more decisively and speedily with the persistent problem of large and growing surpluses of milk and its products, i.e., official "supply management" or, ultimately, government control.

The drafting of Sections 3 and 4 of Part II and the redrafting of the latter portion of Part III (also an insert in Section 1 of Part II) has been marked by considerable dialectical subtlety.

But an evident premise of the writers was that any "big pending issue" is a figment of the "minority's" imagination or a product of their misunderstanding of the true situation and the real nature of "supply management" proposals. These proposals are disarmingly presented under the label "extended use of producer bases in order markets--a natural development of modern pooling

methods.”

The fine points of this debate are adequately set forth, in context, as they emerge in the course of the report. We do not intend to make this addendum a resume of that often technical material but, rather, a brief “position paper” that will make clear the basis of our fundamental disagreement with the proposals of the “majority.” Our dissenting statement will focus on four major issues.

(1) Extended use of producer bases in order markets would not be a sound prescription for what ails the national milk market or even any particular order market, if part of a national marketing system. Its proponents, to be sure, do not claim that it would meet the present dilemma of enormous and growing national milk surpluses and the heavy burden imposed on the Federal budget by current measures for dealing with them. In fact, they try to disengage themselves from this larger crisis by saying that “such would lie outside the assignment of the Committee.” (II-3-16) We doubt, however, that this easy disengagement from the Battle of the Milk Bulge is logically possible or was desired of us by the Secretary. What is done within the order system has unavoidable repercussions in non-order markets, and production and income conditions in the order markets inevitably feel the impact of national surplus and national milk product price supports.

This is tacitly recognized on the very next page of the subcommittee report, where they say: “It seems obvious that steps which will prevent the further development of surpluses--from whatever.

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source, local or otherwise--are basic to improvement of producer incomes.” (II-3-18) And a few paragraphs later: “Under several circumstances producer base plans might usefully be adopted to solve the twin objectives of bringing local milk supplies into better balance with local market needs and reducing the contribution of local surplus to the national milk supply problem.” (II-3-23)

To us, however, it appears unreasonable, on the basis of logic and past experience, to expect that even such local benefit and ultimate contribution to solution of the over-all problem, could equitably be realized. We find no indication that these advocates of “producer bases in order markets” are willing to accept the idea of substantial reduction either of milk volume or milk producers--without which it is hard to see how significant amelioration of the surplus problem could be brought about even in an individual market. “Closed bases” are not authorized under the present law and, even if authorized by new legislation, would be opposed by the insiders of an order market who wished to expand as well as by outsiders, who assert a “right” at least to “earn” entry----however restrictive the terms. “Earning” equates with “performance,” and performance equates with more milk. This is as futile a line of attack on surplus as was King Canute’s legendary attempt to sweep back the

sea.

(2) But it is worse than futile. Our second proposition is that resort to extended use of producer bases would inevitably aggravate the situation of the particular order market and ultimately of the national market. The early base-surplus plans of the cooperatives had two recognized objectives: (a) seasonal supply levelling, (b) income enhancement to members. Some among our committee, on the basis of their studies and experience, have expressed doubt that levelling market supply through change in the seasonal pattern of production has economic justification under present transportation conditions and processing and storage technology. Certainly, supply levelling plays only an incidental (and quite possible mischievous) part in the extended use of bases in order markets. Their use is presented frankly in Section 3 Part II as a means of income enhancement or at least income maintenance. History does not suggest that producer groups that come into possession of a supply management device will fail to exploit vigorously its possibilities for raising their incomes, even at the expense of other producers.

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Income enhancement is not} as such} an unworthy purpose for producers or an improper objective of the order system. But its incorporation into a marketing system raises sharply the issue of degree or of the standards to be used. At what level shall income be maintained or to what level shall prices be raised through supply control? We submit that under any apparatus of bases, allotments, or quotas, the criterion will be one external to the economic functioning of the fluid milk industry. The "extended use of producer bases," even though having a nominally functional determinant in the "performance" or "earring" test, would have to base its scheme of regulations on some explicit or implied price target. This would be formulated in a setting of normative concepts such as "parity" or "fair price" or an "equitable" income position for the milk producers--all concepts or goals that engender controversy and power struggles} including struggles between competing groups of producers} rather than invoking and being guided by well-tested economic principles.

