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## **The Pricing Policies and Goals of Federal Milk Order Regulations: Time for Reevaluation**

by

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# THE PRICING POLICIES AND GOALS OF FEDERAL MILK ORDER REGULATIONS: TIME FOR REEVALUATION

by ROBERT TEMPEST MASSON\* AND PHILIP M. EISENSTAT\*\*

## INTRODUCTION

Virtually all milk in the United States is under either state or federal milk order regulation.<sup>1</sup> Federal milk regulation began in the Depression and developed rapidly during the 1930's.<sup>2</sup> The 1937 Act forms the core of the present system; despite subsequent amendments and expansions, the goals of milk regulation remain as originally codified in 1937. These goals are threefold: (1) providing for "orderly marketing"; (2) assuring an adequate supply of milk; and (3) raising farmers' incomes. The goals are tempered by a balancing test: the Secretary of Agriculture, to promulgate an order, must "fix such prices as he finds will reflect [economic conditions including supply, demand, costs of feed, etc.], insure a sufficient quantity of pure and

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1. Federal regulation constitutes two-thirds of the total; state regulation is similar in practice to the federal. This article will examine only the Congressional goals of regulation.

2. The Agricultural Adjustment Act of 1933 (AAA) Pub. L. No. 73-10, 48 Stat. 31, amended in 1935, Pub. L. No. 74-320, 49 Stat. 750, and the Agricultural Marketing Agreements Act of 1937, Pub. L. No. 75-137, 50 Stat. 246 (codified at 7 U.S.C. §§ 601-624 (1970)).

The 1933 and 1935 Acts were explicitly emergency Acts. The 1937 Act omitted the emergency wording of the earlier Acts, the House Report noting there was no longer an emergency as had existed in 1933. H.R. REP. NO. 468, 75th Cong., 1st Sess. 2, 5 (1937). The legislative history indicates that the Act was intended as a measure to protect farmers who would potentially be hurt by *United States v. Butler*, 297 U.S. 1 (1936), until there could be a substantive decision on the order system as a whole. *Butler* held that a processing tax on certain cotton commodities was based on unconstitutional taxing provisions of the AAA. They were ruled as an unconstitutional exercise of power by Congress, which invaded the reserved rights of the states. Congress was uncertain whether this invalidated the entire Act. The Committee feared that any "test case" might simply cite *Butler* as invalidating the entire 1933 Act. To insure substantive review, Congress reenacted certain provisions of the 1933 Act in the 1937 Act. H.R. REP. NO. 468, 75th Cong., 1st Sess. 2 (1937). Haste was needed because of a perceived emergency in one milk marketing area where a local district court had ruled that *Butler* had invalidated the entire 1933 Act, 81 CONG. REC. 3594 (1937) (remarks of Representative Jones referring to *United States v. David Buttrick Co.*, 15 F. Supp. 655 (D. Mass. 1936)). See also S. REP. NO. 565, 75th Cong., 1st Sess. 2-3 (1937). Congress wanted continuing protection of the orders until a substantive decision could be made on the order system.

wholesome milk, *and be in the public interest*”.<sup>3</sup>

Both the controlling principles and the mechanisms of milk regulation were established in the 1930's. Changes in technology and society, combined with forty years of interpretation by the United States Department of Agriculture (USDA), have resulted in a milk regulation scheme that is widely divergent from the original goals of Congress. Thus, if 1930's principles are to continue to control, it is time for Congress and the USDA to reevaluate the ability of 1930's mechanisms to achieve those ends. If the principles are no longer those that guide milk regulation, Congress should clarify its current goals and explicitly grapple with changed conditions.

The call for reevaluation is based on three premises:<sup>4</sup> (1) programs to raise farmer incomes by raising their prices cannot succeed in the long run;<sup>5</sup> (2) adequate milk supplies and orderly marketing conditions may be achieved with lower prices;<sup>6</sup> (3) since dairy regulation currently levies the heaviest taxes against poorer people to subsidize mainly richer farmers, the reasons for achieving the income goal by current processes are obsolete.<sup>7</sup>

To state the argument positively, it will be shown that costs to society could be lowered in the Upper Middlewest without threatening orderly marketing or supply adequacy by lowering the price of

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H.R. REP. NO. 468, 75th Cong., 1st Sess. 1-2 (1937). *See also* S. REP. NO. 565, 75th Cong., 1st Sess. 2-3 (1937).

For further discussion of the legislative history and background information *see* Fones, Hall & Masson, *Milk Marketing*, U.S. DEPT OF JUSTICE, G.P.O. Washington, D.C. (1977) [hereinafter cited as DOJ REPORT]; Fones, Hall & Masson, *Federal Milk Marketing Orders and Price Supports*, AMERICAN ENTERPRISE INSTITUTE SERIES: FORD ADMINISTRATION PAPERS ON REGULATORY REFORM (1977).

3. 7 U.S.C. § 608c(18) (1970) (emphasis added). Actually the adequate supply goal was modified by amendment in 1973 to include not simply "current needs" but also "anticipated needs." 7 U.S.C. § 608c(18) (1970).

4. The first two premises are strictly economic premises, *i.e.* they are in the realm of "positive economics": their truth is a purely factual issue. Evidence may be brought to bear to substantiate an opinion that they are either true or false, but their ultimate truth is not a matter of opinion or of values. The third premise has a factual basis, but ultimately, at least for future application, requires a judgment on goals. It is in the realm of "normative economics": there is no ultimate truth of this premise. The premise itself involves a value judgment over which reasonable men may disagree.

5. This is consistent with virtually all economic thought since D. RICARDO, *PRINCIPLES OF POLITICAL ECONOMY AND TAXATION* (1817). That even the United States Department of Agriculture (USDA) accepts this logic is evidenced by the Economic Research Service of the USDA, *STAFF OF SENATE COMM. COST OF PRODUCING MILK IN THE UNITED STATES-1974*, 9 (Comm. Print 1976).

6. The complexity of this premise is such that full justification is beyond the scope of this paper. It is sufficient for our present purposes to show that the second premise is true for at least sixteen percent of our nation's grade A milk supply: that portion which is located roughly in the states of Minnesota and Wisconsin and consumed as fluid milk in this area through to Chicago. U.S. DEPT OF AGRICULTURE, *STAT. REP. SERV. MILK: PRODUCTION, DISTRIBUTION, AND INCOME: 1972-74*, 6, 10 (1975).

7. This involves the value judgment that while it may be socially desirable to transfer money from richer consumers to poorer farmers, it is not desirable to transfer it from poorer consumers to richer farmers. Over the last four decades the effects of the dairy regulations have moved from the former to the latter.

fluid milk in these areas. Although this would lower farmers' incomes, the present subsidization of richer farmers by poorer consumers fails the balancing test of the public interest. Therefore, the administration of the milk pricing regulation in these areas contravenes the goals of the 1937 Act. Thus, by establishing the misapplication of the Congressional standards in this market area, a *prima facie* case is established for bringing into doubt whether the standard is appropriately applied in other market areas.

#### MILK REGULATION IN THE 1930'S

##### *The Regulatory Scheme*

The essence of milk regulation is the legislation of minimum prices that buyers must pay for raw Grade A milk.<sup>8</sup> The price that must be paid for Grade A milk depends upon the final use of the milk. Whenever a purchaser of raw milk uses that milk for sale as a fluid product, *e.g.*, bottled milk, he must pay a "Class I price" for the milk. If instead that milk is used for manufacturing purposes, *e.g.*, cheese, butter, powdered milk, ice cream or yogurt, the buyer would only be required to pay the *lower* "Class II price" for the milk.<sup>9</sup> All of the money paid for the milk within an entire market area is put into a "pool". At the end of each month all the receipts in the "pool" are totaled. These receipts are then distributed to the farmers who sold milk in the market in an amount proportional to the farmers' total milk sales, regardless of the final disposition of any individual farmer's milk.

For example, assume a Class I price of ten dollars per hundred-weight (cwt).<sup>10</sup> If one thousand cwts were used as Class I milk, Class I revenues paid into the pool would be ten thousand dollars. Assume further a Class II price of eight dollars. The use of one thousand cwts of Class II milk would add eight thousand dollars to the pool. By dividing the total receipts of eighteen thousand dollars, by two thousand cwts, the average price or "blend" price equals nine dollars per cwt. Every farmer contributing to the pool would receive nine dollars for each cwt he delivered to market outlets. This market would be said to have a "fifty percent Class I utilization", meaning that fifty percent of the milk went into Class I use. By the same analysis, if forty percent of the milk were Class I the resulting blend price paid to farmers would be \$8.80; thirty percent would lead to \$8.60, ten percent to \$8.20, etc.

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8. Grade A milk, the bulk of the milk in the United States, is milk that satisfies the sanitary standards required for milk that may be used for fluid bottling. Grade B milk, which may be used only for manufacturing into cheese, butter, powder, etc., is not regulated. Except as otherwise noted, the term "milk" will refer to regulated Grade A milk.

9. In some markets, higher number classes exist also for manufacturing purposes. Since each of these latter classes have closely similar prices and marketing conditions to Class II, discussion of Class II milk includes these other classes as well.

10. 100 lbs. or 11.68 gallons. \$10 per cwt is roughly typical of recent prices.

*The Goals of Milk Regulation***Raising Farm Income: Desirable Monopoly-Type Pricing in the 1930's**

These regulations operate to legislate a mandatory system of price discrimination; different prices are paid for different units of the same commodity when the cost of production and delivery is the same for these different units.<sup>11</sup> Price discrimination is a tool of monopoly pricing and is used by the industrial monopolist to raise his price and limit his total production. In farming, "monopoly-type pricing" raises the price for fluid use and limits Class I purchases in the process. Individual farmers, however, react to this higher price by expanded production. To maintain the monopoly-type pricing system, the extra production cannot be sold for fluid use but is used instead for manufactured milk products.

Not only was the discriminatory monopoly-type aspect of this pricing recognized in the 1930's, it was considered desirable. In an effort to recover from the Depression, the prevailing economic logic was that higher prices led to higher profits. Higher profits in turn would lead to greater production, and thus greater employment.<sup>12</sup> This logic was applied to the farm sector: "The present economic emergency is in large part the result of the impoverished condition of agriculture and the lack of the ability of farmers to purchase industries' commodities."<sup>13</sup>

The 1933 Act, unlike the 1935 and 1937 Acts, did not specifically mandate classified pricing. On the day it was passed into law, however, PMA, a Chicago area cooperative, applied under the Act for a USDA license that would establish classified pricing for PMA's milk and legally prohibit any competitors from selling below PMA's price. In short order, it was approved by the USDA; by the end of the year, fourteen other markets had closely copied the PMA-regulated license plan.<sup>14</sup> The monopoly aspect of this pricing scheme was a primary desirable element of the program in 1933 (and 1935 and 1937). A 1937 USDA report<sup>15</sup> observed that prior to the legislation, a less restrictive

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11. Often, the farmer delivers his milk to a single outlet on a given day. Whether units of that milk cost the outlet a high price or a low price depends solely upon whether the buyer subsequently "turns the spigot" leading to his bottling line or the spigot leading to his ice cream line.

12. See National Recovery Act, 15 U.S.C. §§ 701-714p (Supp. 1933), under which the National Recovery Act Association (NRAA) was established to help businessmen to agree with each other to charge higher prices. Actually, such a scheme should have generally perverse effects. Higher prices should lead to the ability to sell less, the desire to produce less, and a lessening of the need for employees. The NRA was held unconstitutional in *Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935).

13. H.R. REP. NO. 6, 73rd Cong., 1st Sess. 7 (1933).

14. NOURSE, *MARKETING AGREEMENTS UNDER AAA 50* (1935) [hereinafter cited as NOURSE].

15. U.S. DEP'T OF AGRICULTURE, AG. ADJUSTMENT ADMIN. *SOME PROBLEMS INVOLVED IN ESTABLISHING MILK PRICES 22-27* (1937) [hereinafter cited as PROBLEMS INVOLVED].

and less stable version of this monopoly-type pricing existed in some markets when a single cooperative had a dominant market share. The report presents the basic economic model of this type of "classified milk pricing", using the economists' tools of setting marginal revenue equal to marginal cost to maximize monopoly gain.<sup>16</sup> Monopoly pricing worked because of demand elasticities. USDA and farmers noted that fluid milk had inelastic demand and that manufactured products had elastic demand.<sup>17</sup> For example, assume one hundred cwts of Class I milk and one hundred cwts of Class II milk is being sold, and both are sold at a price of two dollars per cwt, as was roughly typical in the 1930's. Class I revenues are two hundred dollars and Class II revenues are two hundred dollars. Total farm revenues are four hundred dollars and the average price received is two dollars per cwt. Then assume the Class I price is raised to three dollars per cwt, causing Class I consumption to go down to ninety cwts. Class I revenues are then two hundred and seventy dollars, up from the

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16. *Id.* The authors of the USDA report develop the history noting that classified pricing plans arose only where there was cooperative organization of most of the market. They then develop their "commodity price discrimination" model. They note that it is a "monopolistic competition" model, but change the term to "complex competition" to avoid the pejorative connotations. They later defend regulated classified pricing. They state that it is more stable than cooperative classified pricing. They explain, however, how competition can remove the "arbitrary", i.e. monopolistic, element from unregulated cooperative pricing. They continue, in defense, to state that if there is no arbitrary element in regulated prices, the pricing is desirable. They are writing prior to the full implementation of the 1937 Act, so their positions appear to be that USDA will not choose to price where there is any arbitrary element. They seem to be stating in their theory section that arbitrary pricing is monopoly power pricing and monopoly power pricing is the only reason for surpluses in excess of the "seasonal/and daily" excess, i.e. additional surpluses indicate that regulation is "arbitrary," and monopolistic. Their concluding section then states:

It might appear that the purpose of the act . . . could be achieved through the practice of arbitrarily pricing Class I milk . . . . However, any attempt at maintaining prices on an arbitrary level not only has a tendency, other factors being the same, to increase production within the supply area but also has a marked tendency to attract supplies from new sources, *thus making it necessary to adjust prices so that the arbitrary element is removed.*

They saw the 1937 Act as a way of protecting consumers from even higher coop prices and protecting producers from fluctuating prices, not as a mechanism to get Class I prices in excess of those needed to maintain a reserve for daily and seasonal factors. *Id.* at 22-27, 75, 123-28, 165-72, 177-78 (emphasis added).

17. A product is said to have inelastic demand when if the product's price is raised by one percent the amount consumed falls by less than one percent. Clearly, if a price rise of one percent yields a quantity decrease of less than one percent, the total revenues received from the sale will increase as price is increased. Alternatively, a product is said to have elastic demand if a rise in its price of one percent would decrease its consumption by more than one percent. In such a market, total revenues may be raised by lowering price rather than raising it. Thus, for any given milk supply, raising the milk price in the fluid market where demand was inelastic would raise total farm revenues, even if the milk released from that market were not sold elsewhere. The milk released from fluid consumption, however, would then be put into the elastic manufacturing milk market. And putting milk into an elastic market will raise total revenues. Thus both Class I revenues and Class II revenues are increased by this process. PROBLEMS INVOLVED, *supra* note 15, at 123-28 recognized this model as underlying classified pricing.

previous amount of two hundred dollars. We shall assume, as did the 1937 USDA report that developed this model,<sup>18</sup> that when these ten cwt's are added to the Class II market, the price in the market does not go down—it remains at two dollars. Then the one hundred and ten Class II cwt's at two dollars per cwt are worth two hundred and twenty dollars, again up from the previous two hundred dollars of Class II revenues. Total revenues are now four hundred and ninety dollars, and the average price is raised to \$2.45.

So far, it has been assumed that total farm production has not increased and that direct farm production costs have not changed. The forty-five cents per cwt would, therefore, be reflected in increased farm income. Of course, over time, the higher price would attract more milk production, but the logic remains the same. For any amount of production, the price will be higher than that which would have prevailed for the supply without this classified pricing. And if, as all work has shown, the supply curve for milk slopes upwards, *i.e.*, to induce farmers to expand and maintain higher milk production we would have to pay them a higher price, some element of the farm price rise will remain forever.<sup>19</sup>

The demand for a product is simply the price that can be received in consumer markets from a given quantity supplied. In our example the two hundred cwt's of milk received two dollars per cwt from consumers before the classified pricing. After the classified pricing consumers paid an average price of \$2.45 per cwt for the same amount of milk. In effect, this monopoly-type pricing artificially raises the demand curve, which represents what consumers will pay without monopoly-type pricing and establishes a *higher artificial demand curve*, which shows what consumers will be willing to pay *on average* if they must pay an artificially inflated price for fluid milk. This artificially raised demand curve was noted and derived analytically in the 1937 USDA Report cited above. Those authors did not call it a demand curve because of its artificial nature. They instead called it an "a'r" (average revenue) curve. They noted that the market will appear to be in supply-demand equilibrium not when supply is equated with (true) demand, but when supply is equated with a'r' (artificial demand).<sup>20</sup>

Understanding this process is crucial to understanding why these Acts were desired in the 1930's. Understanding this process is also critical, however, to understanding that much of the rhetoric

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18. *Id.*

19. *Id.* Estimates of actual supply curve relationships indicate that not only is it upwards sloping, but it is "steep", *i.e.*, inelastic. Cf. Cheng, Courtney & Schmitz, *A Polynomial Lag Formulation of Milk Production Response*, AM. J. AGRICULTURAL ECON., February 1972 [hereinafter cited as Cheng]; Halverson, *The Response of Milk Production to Price*, J. FARM ECON., August, 1958 [hereinafter cited as Halverson].

20. PROBLEMS INVOLVED, *supra* note 15, at 123-28. The actual demand curve is noted as "ar", average revenue. The a'r' is also called average revenue, but is not called demand.

cited in support of the status quo is fallacious. One continually hears the story that regulation could not have artificially raised prices, because if they had been artificially raised, supply would exceed demand and we would have unused milk.<sup>21</sup> The fallacy in this logic is obvious.<sup>22</sup>

The elimination of disorderly marketing, discussed in the next section, also had the effect of raising farm income. The passage of the 1937 Act was seen as a way to reduce waste and inefficient shipping, thus increasing the benefit to farmers and raising their purchasing power.<sup>23</sup>

### Creating Orderly Marketing: Reducing the Violent and Wasteful Competition of the 1930's

"Orderly" and "disorderly" marketing have defied precise definition.<sup>24</sup> It is clear that milk marketing in the 1920's and 1930's was

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21. If GM were an automobile monopoly one would never see "surplus unsellable" cars because GM would artificially restrict output to less than competitive supply. Similarly here, we would not observe "surplus unsellable" milk because the demand is artificially raised by the system. In neither case does the absence of unsellable surpluses indicate that prices are reasonable, efficient, or competitive.

22. Of course much milk surplus is removed through price support purchases. In the 1960's support purchases ran from 2.7% to 11.2% of total production and cost from \$68.6 million to \$412 million. In the 1970's through 1975 support purchases have run from .6% to 6.05% and the expense has run from \$70.9 million to \$496.1 million. *Agricultural Stabilization and Conservation Service, USDA, Washington, D.C. See also Bergland, U.S. Department of Agriculture Comments on the Department of Justice Report on Milk Marketing*, May 26, 1977 [hereinafter referred to as *Comments*]. In this document, transmitted from the Secretary of Agriculture to the Attorney General, the USDA states that the 1975 values (2.08% and \$496.1 million) were "unusual", e.g., "high". They continue by asking: "However, these expenditures are misleading in terms of the actual milk supply-demand situation. During 1975, market prices for butter and cheese exceeded Government purchase prices by substantial amounts." *Id.* at 30.

We are not certain about this "alternative explanation." In the years 1960-1975, 2.08% was the second lowest percent observed, surpassed only by .61% in 1974. In 1977, purchases were about \$700 million. Many observers are speculating on a new record level of Commodity Credit (CCC) expenditures on milk for this year. Informal projections arrive at predictions of support purchases in excess of \$1 billion this year, although published projections are only around \$900 million. The surplus has now reached "emergency" proportions. Congressman Jeffords has in response introduced "The Dairy Herd Reduction Act of 1978" to pay farmers by the pound for all cows eliminated in excess of 12% of their herd size, but not to exceed 25%. His stated intention is to reduce the United States dairy herd by five percent (570,000 cows) because "the CCC will find itself in the impossible position of trying to dispose of unneeded supplies . . . [from] an already overburdened market." 123 CONG. REC. E 7547 (daily ed. Jan. 4, 1978) (remarks of Rep. Jeffords); letter to Dear Colleague, from James M. Jeffords, February 15, 1978.

With respect to the reference to prices in *Comments, supra*, the fact that sellers willingly sold almost \$500 million worth of products to the government, in our mind controls over noting some price divergences.

23. H.R. REP. NO. 468, 75th Cong., 1st Sess. 2, 5 (1937).

24. It has something to do with "an orderly flow of the supply thereof to market throughout its normal marketing season to avoid unreasonable fluctuations in supplies and prices." 7 U.S.C. § 602(4) (1970). As we shall see, however,



characterized by numerous milk strikes and lockouts.<sup>25</sup> These in turn led to violence, in the course of which milk trucks were shot at and milk plants (some owned by farmers) bombed.<sup>26</sup> The result was that much milk was wasted by inefficient shipment and literal spilling, with no benefit to the farmers. The reasons for the disorderly conditions are traceable to several factors, including the interaction between milk's inherent characteristics (perishability) with the technology and the social climate of the times, as well as recent legal changes that had begun to affect the relative bargaining strength of organized sellers versus their buyers.<sup>27</sup>

Prior to the passage of the Clayton Act<sup>28</sup> and the Capper-Volstead Act<sup>29</sup> almost all farmers had no market power. Organization into a joint marketing cooperative could have been held to be an illegal contract or combination in restraint of trade in violation of either the Sherman Act<sup>30</sup> or any of several state statutes. Prior to 1916 cooperatives had little permanent foothold. But shortly thereafter the coop movement ballooned and the first serious classified pricing plans emerged.<sup>31</sup>

Processors of fluid milk, on the other hand, could exercise some buying power in many markets. The exercise of such monopsony power requires few enough buyers in the market to enable them to effectively operate in concert with other buyers to suppress the buying price. Although fluid bottling operations were much smaller in the 1920's than they are currently, markets were also vastly smaller.<sup>32</sup>

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this standard may lead to widely divergent interpretation. Clearly the disorder under consideration creates fluctuations; but is anything that creates fluctuations disorderly?