Thus, a foreseeable consequence of acceptance by the Secretary of Agriculture of extended bases as the apparatus of "more direct and sharply defined measures to achieve a better balance between fluid milk market supplies and demand," would be a price bulge in this market or that, Where conditions were particularly favorable or leadership particularly aggressive. Whether this was brought about through the Class I price or through a negotiated marketwide premium, other markets would seek to emulate or top this local achievement, and the Department would be under the greatest pressure to "co-ordinate" the price structure by letting other markets come up to this new price level.

In a word} the extended use of producer bases would tend to engender a

consumption-damping price trend just when consumption encouragement is indicated by all the laws of logic.

(3) Such a course of events would be highly inimical to the full flowering--or even the present state of health--of the "unique" institution of private-and-public price administration embodied in the milk marketing order system. Instead of an evolving system of markets, becoming more and more integrated over the years on a regional and national basis, through comprehensive study of interrelated market forces, we would have a congeries of self-contained, largely unrelated, restricted, and monopoloid markets. The system rather than moving, however haltingly, toward commercial co-ordination of free movement of milk, and sound allocation of productive resources

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would become fractionated, with lowered efficiency, retarded technological progress and neglect of the public interest. Extended use of producer bases could be viewed as "a natural development of modern pooling methods" only if "modern" pooling is, in intent and effect, a restrictionary device, which was now to be made standard practice for the whole national market, under Secretary's orders.

It is not too difficult to see why the representatives of fluid milk producers in the relatively high-cost areas of the Northeast or the Southeast, where a seasonal deficit for a metropolitan market has been normal, might find "extended use of producer bases" an attractive proposal. But that operators or students located in the Upper Mississippi Valley or Great Lakes Region, and some similar situations where they are "surrounded by a sea of milk" and a strongly rising tide of production newly qualified for Grade A should suppose such an apparatus for sectional market restriction, would operate to their advantage does not seem to square with recognized principles of logic.

Furthermore, immediate gains to established and favorably situated producers, if realized, would without much delay be capitalized into land or "franchise" values, and average costs would trend upward. Vested interests would steadily be crystalized instead of being progressively liquidated in the public interest. The phenomenon of capitalization of profits (as has been all too well demonstrated under the tobacco programs) has adverse impacts on producers in the long run as well as adverse effects on consumers from price increases. Only one generation of farm operators (and that a short one) reap the immediate benefits of a given price upping, whereas future farmers are confronted by a higher financial hurdle to entrance into the business and must meet higher fixed charges against their operating revenues.

It is plainly evident that the base-excess pricing proposal submitted in this report represents a defeatist philosophy with regard to the future of agricultural policy and individual farm operation. The "majority" report glosses

over the fact that the failure of the marketing order program to cope with the problem of ever-growing surplus milk is not due primarily to structural defects in the order system but to the level of class prices and negotiated premiums that it has underwritten administratively and to the support prices for dairy products based on other laws.

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Discouraged at the severity of the task of getting back to a self-sustaining price-and-production pattern for fluid milk, the Administration would now inaugurate a "crash" program of production quotas and nationwide control, with drastic dropping of dairy support prices and massive dumping of CCC stocks as the grim alternative. Shirking the interminable intellectual effort and the civic (i.e., public interest) individual and group self-discipline entailed in "agricultural adjustment" of this segment of the economy to changing circumstances of technology and market demand, these men-of-action would cut "the Gordian Knot" with the sword of government control.

Our position on the issue now pending before the Congress and in the milk marketing order markets is admittedly a "conservative" one--conservative in the literal sense of conserving the principle of private enterprise in agricultural production and in the distribution and processing of milk and dairy products. It does not define the Secretary's official duty as "giving the farmers what they want." Nor does it promise to produce prompt and substantial enhancement of income to the dairy industry" as is." It presupposes a willingness of organized producers of milk for city markets (i.e., "metropolitan complexes") to gear their farm management and market bargaining to the realities of demand elasticities, cost ranges under varying operational conditions, and the final criterion of competitive individual efficiency and optimum allocation of resources of labor (including special skills) and capital in this large segment of the agricultural industry.