25. See U.S. DEP'T OF AGRICULTURE, TECH. BULL. NO. 179, COOPERATIVE MARKETING OF FLUID MILK 11 (May, 1930) [hereinafter cited as COOPERATIVE MARKETING]; BEAL & BABKIN, FLUID MILK MARKETING (1956) [hereinafter cited as FLUID MILK MARKETING].

26. *Id.*

27. The "disorderly marketing" was not simply a response to declining income. It had emerged earlier, even in the late 1920's when dairy farmer income was relatively favorable. See COOPERATIVE MARKETING, *supra* note 25, at 11; 77 CONG. REC. 1426 (1933) (remarks of Senator Copeland); H. FOREST, CONFERENCE ON MILK PRICES AND THE MARKET SYSTEM, 45 (1975).

28. 15 U.S.C. § 12 (1970).

29. 7 U.S.C. § 291 (1970).

30. 15 U.S.C. §§ 1-27 (1970).

31. By 1917, legislation legalizing formation of cooperatives had been enacted in thirty states. Cf. FLUID MILK MARKETING, *supra* note 25, at 202, for an explanation of the problems this legislation was to end. Federal antitrust prosecution was feared, however, and various cases were brought. *E.g.*, in Cook County Illinois in 1917-1919 (jury verdict: not guilty); in Minnesota in 1917-1919 (case dismissed); in New Orleans, Louisiana (indictment quashed). COOPERATIVE MARKETING, *supra* note 25, at 3, 11, 13-14. See also PROBLEMS INVOLVED, *supra* note 15, at 21-40; U.S. DEP'T OF AGRICULTURE, CONSUMER AND MARKETING SERV., MARKETING BULL. NO. 27; THE FEDERAL MILK MARKETING ORDER PROGRAM, 27 (April, 1968) [hereinafter cited as MILK MARKETING PROGRAM].

32. Milk today gets transported long distances. Although the actual magnitudes are small, some shipments exceed one thousand miles. For instance, in October of 1973 (a "short production year") bulk milk shipments from the Chicago and Minneapolis-St. Paul order areas to milk orders in Florida amount-

In the 1920's electrified farm refrigeration was virtually unknown. Milk transportation took place in non-insulated cans, on relatively slow vehicles, over circuitous roads with multiple arterials. Not only would milk be unable to travel many miles before turning bad, but information systems were poor as well. Farmers without phones and often without cooperatives could not easily find alternative market outlets. Furthermore, without accompanying one's own load of milk one might not know whether a new, and possibly temporary, outlet would give an honest value of the weight and butterfat test of the load. A processor had similar problems in knowing what standard of quality individual farmers met unless they had established connections with that farmer or with his cooperative. One can of soured or tainted milk could potentially contaminate an entire day's milk supply.

Although the farmers could use their milk for the production of less perishable manufactured goods, this would be non-economic for any extended duration. The result would be that products made with higher cost milk, that which met the Grade A fluid health standard, would be competing with products made with lower cost Grade B milk. Certainly dairy farmers could only sell in restricted areas and hence to few fluid processors. The processors thus had substantial market power in the purchase of the raw milk.

As bargaining coops began to develop, the balance of power started to shift. As with the early years of labor organizing, where there were both members and non-members, and non-members charge less, tensions were inevitable. As in labor, these tensions manifested themselves in strikes and lockouts. A coop might call a milk strike if buyers refused to accept a price increase. The buyer might counter by buying milk from more distant sources, probably at extra expense, but with a good chance of breaking the strike.<sup>33</sup> Alternatively, a buyer could lockout the milk of a coop and buy outside milk until the coop agreed to a lower price or until coop members quit. Without market outlets their milk, which was produced at great cost, might spoil and have to be used as animal feed. When a day's milk production is not used (like when a day's labor is not used) the milk (or labor) cannot be inventoried for later use. Thus, strikes and lockouts are costly.

It is important to note that the cooperatives' goals were not simply countervailing power, but market power in excess of buying power.<sup>34</sup> It is market power in excess of buying power that created

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ed to about seventy-five over-the-road fifty-five thousand pound bulk milk tankers, two and a half per day. *Memo* from Herb Forest, Director (Dairy Division) to Division Staff and Market Administrators, entitled "Movements of Milk In and Out of Federal Order Markets," (August 8, 1975) [hereinafter cited as Forest Memo].

33. COOPERATIVE MARKETING, *supra* note 25, at 11.

34. PROBLEMS INVOLVED, *supra* note 15, at 20-32, 75, 177-78. This article points out numerous statements by coop organizers to this effect. It states,

the undercutting tensions in the industry. Buying power's objective is to push down the selling price of the raw milk, with a resultant decrease in the total amount of milk supplied. If a coop were to use its market power to raise price up to a level that countervailed the buying power, *buyers would buy more milk not less.*<sup>35</sup>

This curious paradox is no more complex or mysterious than its analogue for selling power. A monopolist, because he can limit his sales and by so doing drive up the price, will do so. Eliminate his selling power and he no longer benefits by restricting his sales; therefore he will supply more at a lower price. Similarly, for buying power a monopsonist can drive down the price he must pay for an input by limiting his purchases; therefore he will do so. Remove the power over price and he no longer will have the incentive to restrict his purchases.

Let us say that a coop had exactly countervailed buying power so the price for raw milk is exactly what it would have been if neither buyers nor sellers had market power. *In other words, the price is raised to the competitive level—that which would have existed had there been competition on both sides. Supply equals demand at that price.* By definition, *all sellers* are selling as much as they would like at that price. At any lower price, *each and every seller* would want to sell less (or at least no more) than he is currently selling. With even a fractionally lower price and the ability to adjust supply, any seller's total earnings would fall if he were to sell at that lower price. *Thus, if the price arrived at by the coop is only one that countervails the market power of the buyers, then no producer, coop member or non-member, will have any incentive to undercut the coop's price.* The basic problem encountered by the coops' attempts to establish power over price, however, was that "free-riders" or "chizelers" were attempting to "free load on the system," letting the coop members undertake the expense of bargaining to raise the price, and then slightly undercutting the coop's price to gain at coop members' expense.<sup>36</sup>

Governmentally enforced classified pricing to achieve this result will also have some monopoly element. The fact that the selected higher Class I price is more than a countervailing price should be

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however, that the monopoly element of coops at that time is overstressed. This argument rests on the ineffectiveness of the attempts to achieve market power and the feeling that a little market power is natural, and hence should not carry the term "monopoly." *Id.*

35. Emphasis added.

36. PROBLEMS INVOLVED, *supra* note 15, at 20-40, 165-66 (emphasis added). Note that free-riding on a cooperative's bargaining efforts may occur at the countervailing price, but this free-riding will not involve price cuts. If the cooperative has only succeeded in attaining the competitive price, then demand will equal supply at that price. The free-rider will not have paid his portion of the costs of developing countervailing market power. But since demand is sufficient to sustain the total supply, the free-rider can sell all he desires *without price cutting*. He has all the benefits and none of the costs of establishing countervailing power. Hence, the free-ride.

clear. When the Class I price is \$3.00 and the Class II price is \$2.00 and one-half the coop's milk is sold in Class I, the coop member will receive a "blend price" of \$2.50. A member could quit the coop, and, as a free-rider, sell to a user of only Class I milk for \$2.90, undercutting the coop's price, and receive for himself a price of \$2.90 for all of his milk rather than the coop's "blend price" of \$2.50. Classified pricing to achieve monopoly-type goals thus led to free-riding; free-riding in turn led to violence. In those markets where classified pricing had led to instability, the government, if it wished to act, had two basic possible approaches: it could either reduce or eliminate the selling power the coops had recently established, or, alternatively, it could fortify the selling power by going beyond the facilitation of coop organization, to legislation of the classified monopoly-type pricing structure the coops had been fighting to get. Either method would eliminate the free-riding problem, the first by making the free-riding issue moot (there would be no elevated price to undercut), and the second by making free-riding illegal.

A combination of factors led to Congress' choice of the latter alternative. While processors were hurt by the depression, they were not hurt as badly as the farmers.<sup>37</sup> For decades the balance of power had been on the buyers' side of the market. There was a general reemergence of a populist attitude that went along with the general National Recovery Act (NRA) philosophy that raising prices would lead to economic recovery. Finally, there was a fear over exit of farmers and "supply inadequacy."

The federal government undertook exactly the same classified pricing activities as had previously been carried out by the dominant coops in some markets, and ruled that free-riding on that pricing structure was illegal.<sup>39</sup> Unstable markets became stabilized through the elimination of free-riding on the monopoly-type price. Other markets that had been stable with a low level of coop activity were able to maintain their stability at a higher price without first having

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37. See FLUID MILK MARKETING, *supra* note 25, at 87; COOPERATIVE MARKETING, *supra* note 25, at 3, 11; PROBLEMS INVOLVED, *supra* note 15, at 20-40. These references give some factual background. Our assertion rests on facts of this nature, the logic presented in text, and observations in note 34, *supra*.

38. 15 U.S.C. § 701 (Supp. 1933). For instance: "The present economic emergency is in large part the result of the impoverished condition of agriculture and the lack of the ability of farmers to purchase industrial commodities." H.R. REP. NO. 6, 73rd Cong., 1st Sess. 7 (1933).

39. See NOURSE, *supra* note 14, at 50,199; J. BLACK, THE DAIRY INDUSTRY AND THE AAA, 96-97 (1935). Under the 1933 Act the exact mechanism was not made explicit. A coop could request an "order" (a "license" under this Act) of its own authorship, as did PMA immediately after the passage of the Act. PMA in effect simply requested, and was granted, the right to run the same type of pricing program they had attempted to run privately. The USDA order under the Act made this pricing binding on all participants in the market and established a "check-off," which was taken from all producers' milk. PMA members' check-off was refunded to PMA, nonmembers' check-offs were not refunded. Even nonmembers had to pay an amount like cooperative dues.

to organize into a highly dominant cooperative position. The elimination of disorderly marketing was a success.