But this is not a reactionary position----as the present text tries to represent it. We did not claim or even imply that price is the only determining force in the milk market. Technology, marketing institutions, and the policies of administrative officials of co-operative associations, of distributor organizations, as well as managerial decisions of individuals, and of the Department, were all recognized as significant parts of the economic complex that is our modern milk industry. The whole order system is an institution designed to supplement "the great impersonal force of the market."

At the same time, we were not ready to disavow the primacy of prices in this whole mechanism of production, income distribution, and consumption. We were not dreaming of economic "short cuts" through which the responsibilities of making business choices and living with the consequences of these decisions would be evaded--or through which

the possibility of also reaping the fruits of opportunity seized would be curtailed. Under the law as it stands, the Department is restricted to use of the price mechanism, modified from a privately competitive market structure to one of independent producer operation but with limited regulatory powers in Government hands. This is designed to accomplish the goal of active competition among large producer and handler units--a "perfect" administered market.

(4) Finally, we believe that the proposed extension in the use of producer bases must be evaluated in the broad context of its ultimate consequences, rather than in the narrow perspective of insulated action taken voluntarily and tentatively in particular order markets.

The Majority of Nine, in their passages in the report of this committee are careful to keep clear of overt espousal of the national quota plan. But the "extended use of producer bases" would not be a benign growth of an accepted and acceptable feature of traditional co-operative practice congenial to the public interest and supply and-demand criteria: laid down in the Marketing Agreement Act. It makes one of the most dubious--because most potentially decisive and restrictionary--devices permitted within the order system the point of departure from which to inaugurate the march toward full government control for the fluid milk industry. It might be that what would follow would be only a succession of mincing little steps in that direction, rather than the bold stride proposed in the Administration bill at the present time. But the decision to extend the use of producer bases would be seen in retrospect as the decisive step that marked a basic change in direction of the order system from private-and-public regularization to government control.

We believe that it is the first step in a sequence difficult, if not impossible to reverse, that would lead from extended producer bases, to market allotments, quotas, eventual production control, and finally, distribution. Their attempt to minimize the character of the step they propose is reminiscent of the well-known excuse of Trilby for her mis-step on the ground that it was "such a little baby." .

Supply management for producers within a milkshed would most assuredly lead to outright restriction of entry of competitive milk supplies including milk from other order markets. This would involve amendment of the Act to authorize such limitation of entry, and hence would require amendment or repeal of Section 8c(5)(G). It would

involve an internal contradiction to permit entry of "outside" milk while at the

same time conducting a quota program to restrict bases of producers regularly associated with the market.

Furthermore, administrative difficulties would be colossal if not insuperable. Equity and workability in relationship between order markets, between producers and handlers serving different markets, between producers within the same market, and between regulated milk markets and nonregulated segments of the dairy industry would be difficult to establish and even more difficult to get accepted. But administration of orders must be as an intergrated system, not a conglomeration of separate and special "deals." The piecemeal attack advocated in the report would be ineffectual even within the terms in which it is proposed. Supply management, to be effective, must be rigorous and authoratative. A "soft" program would undermine the whole idea of coordination, so basic to the whole order system.

We are unable to accept the trend toward extension of Government control proposed by the recorded majority in this report. We admit that under the more self-reliant philosophy expressed in the present order systems, with its multi-managerial organization, resu.lts are slow of realization and beset by ever-recurring new problems, as technology, consumer behavior, and the normal clash of individual or group interests have to be dealt with. The same may be said of the free enterprise system as a whole and of the democratic pattern of Government within which the entire economy has its setting. But we believe its results justify its continuance.

Gordon M. Cairns,	George N. Pederson,
David A. Clarke,	Otie M. Reed,
Edwin W. Gaumnitz,	James L. Reeves
Judson P. Mason,	C. W. Swonger,
Edwin G. Nourse,	E. E. Vial