Under federal regulation, however, a new style of potential free-riding emerged. The federally raised price could not be undercut by producers within or outside of the market area. If a producer outside the area could, by making some sales in the area, join into the market, he could share in and draw off some of the market proceeds. Highway transportation, farm refrigeration, communications, and pasteurization technologies developed. By the 1960's outsiders quite distant from the market became potential free-riders. When they did free-ride they were said to be "riding the pool." Many coops feared that if they charged prices in excess of the federally mandated minimum prices that outsiders could get sales in their market spreading the revenues thinner. Premiums above the federally mandated price were therefore uncommon.<sup>40</sup>

Then several changes occurred that led to United States Department of Justice (DOJ) action. Much of what follows here comes from cases filed by DOJ. None of the cases have been adjudicated, and almost all of the following allegations have been denied or disputed. In our opinion it is, however, an accurate characterization of the facts.<sup>41</sup>

Coops had tried to raise premiums before, but, excepting in insulated markets, generally with little long term success due in large part to competition from sources outside their markets. In 1967, coops from Wisconsin to Georgia to New Mexico used mergers and agreements to essentially reduce the potential for intermarket rivalry. Starting in September, 1967 they established a subsidy on a monthly basis to the producers in the vast surplus production areas of the far Upper Middlewest in return for their agreement to ship milk out of their area only upon demand. On September 1, 1967 virtually all of these cooperatives established large premiums over the federally mandated Class I price.<sup>42</sup> Again, there was an incentive

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40. Premiums existed in some markets. These were markets for which distant milk was more expensive than local milk. This could occur if regulated price differences did not reflect transport costs and there was either a local monopoly cooperative that could raise a premium or a local shortage and milk importation was required. See EISENSTAT, MASSON & RODDY, *THE ASSOCIATED MILK PRODUCERS, INC. MONOPOLY*, 440-60 [hereinafter cited as *AMPI MONOPOLY*], report filed with the court in *United States v. Associated Milk Producers, Inc.*, 394 F. Supp. 29 (W.D. Mo. 1975), *aff'd*, 534 F.2d 113 (8th Cir. 1976); R. MASSON, *SOME ISSUES OF COOPERATIVE MARKET POWER, CARTELIZATION AND THE CAPPER-VOLSTEAD ACT, GOVERNMENT REGULATION OF AGRICULTURAL COOPERATIVE* 148-60 (1976) [hereinafter cited as *MASSON*]. DOJ REPORT, *supra* note 2, at 365; REPORT OF THE MILK PRICING ADVISORY COMMITTEE, *THE MILK PRICING PROBLEM* 35, (March, 1972) [hereinafter cited as *MILK PRICING PROBLEM*].

41. *United States v. Dairymen, Inc.*, Civ. No. 7634-A (W.D. Ky. 1973). The District Court has issued an opinion finding Dairymen's pooling practices to violate the antitrust laws. *United States v. Associated Milk Producers, Inc.*, 394 F. Supp. 29 (W.D. Mo. 1975), *aff'd*, 534 F.2d 113 (8th Cir. 1976). This case was settled by consent in 1975.

42. MASSON, *supra* note 40, at 155-60. See also *AMPI MONOPOLY*, *supra* note 40, at 440-53. The conclusions in these articles are disputed in Cook & Blakely, *Review of Eisenstat, Philip, Masson, and Roddy "An Economic Analysis of the*

to free-ride a monopoly-type price. The USDA did not receive and pool these "over-order premium" revenues; they were paid directly to the cooperative. If a cooperative were charging a one-dollar premium on Class I milk and none on milk for Class II uses,<sup>43</sup> then the coop member would receive the federally paid blend price plus fifty cent premium revenues per cwt averaged across his total milk sales. If a member could leave the coop he could undercut the coop's Class I premium/price. If an ex-member sold milk to an all Class I user for only a ninety cent premium, he would receive the federally paid blend price plus ninety cents rather than fifty cents and the bottler would benefit as well. In 1967 this could raise a farmer's gross receipts by about three to eight percent and would increase his net return even more.

The consequences were virtually like those in the 1920's and 1930's even with the regulations. The United States Department of Justice Antitrust Division has alleged that there have been cooperative milk withholding actions (strikes),<sup>44</sup> and evidence has emerged of some refusals to purchase milk at the premium prices (lockouts).<sup>45</sup> Just as in the 1920's and 1930's, these market disruptions are alleged to have led to unprecedented massive price fluctuations<sup>46</sup> and farmers and processors were driven from the market or into submission by below cost pricing<sup>47</sup> and by manipulation of the regulatory system. In the social climate of the 1960's violence was less common, but not unknown. Several of the regulated markets of the late 1960's and 1970's exhibited exactly the same behavior that the federal order system had been designed to cure.<sup>48</sup>

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*Associated Milk Producers, Inc. Monopoly*," UNIVERSITY OF WISC., BULL. NO. R2790, 24-29 (1976) [hereinafter cited as Cook & Blakely].

43. A substantial premium on Class II milk for any extended duration could irrevocably damage the Class II buyer. This Class II buyer will be selling most of its products in competition with buyers throughout the United States that have purchased milk at approximately the Class II price and have low transport costs between market areas.

44. See AMPI MONOPOLY, *supra* note 40, at 535, 548-52.

45. *United States v. Dairymont, Inc.*, Civ. No. 7634-A (W.D. Ky. 1973). See, e.g., Testimony of Ben Morgan, Tr. 3471-72.

46. See AMPI MONOPOLY, *supra* note 40, at 194-439 for some examples, including the historical prices versus these new fluctuations.

47. *Id.* at 194-439, 529-601. See also U.S. DEP'T OF AGRICULTURE, PRESSURE POOLING STUDY (1971) [hereinafter cited as PRESSURE POOLING STUDY]. In this study, one USDA employee highlights one case and states that this pool loading's

[G]oal is to increase the spread between member and nonmember prices, forcing these producers to join [the coop] or handlers of their milk to increase their pay prices, and thereby increase their ability to exact substantial premiums on Class I milk.

Obviously, the orders were not intended for this purpose.

In at least one case a coop violated these order provisions in such fashion so as to be required to reimburse the market for its actions. A subsequent USDA affidavit by Herb Forest, Director of the Dairy Division, states that no violation of provisions had occurred. This, however, must be interpreted as no violation having still occurred since the records were retroactively recalculated and recorded so that the cooperative did, in the end, pay the appropriate amount and these receipts went to the appropriate market. AMPI MONOPOLY, *supra* note 40, at 425-26.

48. The first pool loading started in the Fall of 1967, contemporaneously

USDA memos accumulated over a period of years. In 1971 the USDA finally took action to make this behavior more costly and thus less prevalent. By changing the provisions in various orders,<sup>49</sup> the manipulation and predation were reduced. This disorderly marketing was caused by the same monopoly-type pricing that had caused the earlier one. Much of the residual predation/disorderly marketing was eliminated by the Antitrust Division. This time, however, the government through the DOJ noted that "free-rider" was synonymous with "competitor". DOJ acted to protect the competitor who was "free-riding" monopoly prices above the federal specified minimum prices rather than outlawing his price cutting as has had been done in the past via the Acts.

The Mississippi market in 1971 provides an example that will serve as a useful contrast to a later disorderly marketing finding. This example is extracted from a lengthy transcript and reflects our interpretation, which was disputed by the defendant. The trial court opinion finds this to violate the antitrust laws.<sup>50</sup> The dominant cooperative was charging a premium over the regulated Class I price. This cooperative's share of the market, however, was only 75.5 percent,<sup>51</sup> and it was running into free-riding problems from non-members.<sup>52</sup> During this time period the cooperative used milk from its other divisions to drive down the price that non-members received in this market.<sup>53</sup> A coop executive had written a recommendation to "pool" the milk "to cause non-members to lose [money]."<sup>54</sup> Equally significant part of this scheme, the coopera-

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with the institution of the standby pool, and continued, at reduced levels after 1971, until at least the summer of 1974. See *AMPI MONOPOLY*, *supra* note 40, at 194-439. See also 36 Fed. Reg. 10775-777 (1971).

49. 36 Fed. Reg. 10775-777 (1971); 36 Fed. Reg. 17492 (1971). Not all of the Orders' pooling activities were affected by these changes in the regulations. *AMPI MONOPOLY*, *supra* note 40; *PRESSURE POOLING STUDY*, *supra* note 47.

The USDA has stated that they eliminated this problem in 1971, that the problem only started in 1970, and that it did not reemerge. "The Department considered the events of 1970-71 to be a pooling problem and it was eliminated by Department initiatives. There has been no recurrence of pool loading." *Comments*, *supra* note 22, at 10, 32. It is erroneous, however, to conclude either that this disorder started in 1970 or was eliminated by administrative remedies. The section of the DOJ REPORT *supra* note 2, notes various pooling incidents including the "AMPI pool loading experience in South Texas. Pool loading activities cost AMPI on average about \$25,000/month over several years." *Id.* This South Texas incident is footnoted to *AMPI MONOPOLY*, *supra* note 40, at 395, in which it was shown that this pool loading lasted until at least mid-1974. Throughout this same section most incidents are shown to have started earlier, often in 1967 or 1968. *Id.* at 194-439.

50. *United States v. Dairymen, Inc.*, Civ. No. 7634-A (W.D. Ky. 1973). Opinion issued 1978 but no final judgment yet.

51. *Id.* at GX 649-GX 658.

52. *Id.* Testimony of P.L. Robinson, Trial Tr. 3927-28, 3931-32.

53. *Id.* Testimony of Robert Masson, Trial Tr. 2638, 2701-08.

54. Memo to D.P. Alagia, Jr. from A.J. Ortego, *Removal of Premium from Mississippi Markets*, February 2, 1971. The memo states a first alternative, a removal of the premium, and states: In short, we would forfeit approximately \$44,000 to cause non-members to lose \$16,000." The memo continues by proposing pooling as an alternative. "I would prefer to see us move milk into Mississippi from other DI Divisions even if it costs the amount of the Mississippi premium." *Id.* at GX 167.

tive at a loss in order to suppress the price yet even further. The estimated cost to the cooperative was forty thousand dollars per month for three months, and USDA reports indicate the coop continued this activity for eight months.<sup>55</sup> Furthermore, during the period that it was bringing in the outside milk, the cooperative had so much milk in Mississippi that it was forced to ship a great deal of excess milk from Mississippi to Tennessee at a loss in order to dispose of it.<sup>56</sup>

Thus, we see disorderly marketing in a regulated market: it involves a classified-pricing-monopoly-premium, free-riding, and predatory transport and pricing of milk between markets to damage competitors.

In June and September, 1971, USDA changed the regulations. Among its stated reasons was the activity by this coop in Mississippi.<sup>57</sup> In 1973, the same dominant cooperative voted to eliminate the regulation in Mississippi.<sup>58</sup>

A year and half later, the same cooperative petitioned for reinstatement of regulation. A USDA finding was required to show that the regulation was needed to effectuate the goals of the Act.<sup>59</sup> In support of regulation, Herb Forest, Director of the USDA Dairy Division, in an affidavit, listed three points as the *elements* of disorderly marketing in Mississippi. These were cited *not as evidence* of disorderly marketing, but as *the* disorderly marketing itself:

1. There was evidence that handlers were buying *on a flat price* regardless [of whether the milk was used for Class I or Class II].
2. [T]here had been no reliable *procedure* for establishing class prices . . . .
3. [T]here was no *impartial* audit of handler's records to verify payment to producers and no verification of weights and butterfat . . . .<sup>60</sup>

These three points will be taken in inverse order. The third point would have had some validity before the 1950's (or 1960's in some areas). Then milk had to be weighed and tested can by can or at the receiving plant. With today's bulk tanks and testing procedure, even the farmer knows how much total milk he has sold by a glance at his

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55. *Id.* at GX 850. The estimates are based on the months of February, 1971 through April, 1971. Although not introduced in trial, a statistical report by a USDA official that was prepared for USDA oversight, but not in the regular course of business, indicates that this pooling action was started in January, 1971 and continued through August, 1971. PRESSURE POOLING STUDY, *supra* note 47 at 00123-158.

56. *United States v. Dairymen, Inc.*, Civ. No. 7634-A (W.D. Ky. 1973), at GX 1061; Trial Tr., 5253-56.

57. *See* note 48, *supra*.

58. *Marketing Assistance Program, Inc. v. Knebel*, (C.A. D.C. #76-1696), brief for Appellee. The exact date of the end of regulation was April 30, 1973. *Id.* at 8.

59. 7 U.S.C. § 608c (3)-(4) (1970).

60. *Marketing Assistance Program, Inc. v. Knebel*, (C.A. D.C. #76-1696), brief for Appellee at 9-10 (emphasis added). It is also interesting to contrast these statements with the legislative language. *See* notes 3 and 24, *supra*.



tank depth. Butterfat testing is also vastly simplified. Moreover, under current regulation, most of the milk in this market is weighed and tested by the dominant cooperative under license from the USDA, just as it was during this recent period with no regulation. At times they have even insisted that buyers buy on the basis of the coop's weights and tests rather than the official ones.<sup>61</sup>

There was no "reliable procedure for establishing class prices." In other words, the market did not have regulated prices announced by the USDA. During most of the period between 1968 and the time the order was removed, the cooperative(s) did not charge this "reliably determined price" anyway, but selected a premium over that price. In nearby markets, the same coop seldom, if ever, charged the order price. *If this criterion were consistently applied almost all of the regulated markets would currently be deemed to be "disorderly".*<sup>62</sup>

The first point was that some of the milk was being sold without any price discrimination. This criterion objects to the presence of competitive pricing and the lack of monopoly-type pricing. Thus, a competitive market, even if it were complete with price, customer, and transport channel stability is considered "disorderly". Conversely, if one relied *only* on these criteria, the regulated Mississippi market in 1971 would be "orderly", despite the disruptions that existed.<sup>63</sup>

Given USDA's administrative discretion, their liberal construction of the term "disorderly marketing" is not clearly inconsistent with their powers under the Act. As currently construed to include a lack of a "reliable *procedure*" and the lack of an "*impartial* audit," by definition any unregulated milk market would be disorderly by virtue of the lack of a market-wide pricing procedure and an impartial audit, and hence in need of regulation to become orderly.

Thus, for everything that follows in terms of questioning the current system's ability and effectiveness in meeting the goals of the 1937 Act, we shall remain with our interpretation of the intent of Congress as we have presented it.<sup>64</sup> We feel that, academically and

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61. *United States v. Dairymen, Inc.*, Civ. No. 7634-A (W.D. Ky. 1973), testimony of Ben Morgan, Trial Tr., 3494-97, 3512-813. These conditions are in sharp contrast to the citation. In the Appellee's brief these conditions are supposed to represent the disorder that led this dominant coop to ask anew for regulation. *Id.*

62. *Id.* at DX 129-63 (emphasis added). See also "DOJ Report," *supra* note 2, at 367.

63. Again the legislative language should be contrasted with this. See note 24, *supra*. Note should also be taken of numerous other markets like South Texas, Oklahoma, Corpus Christi, etc. (which were loaded for years). See AMPI MONOPOLY, *supra* note 40, at 194-439. In the earlier decision to inhibit pool loading in Mississippi and other areas, however, a finding was made that the decision was needed "to maintain orderly market conditions." 36 Fed. Reg. 10777 (1971).

64. In *Marketing Assistance Program, Inc. v. Knebel*, (C.A. D.C. #76-1696), brief for Appellee at 4, the USDA states:

economically, this is more valid than to use the liberally construed definitions that by expedience can justify any action. For this reason, regardless of the possible merit of the argument that current construction is legally valid, we will employ as a policy standard of "disorderly marketing" the type of disruptive behavior we feel that Congress had in mind in the passage of the Act, rather than more recent constructions.

### Assuring Adequate Supplies: Never Risking a Supply Less than Demand

There were two aspects to the adequacy of supply problem that concerned Congress in the 1930's. First, Congress stated that it was facing an emergency when it passed the Acts of 1933 and 1935.<sup>65</sup> The perceived emergency was that if milk prices remained depressed for a substantial period of time, dairy farmers would drop out of production.<sup>66</sup> After recovery, however, demand would be reestablished. Because of the reduced supply and the inelastic demand, price would skyrocket. Current supply would equal current demand simply due to the very high price. The price, however, would be well above that price which could easily equate supply and demand if farmers had been protected during the depression. The high prices would, of course, lead to herd expansions and possibly even to entry into the business. It takes about three years, however, for new milking cows to reach productive capacity. In other words, current supply would be far short of the stable long-run sustainable equilibrium supply. Congress was concerned that, with the high prices, an important food source would unnecessarily face curtailed consumption. This fear of what economists call a "cobweb" equilibrating process was probably well taken. In the 1937 Act, Congress recognized that substantial economic recovery had occurred and dropped the "emergency"

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The provisions of the Agricultural Marketing Agreement Act relating particularly to the milk industry were enacted as "the result of nationwide distress which had culminated in a milk farmers' 'strike' accompanied by violence constituting an incipient agrarian revolution that threatened to cut off a vital part of the nation's food supply". Cited to *Queensboro Farm Products v. Wickard*, 137 F.2d 969, 974 (2d Cir. 1943).

Thus in the same brief the USDA appears to be accepting our version of disorderly marketing and then citing their new, and we assert unrelated, version as evidence to support their claim.

65. H.R. REP. NO. 6, 73rd Cong., 1st Sess. 7 (1933); H.R. REP. NO. 468, 75th Cong., 1st Sess. 3 (1937).

66. Contrast the prices dairy farmers received for their milk in 1929 and the prices they had to pay for products they used on the farm, with the same figures for 1933. We can use the base period, 1929, as an index. Defining the ratio of price received to prices paid to be 100 percent in 1929, this index had fallen to 59.9% in 1933. In other words, although all prices were falling, the prices received by dairy farmers were plummeting relative to the prices of goods that farmers bought. Many farm mortgages were foreclosed. These indices are calculated from the parity index. 77 CONG. REC. 688-901 (1933) (remarks of Rep. Frear). Higher prices, and thus incomes, for dairy farmers were desirable to reduce strife and to assure that sufficient numbers of farmers would stay on the land to be able to support the anticipated reestablishment of demand for milk as the nation recovered from the depression.

wording and required an *explicit* finding on supply adequacy for each regulation.<sup>67</sup> In addition, we now find that since 1973 the Depression has disappeared and the bulk of the regulated market areas only first achieved regulation after the Depression.<sup>68</sup> Moreover, Congress, both by inaction and by the passage of amendments, has reaffirmed the 1937 Act and its requirements as relevant for a non-depression economy as well. Thus, for current policy the definition of adequate supply should be geared to nondepression periods.

Congress' second concern was the sharp price fluctuations that occurred in some markets if supply declined due to random conditions such as weather, or due to the natural cycle of milk production that creates shorter supplies during the fall months.<sup>69</sup> At the time of passage of the Acts markets were highly localized, so that a single market experiencing a somewhat lower supply than usual and facing an inelastic demand for fluid milk could experience a radical price increase. Such fluctuations could be avoided by three possible means: (1) Encourage sufficient local milk production so as to have a cushion or surplus reserve; (2) Lower the quantity of milk demanded by consumers; or (3) Arrange for alternative sources of milk supply for individual markets facing shortages.

The third option was virtually unavailable in light of the technological conditions governing milk transport at the time. Classified pricing, however, can be used to satisfy both of the first two goals. By raising the Class I price along the inelastic demand curve, the artificial demand (*a'r*) shift is achieved, the farm blend price rises, and supply is increased. Clearly the additional supply means that an inadequate supply availability to satisfy Class I uses at the regulated prices is much less likely. More subtly, Class I demand has been curtailed by the higher Class I price. Supplies will in part tend to be adequate (sufficient to cover demand at the relatively stable federal price) because the price has been raised, making milk generally less affordable.

As a general rule of thumb, dairy experts often assert that *for any individual market* a margin of total production twenty percent in excess of total Class I demand in a typical fall season would be sufficient to assure an adequate supply of milk by this standard.<sup>70</sup> We

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67. H.R. REP. NO. 468, 75th Cong., 1st Sess. 3 (1937).

68. In 1940 only about 20% of milk was federally regulated and about 20 states regulated as well. Now it is virtually all regulated. Cf. U.S. DEP'T OF AGRICULTURE, ECON. RESEARCH SERV., AGRI. ECON. REP. NO. 229 GOVERNMENT'S ROLE IN PRICING FLUID MILK IN THE UNITED STATES, at 2-3 (July 1972) [hereinafter cited as GOVERNMENT'S ROLE].

69. In the 1937 Act they explicitly note that there is no longer an emergency as in the past, and require that the price be set to "insure a sufficient quantity of pure wholesome milk." H.R. REP. NO. 468, 75th Cong., 1st Sess. 3 (1937).

70. U.S. DEP'T OF AGRICULTURE, RESEARCH REPORT NO. 19 COOPERATIVE BARGAINING DEVELOPMENTS IN THE DAIRY INDUSTRY, 1960-70, at 17 (Aug. 1971). See Bartlett, *Bringing Federal Order Class I Pricing Up to Date and in Line With Antitrust Regulations*, ILL. AGRICULTURAL ECON., Jan. 1974 at 7; Cook & Blakely, *supra* note 42, at 11.

have serious misgivings about whether such a large margin is required.<sup>71</sup> But even assuming *arguendo* that it is required, the narrow

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More recently, USDA in *Comments, supra* note 22, at 29 states that: "The 20 percent surplus (reserve) referred to [by DOJ] is a conservative supply . . ." and later notes that DOJ, in error, did not compute the reserve for a fall month but an annual average. They then state that with a 65% total system utilization the necessary total amount to assure Class I sales plus reserves is 78% (*i.e.* 120% of 65%), and "[t]hus, surplus Grade A production in 1975, above the minimum volume needed to assure an adequate supply for all fluid milk plants, was in the range of 10 to 20 percent of the total." Presumably they meant their best estimate, rather than a minimum, because by the conservative measure of 20% there was an excess surplus of 22% of the total supply. Since the 20% required reserve based on 65% Class I utilization is 13% of the total, their calculations with a 20% reserve imply that reserves are 270% of required reserves (22% plus 13%, divided by 13%). Even their most favorable number, 10% excess, yields a reserve of 177% of the required reserve.

Possibly for this reason they introduce a novel definition: "[I]t is no longer realistic to think of the Grade A supply only in relation to the fluid requirements of a market." They state that an adequate supply must now consider also manufactured milk products.

This concept seems antithetical to all past conceptions of the problem. Indeed, high import barriers have been erected against importation of manufactured products so as to support the entire pricing system without *too much* supply of manufactured products. To support their new interpretation would appear to require a reinterpretation of the past forty years of understanding of the Acts. For instance, given the ease of transport of Class II products, it would not make sense by this new definition to refer to a single area as a surplus area. In 1974, in promulgating Order 68, a five county area was called a "surplus production area," leading to a finding that it did not need a higher Class I price. This finding and the whole tone of the proceeding shows an interest in "fluid grade milk" to handle fluid demand. (Nonfluid grade milk isn't even regulated by the Acts.) See 41 Fed. Reg. 12436-68, esp. 12444 (1976). The appropriate measure for USDA if it is facing a manufactured milk products shortage would appear to be to go to Congress. Congress could (a) decrease the substantial levels of support purchases of manufactured products the government makes to avoid depressing their prices with a glut; (b) ease import quotas; or, (c) endorse this new USDA view and raise the price of milk yet further.

For our purposes we feel that the meaning that the term has held for the last forty years should be controlling. We shall remain with that interpretation here even though the Secretary may have the administrative discretion to redefine this concept.

71. Some reasons are:

1. Given current technology, milk can be shipped great distances. A 20% margin is not needed in one area if milk from another area is readily available.
2. The reserve percentage is based in part on "daily balancing" spreading a constant daily supply over a wide weekly cycle. Given a constant federal order price a buyer will buy on Thursday (for large Friday sales) and not on Saturday (for miniscale Sunday sales). In areas where coops have had price flexibility, however, they have been able to price Saturday milk lower and by so doing induce Saturday purchases for storage or bottling for Monday and Tuesday sales. Since current technology can store milk for a few days at a time, the daily balancing need for a surplus is created by price rigidity rather than the reason for a higher reserve to be achieved by a higher (rigid) minimum price.
3. As will be noted, see text accompanying notes 108-127 *infra*, necessary reserves can be maintained by powdered milk. This milk could potentially be reconstituted and mixed with fresh milk at a rate of one, five, or ten percent of the total with little effect on the taste, a lowering in total price, and a lowering of necessary reserves. But currently its use is penalized by the Order system.
4. An "inadequate supply" should not be defined as one that requires slight price elevation during the natural short production season. Tomatoes, lettuce, ski trips, vacations at the beach, and a variety of

point that we have chosen to demonstrate still follows. This point, as we have stated in the introduction, is that the regulated price of milk in the areas of Minnesota, Wisconsin, and northern Illinois is higher than can be justified given the original intent of the 1937 Act.

For this article, we shall remain content with the definition of adequate supply that follows stated USDA policy:

The concept of equating supply with demand for fluid milk in a marketing area is the primary standard for establishing Class I (fluid use) prices. Minimum prices for Class I milk are established at levels which will assure *consumers* an adequate supply of pure and wholesome milk.<sup>72</sup>

In accepting this we shall also accept a twenty percent margin in fall months as necessary to "assure" consumers of this in all years.<sup>73</sup>

### *The Public Interest Test*

The three goals of milk regulation are to be pursued, but there is a public interest balancing test. For example, raising farmers' incomes by classified pricing is very simple. It is a simple technical economic exercise to show that the federally administered prices for Class I milk have not been set so high as to maximize farmers' incomes.<sup>74</sup> Not only are higher farm incomes available, but the price of milk is well below one hundred percent of parity.<sup>75</sup> Certainly, if the USDA were to have only the three goals, it could have raised prices yet further anytime in the last few decades and increased farmers' incomes, achieved even more supra-adequate supplies and maintained orderly marketing. Where then should the Class I price be set?

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other seasonal goods vary radically in availability and price over the year without being deemed to be in "inadequate supply."

Obviously each of these four points, either individually or collectively, could be used to question whether ultimately a 20% reserve would be needed if an otherwise rational policy were pursued by USDA.

72. GOVERNMENT'S ROLE, *supra* note 68, at 5 (emphasis added). Note that the word "consumers" indicates fluid milk for fluid consumption in contrast to *Comments, supra* note 22, at 29.

73. The reader may easily demonstrate for himself that our *prima facie* case, *see* texts accompanying notes, 77 to 108, *infra*, is only weakened very slightly at best if one accepted a need for a 25%, 30%, 40% or even 50% surplus. The surpluses we shall discuss exceed 100%.

74. To maximize farmers' (i.e., farm owners') returns would require raising the Class I price until the marginal revenue from another cwt of Class I milk is equal to the marginal revenue from another cwt of Class II milk. We have noted elsewhere that these are widely divergent. *See* Ippolito & Masson *The Social Cost of Government Regulation of Milk*, J.L. ECON. (1978) [hereinafter cited as *Social Cost*] (forthcoming) and A. Masson, Masson & Harris *Cooperatives and Marketing Orders, COOPERATIVES AND THE PUBLIC INTEREST, UNIVERSITY OF WISCONSIN* (1978) (forthcoming). The USDA defends their prices by quoting "strong evidence that the stability objective rather than the price enhancement has [sic] been pursued." *Comments supra* note 22, at 12. As we shall show, some price enhancement has been pursued in the Upper Midwest. *See* then accompanying notes 77 to 108, *infra*. Citing the fact that prices are not maximally enhanced or even close to maximally enhanced, although probably true, misses the point.

75. A standard that we believe to be economically unsound, but one often cited to justify a policy action.

USDA states the public interest test as: "The 'public interest' is served by an adequate supply of milk at a reasonable price."<sup>76</sup> It is our contention that although USDA does not "maximize" farmers' incomes, it is violating its own standard as stated here. This is demonstrated in the discussion of the Upper Middlewest that follows.

THE MILK PRICE IN THE UPPER MIDDLEWEST:  
ESTABLISHING A PRIMA FACIE CASE

As a preliminary matter, it is important to consider how this area is defined and situated. The Upper Middlewest is a major milk producing area of the United States, producing about one-sixth of the total fluid grade supply.<sup>77</sup> Two federal orders, Upper Midwest #68 and Chicago #30, cover most of this area. Most of the federal regulation is based on a price structure that could be closely modeled as Eau Claire, Wisconsin, price plus fifteen cents per cwt for every one hundred miles east, south or southwest of Eau Claire.<sup>78</sup> Roughly speaking, then, if the Class I price in Chicago, the biggest market in the area, were \$8.00 per cwt, then the Class I price in St. Louis, about 250 miles south of Chicago would be \$8.37 1/2. The adjustment of fifteen cents per cwt per one hundred miles is used to reflect transport costs, but currently transport costs are closer to twenty-five cents per cwt per one hundred miles. Thus, to break even by buying milk in Chicago at \$8.00 and shipping it to St. Louis would require a sales price of \$8.62 1/2.

This enables us to consider these two Orders, Chicago and St. Louis, separately. Because of transport costs of milk in excess of the regulated intermarket price differentials, these markets are somewhat insulated from other markets. Thus small changes in Class I prices in these markets will not have substantial effects on other markets.<sup>79</sup>

*Adequate Supply and Orderly Marketing Goals  
for the Upper Middlewest Today*

In the two Upper Middlewest<sup>80</sup> milk orders, milk supply is cur-

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76. U.S. DEP'T OF AGRICULTURE, CONSUMER AND MARKETING SERV., MARKETING BULL. NO. 27, THE FEDERAL MILK MARKETING ORDER PROGRAM, 27 (April 1968).

77. U.S. DEP'T OF AGRICULTURE, STAT. REP. SERV., MILK: PRODUCTION, DISTRIBUTION AND INCOME 1972-74, 6-10 (April 1975).

78. West of the Rocky Mountains the pricing structure is different. *Social Cost*, *supra* note 74.

79. See Memorandum to Daniel Booker from Robert Masson and Philip Eisenstat, U.S.D.O.J. (8/24/76), filed as Exhibit No. 46 of the National Farmers Organization, *Hearing in Connection with Determining the Public Interests in the Proposed Consent Decree*, United States v. Mid-America, Dairyemen, 73 Cv. 681-W-1 (W.D. Mo. 1973).

80. By the term "Upper Middlewest" we refer to much of Minnesota and Wisconsin as well as parts of Illinois and Iowa. In this area there are two milk orders. One is called the "Chicago Order" and encompasses much of Wisconsin and Northern Illinois. The other is called the "Upper Midwest Order." This

rently far in excess of Class I demands. For example, in the Chicago Order Class I utilization rarely exceeds fifty percent. This means that reserves are almost always one hundred percent or more above Class I usage. In the new Upper Midwest Order<sup>81</sup> Class I utilization appears to be running at about twenty-five to thirty percent, meaning a reserve above Class I usage of about two hundred to three hundred percent.<sup>82</sup> The rule of thumb for adequate reserves, as noted above, is about twenty percent in fall months. The question is whether there would remain an adequate supply of milk with a lower Class I price. The answer is definitely yes. This will be shown by the postulation of two extreme cases.

First, assume only one Order with a utilization rate of forty percent (roughly the average of the highest likely utilization). Assume further that the approximate amount by which the Class I price exceeds the Class II price is one dollar and that the Class II price is about eight dollars.<sup>83</sup> The producer blend price would be \$8.40 (forty percent utilization times the one dollar differential, plus the Class II price). Now assume that the Class I price was decreased by twenty cents (slightly less than two cents per gallon) and that the Class II price did not change. Then, assuming no change in production or consumption, the farmer blend price would be \$8.32 (forty percent utilization times an eighty cent differential plus eight dollars). *The change in the price received by farmers would be less than one percent.* Historically, a change in the milk blend prices of this magnitude would reduce milk production by less than one percent, and thus utilization would rise from forty percent to about 40.5 percent—reserves would average about 147 percent, well above the required reserves of twenty percent.<sup>84</sup>

Arguably, production could drop by more. As a second hypothetical, assume that all farmers will refuse to supply milk at a blend price below \$8.40.<sup>85</sup> By the same manner that this case affects the quantity supplied by the maximal amount, a reduction in the Class I price in this case leads to the greatest probability of arriving at an "inadequate" supply level. The question then is: Would supplies be

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encompasses much of Minnesota and parts of Wisconsin and Iowa. Thus in our terminology, the "Upper Midwest Order" is only part of the "Upper Middlewest."

81. See note 79 *supra*.

82. U.S. DEP'T OF AGRICULTURE, FEDERAL MILK ORDER MARKET STATISTICS. (Annual Summaries for various years).

83. These rough approximations yield results less favorable to our case than the actual numbers for any given year; they have been chosen for ease of analysis and represent the higher level of actual changes.

84. Cheng, *supra* note 19; Halverson, *supra* note 19 (emphasis added).

85. In that case, no price lower than \$8.40 can be obtained in that market, whether or not it is regulated. It follows that since the regulation has only achieved the price of \$8.40, the regulation has not raised the farmers' price above what it would have been absent regulation. In this case the costs of regulation are higher than they would be in the first case. More generally, the less the classified pricing can succeed in raising farmers' prices, the greater the costs of that classified pricing to society. *Social Cost*, *supra* note 74, esp. figures 3 and table 5.

adequate if the Class I price were decreased by twenty cents? Again, for simplicity, assume that the Class II price does not change. The answer is that some farmers will exit the market, *e.g.*, produce other products, and this will continue until supply again is equal to the (artificial) demand at a price of \$8.40. This would occur when milk supply has declined enough that the utilization rate is fifty percent and market reserves are still one hundred percent of Class I use.<sup>86</sup> Even stacking the deck against our case by as much as this, supplies will still be five times the "rule of thumb" necessary reserve of twenty percent of Class I use.

The theory of critics can be assailed as pure advocacy. We can, however, look at various other indications of the same phenomenon. One report has dealt entirely with the "worsening problem" of *too much milk* in this area.<sup>87</sup> A 1965 amendment to the 1937 Act established special plans available upon request for some markets to reduce production.<sup>88</sup> This amendment was justified by Congress by noting that "excess production" is "uneconomic production."<sup>89</sup> Of course, a lower price instead could achieve the same result, but the other two goals could justify the high price and necessitate these new provisions. The Georgia market opted for and was granted this authority to limit excess/uneconomic production. Georgia's utilization rates have always been twice those in the Upper Middlewest. Georgia's reserves sometimes even fall below twenty percent.<sup>90</sup> If Georgia has excess reserves then the Upper Middlewest must be glutted with them. The surplus problem is worsening. In the findings necessary to establish Order 68, USDA specifically addresses the escalating "problem" of the vast excess and rules that virtually none of it need be shipped to any Class I market except by a specific request. The House of Representatives now has before it *a bill to pay farmers to kill five percent of the nations dairy cows to help reduce total production*.<sup>91</sup>

Another key question here is orderliness of marketing with this lower price. As long as supplies are adequate, it can be easily verified

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86. As supplies decline utilization rises until the blend price is \$8.40. The final solution occurs with a utilization of 50% because the \$8.40 blend price will be arrived at by 50% utilization times the 80¢ differential plus the Class II price.

87. T. GRAF & R. JACOBSON, *RESOLVING GRADE B CONVERSION AND LOW CLASS I UTILIZATION PRICING AND POOLING PROBLEMS*. UNIVERSITY OF WISCONSIN (June 1973).

88. 7 U.S.C. § 608C (S)(B)(F) (1970).

89. H.R. REP. NO. 631, 89th Cong., 1st Sess. 7 (1965).

90. U.S. DEP'T OF AGRICULTURE, *FEDERAL MILK MARKET ORDER STATISTICS*, (Annual Summaries for various years) [hereinafter cited as *MARKET ORDER STATISTICS*]; DOJ REPORT, *supra* note 2, at 253.

91. Order 68 is covered in 41 Fed. Reg. 12,436-68 (1976), esp. 12,440-42 & 12,451. This latest bill is discussed in note 22, *supra*. Since cows take a few years to grow to full producing age, the premise of this bill is not simply that supplies are supra-adequate for 1978, but also that they will remain supra-adequate for the next few years. Although all other indications are also of a long term glut, this bill is in sharp contrast to the 1973 amendments, which stress not only current supplies but anticipated supplies. See note 3, *supra*.



that all conditions for orderly marketing, as we have interpreted the original Congressional purpose, are still met. Minimum prices are still regulated and the blend price system is still disbursing receipts equally regardless of the use of individual farmers' milk.

The only remaining orderly marketing or adequate supply problem is the transition problem: What if too many farmers exit too rapidly in the face of this (less than one percent) blend price decline? What if farmers stage violent protests? Assuming that over-exit was a possible problem, one need only "taper" the Class I price decline over time, *e.g.*, lower the Class I differential by 1/2¢ per month over a period of 3 1/3 years. Each blend price monthly decrease is only one-fiftieth of one percent of the blend price, and the annual decrease remains less than one-quarter of one percent. This is hardly likely to spur a mass over-exit. For the problem of violent protests, the tapering approach may help as well. This problem is not analogous, however, to the marketing violence of the 1920's and 1930's. It would instead be a calculated political action, holding public peace hostage to coerce the government to force consumers to subsidize farmers. Certainly conspiracy to do so would be illegal. And without conspiracy the mass of poorer farmers would realize that the impact of the reduction was minimal.<sup>92</sup>

By this analysis the conclusion is that the only possible reason under the 1937 Act not to lower the Upper Middlewestern Orders' Class I prices by at least twenty cents per cwt must be the farmer income goal combined with the public interest test.

### *The Farmer Income Goal Today*

There are two points to be made here: (1) Price enhancement for the farmer income goal has helped few of today's dairy farmers; and (2) Notwithstanding point (1), the price enhancement for the farmer income goal is spent primarily in subsidizing richer farmers at the primary expense of poorer consumers and some poorer farmers.

The first point is based on the salability of land. Assume, for analogy, that one owned a salable bond that paid ten dollars per annum in perpetuity. If the going rate of interest were ten percent, this bond would sell for one hundred dollars. Next, assume that the government agrees to match the dividends on this bond in perpetuity, making its annual pay out twenty dollars per annum. The price of the bond would rise to two hundred dollars because at ten percent interest only two hundred dollar investments would pay twenty dollars. A bond holder has three options: holding the bond literally forever; selling it immediately; or holding it for some time and then selling it or bequeathing it. For the holding period the person has had his income raised; at the selling point he has had his wealth raised—a

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92. Cf. DOJ REPORT, *supra* note 2, at 566-75, esp. 571-72.

windfall capital gain. The subsequent purchaser of the bond, however, earns the same twenty dollars, no more per dollar invested from this bond than he would have earned from a non-subsidized bond. Furthermore, he does not realize a capital gain from this government action. In fact, his income has not been raised at all by government subsidy.

Exactly the same principle obtains for any tangible asset, real or personal. In this connection, the USDA has stated:

The benefits of whatever improvements in blend returns may remain after a prolonged period tend to be dissipated by higher costs of production, including those costs associated with higher land values. The ultimate situation is that *the high price of Class I milk remains, but the excess profits of operation are gone*. Some producers may benefit from an increase in the capitalized values of their farms, *but new producers coming on the market would not share* in this benefit.<sup>93</sup>

In effect, the initiation of regulations and each individual price hike helped the original farm owners (raised their incomes and sale value of land). It *has not helped* any post-change farm purchasers (has not raised their incomes) or farm renters (whose rents would be raised). Furthermore, *an economist would not measure a high farmer return* even for any initial owners whose actual cash flows (wealth) were raised substantially. The USDA recognized exactly this problem in a recent report to Congress. They stated that in the dairy industry, if prices were raised whenever profits/incomes were measured as low, each price hike would rapidly be followed by farm values being bid up, low measured profits and a new price rise, "resulting in a never-ending cost-price spiral."<sup>94</sup>

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93. U.S. DEPT OF AGRICULTURE, TECH. BULL. NO. 1184, CLASSIFIED PRICING OF MILK, viii (1958) (emphasis added) [hereinafter cited as CLASSIFIED PRICING].

94. STAFF OF SENATE COMM. ON AGRICULTURE AND FORESTRY, CONG. SESS., COSTS OF PRODUCING MILK IN THE UNITED STATES 9 (Comm. Print 1976). The USDA takes exception to the Department of Justice's noting of this phenomenon. It first states: "The tendency for higher milk prices to be capitalized in higher land values, of course, exists." It then correctly notes that other factors (e.g., urbanization) have also raised farm land values. But it goes on to conclude: "Hence, a conclusion that the benefits of higher milk prices have been capitalized in increasing land values directly reflecting monopoly rents is invalid." *Comments, supra* note 22, at 20. As we note elsewhere, this does not invalidate our conclusions.

Some farm lands are earning revenues at a rate below the normal rate of return, which they could earn if the land were developed in conjunction with expanding urbanization. Consider land that would optimally be exploited by development ten years hence. If this land were to remain fallow for that period, owning the land for speculation would be marginally profitable at some price of land,  $p^*$ . If during the interim the land can be used to generate farm revenues in excess of variable costs (even if below full costs including a rate of return based on the land price paid), then the land will be worth  $p^*$  plus the capitalized value of farm revenues net of variable costs. The returns to speculative land holdings are increased by regulation which raises farm product prices, and rents accrue even when the land's primary value is based on its prospective development value.

Masson & Eisenstat, *Goals and Results of Federal Milk Regulation: A Reevalua-*

None of this means that farmers would not experience a capital loss if the regulations were removed. What it does mean is that, even if a program is well designed as an emergency measure to raise farmers' incomes by raising their prices temporarily in a time of stress, such a program will be ineffective in maintaining raised farmer incomes. In later years, the farm owners have paid for the benefits in the costs of their land, and they get absolutely no enhanced returns. *Although the benefits of the program are transitory, however, the costs of raising the price remain in perpetuity.*<sup>95</sup> With respect to the farmer income goal, the 1933, 1935, and 1937 Acts were not designed properly to achieve the farmer income goal of 1978. Indeed, for long-run purposes, practically any program of farmer income enhancement will have its effects canceled out. Methods of direct annual farmer income grants to all farmers of record on a particular stated date, however, would have a claim to effectiveness.

Despite the inappropriateness of the 1937 Act for raising farmers' incomes over the longer haul, the Act has been in place for several decades. An additional Class I price increase could be used to again raise farmer income/wealth, and a lowering of the Class I price will lower their income/wealth. A raising of the price, however, will impose costs on society in excess of the private benefits to farmers, and a lowering will reduce costs to society in excess of the reduced benefits to farmers.<sup>96</sup> Also, if prices were lowered, a direct subsidy to farmers of equal value could be financed out of generally progressive income taxes rather than the regressive "sales tax" imposed by the milk pricing system. If the desire to have the subsidy is to help and encourage those farmers who are not wealthy, then most of the current subsidy dollars are being wasted.

Before the 1960's, regulatory programs transferred income from consumers with generally higher incomes to producers with generally lower incomes. In the earlier years of the twentieth century, technological change in agriculture led to ever increasing efficiency, which in turn led to transitory farm gains. The ability to produce more with less labor input, however, drove down the incomes to be earned in farming after the initial development phase disappeared. Farmers with specialized skills who were too old to find other occupations continued to produce more and more, driving farm incomes down. Younger people facing this depressed income sector tended to move to more lucrative pursuits. Since many farmers were too old to find it advantageous to develop new skills, they stayed on the farm and for decades their production depressed incomes. Some farmers took alternative employment at jobs with lower incomes than what would have been available to them in their youth. The farm sector was hard hit by the type of progress that saved labor. But over the

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ation, JOURNAL OF THE NORTHEAST AGRICULTURAL ECONOMICS COUNCIL: PROCEEDINGS 193 (1977) [hereinafter cited as Masson & Eisenstat].

95. *Social Cost*, *supra* note 74; CLASSIFIED PRICING *supra* note 93, at viii (emphasis added).

96. *Social Cost*, *supra* note 74.

years the labor market has been moving toward equilibrium. While older farmers retired, depressed farm incomes led younger people to choose other occupations. This process is reflected in the fact that average farmer age increased relative to the population. As the numbers of retired farmers increased faster than new entry, farm incomes slowly rose.

Finally, in the 1970's, now that almost all milk is regulated, average farm income per capita has become close to average urban income per capita. It even exceeded the average urban income per capita in 1973.<sup>97</sup> If there are fewer very rich people in farming than in the urban sector, then the typical farmer's net income even exceeds that of his urban counterpart.

Classified pricing raises the price of milk to fluid milk drinkers. Milk drinkers are paying a subsidy to help farmers whose incomes on the average are almost as high as the national average. Another effect of the classified pricing type of regulation is that by encouraging over-production and dumping that over-production into cheese, dry milk, etc., there will be some price lowering effect on these products. Consumers of these products benefit, whereas consumers of fluid milk are hurt. In general, though, high consumers of fluid milk are higher consumers of other milk products as well.<sup>98</sup> The general effect is that consumers pay a subsidy to raise farmers' incomes.<sup>99</sup>

Which consumers bear the burden of this subsidy? The average expenditure on fluid milk of a family with an income of over fifteen thousand dollars is only about two and a half times that of a family with an income under four thousand dollars.<sup>100</sup> The incomes of this higher income group are assuredly more than four times those of the lower group, but their milk consumption is only two and a half times greater. In fact, there is evidence that seems to indicate that families with incomes just under seventeen thousand dollars tend to consume more milk than would similar families with yet higher incomes.<sup>101</sup> This means that poorer families pay a higher share of their income into the milk subsidies. If farmers' incomes are now approximately equal to the average national income, then in terms of percentage of

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97. In 1959 average farm income per capita was 48.7% of its urban counterpart. It surpassed 50% the following year and 60% three years later. Since 1965 it has not fallen below 60%, since 1968 it has not fallen below 70%, and since 1972 it has not fallen below 80%. 1973 and 1974 are, however, the only reported years above 90%. UNITED STATES DEP'T OF AGRICULTURAL, AGRICULTURAL STATISTICS 1977, 470.

98. Buxton, *Welfare Implications of Alternative Classified Pricing Policies for Milk*, 1977 AMERICAN JOURNAL OF AGRICULTURAL ECONOMICS 529 [hereinafter cited as Buxton].

99. If they were not paying a subsidy, the farmers' incomes would not be raised, and even this goal would not justify the level of the Class I price(s) in the Upper Middlewest.

100. Buxton, *supra*, note 98, at 528.

101. Thraen & Buxton, *An Analysis of Household Consumption of Dairy Products*, UNIVERSITY OF MINNESOTA AGRICULTURAL EXP. STA., BULL. NO. 515 (June 1976).

income their subsidy dollars are putting the heaviest burden on people who are poorer than themselves on the average.

The story would end here if all farmers received an equal subsidy. The burden of their subsidy would rest only slightly heavier on people poorer than themselves. But the truth is that the actual *average* subsidy flow is from poorer to *considerably* richer. The higher a farmer's wealth, *i.e.*, the larger his farm, the more subsidy dollars he receives. The Orders raise farm incomes by raising prices. Therefore, the larger the quantity of output a farmer sells, the larger his benefit from the order. In general, if a farmer whose total *sales* are five thousand dollars per year has his income augmented by one hundred dollars, a farmer with sales of one hundred thousand dollars will have his income augmented by about two thousand dollars, and one with five hundred thousand dollars will receive ten thousand dollars. About three percent of all dairy farmers account for about twenty-five percent of the total dairy output and thus receive about twenty-five percent of the subsidy dollars. The most affluent farmers (the top fifteen percent) receive about one half the subsidy dollars. In contrast, the most affluent fifteen percent of the population only pays about twenty percent of the total burden. Just as striking, the forty-five percent smallest farms receive no more than six percent of the subsidy, whereas the forty-eight percent poorest families pay for thirty-seven percent of these subsidy dollars.<sup>102</sup> Thus, not only is the tax on the consumer regressive, but the benefits to farmers generally are captured by the more affluent farmers, with incomes that exceed the national average.

The distribution of dairy farm sizes may be applied to approximate how much subsidy money went to which group of farms. One writer estimates that the fluid differential in the United States could be lowered at an average cost of about \$309 per year per farmer.<sup>103</sup> If this can be used as a measure of subsidy per farm,<sup>104</sup> then it can be seen that the most affluent 3.3% of farms receive about 2,230 subsidy dollars per farm per annum. The next most affluent 12.2% receive about \$678, and *the smallest 44.8% receive only about \$47*.<sup>105</sup> Note too that the term used is *farms*, not *farmers*.

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102. Calculations of the dairy farm income distribution were based on UNITED STATES DEP'T OF AGRICULTURE, ECON. RESEARCH SERV., THE IMPACT OF DAIRY IMPORTS ON THE U.S. DAIRY INDUSTRY, 8 (Jan. 1975). The calculations on the consumer burden distribution comes from the index of consumption from Buxton, *supra* note 98, at 528 and the United States income distribution in U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1973, 328. The calculation for 15% of the population is based on the index for the highest income category (*i.e.* about 25% of the population). The justification for applying this same index to the top 15% is based on the peaking out of consumption at about \$17,000. *Id.*

103. Buxton, *supra* note 98, at 529.

104. Our estimates are closer to \$666.67, DOJ REPORT, *supra* note 2, at 563. Buxton estimates a lower maximal Class I price reduction, *supra* note 98, at 527-28.

105. A standard economic formula tells us that the value of the right to \$R per annum in perpetuity is equal to  $R/i$  where  $i$  is the interest rate. If the interest

About twenty-five percent of dairy farm land is operated by non-owner farmers. The non-owning farmer will not benefit from the subsidy dollars because the subsidy makes dairy land more profitable, and the landlords, ninety percent of whom are non-farming, will receive the benefits of this from the subsidy through higher rents.<sup>106</sup> Hence, potentially 22.5% (25% of value times 90% non-farm owners) of the subsidy dollars do not even go to farmers.

One other effect that accentuates this even further is the fact that another group of farmers, grade B (or "ungraded") milk farmers, are hurt by the system. These are farmers who produce milk for manufacturing purposes only. Since the system creates surpluses of grade A milk used for manufacturing, the grade B price is suppressed. Furthermore, as a general principle, the grade B farmer is poorer than his grade A counterpart.<sup>107</sup>

In summary, the system taxes poorer consumers proportionally more than richer consumers. The subsidy is paid more to richer farmers and non-farmer landowners than to poorer farmers. Grade B farmers who are generally not affluent and are often the poorest farmers are hurt by the system. A few decades ago, taking money from consumers and distributing the proceeds to practically any group of farmers resulted in the more affluent subsidizing the less affluent. But today, the system basically taxes those who are, on the average, poorer to subsidize those who are, on the average, richer. Given the regressiveness of the tax and the progressiveness of the subsidy, this conclusion would still be reached even if farmer income was, on the average, significantly lower than the national average.

All of these figures are, unfortunately, not specific to the dairy farmers and consumers of the Upper Middlewest. The USDA has conducted a survey of two milk producing areas, including the Upper Middlewest. This has shown that, even excluding land value appreciation, typical dairy farmer income in the past decade has exceeded average urban income by forty percent. The estimates we present are based on approximate equality of incomes. The new estimates strengthen our *prima facie* case for "reevaluation."<sup>108</sup> It has been demonstrated that the Class I price in the Upper Middlewest could be lowered by twenty cents per cwt (about two cents per gallon) without impairing supply adequacy or the goals of orderly marketing. The remaining criteria are the farmer income goal and the public interest balancing test. The farmer income goal is obviously no longer needed to meet the depression emergency; therefore, this goal now develops only an equity aspect. Given the assumption that Congress did not *and does*

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rate were assumed to be 10% then the effect of a rise of \$2,230 per annum in returns would be to raise the farm value by  $(2,230/.10)$  or \$22,230. But for the poorest 44.8% of farmers their farm resale values would only be raised by \$470.

106. U.S. DEP'T OF COMMERCE, II 1969 CENSUS OF AGRICULTURE, ch. 8, at 33.

107. For estimates of the magnitude of this effect, see *Social Cost*, *supra* note 74, or as reprinted in DOJ REPORT, *supra* note 2, at 410-12.

108. U.S. DEP'T AGRICULTURE, AGRICULTURAL ECONOMIC REPORT No. 402, DAIRY PRICE POLICY SETTING, PROBLEMS, ALTERNATIVES (Apr. 1978).

not intend to tax poorer individuals to subsidize richer ones, the current price level in this area should be reevaluated by the USDA and/or Congress.

#### HOW FAR DOES THIS LOGIC LEAD?

How far does this logic take us in terms of reevaluation? In how wide a geographic area could Class I prices be lowered without endangering supply adequacy or market order? How far could prices be lowered? The following is only a brief sketch of the logic behind the answers to these questions. Class I prices could be dropped at least fifty cents per cwt (about 4 1/2¢ per gallon) everywhere and even further in most places.

Most areas in the United States have surplus grade A milk far in excess of the twenty percent rule of thumb necessary reserves. Some areas, however, do not have this surplus. Florida, for example, has reserves of under ten percent in a typical short production fall month.<sup>110</sup> The markets in Florida succeed in operating with very high Class I utilization by highly efficient use of existing stocks. Obviously, operating with even less milk in Florida would be very hard during fall months, and if a lower Class I price led to a lower blend price then Florida milk production would fall. This logic may only be used fallaciously to defend the Class I price level in Florida. The fallacy arises from equating the terms "milk in Florida" with "milk produced in Florida."<sup>111</sup> Florida does bring milk in from other market areas.<sup>112</sup> The key point is that the Florida Class I price can be lowered without affecting supply adequacy if the Georgia price is lowered along with the prices in Tennessee, Kentucky, Indiana, Illinois and Wisconsin.<sup>113</sup>

By lowering the Wisconsin Class I price, the vast surpluses of Wisconsin milk are made more economically viable sources for Illinois and Indiana if they need additional milk.<sup>114</sup> Then if Kentucky

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109. The logic is presented in more detail in the DOJ REPORT, *supra* note 2, at 514-26. An examination of more issues and more complex logic may even support a case for complete phased deregulation of classified pricing, if there is the addition of some less stringent alternatives. See DOJ REPORT, *supra* note 2, at 527-54.

110. MARKET ORDER STATISTICS, *supra* note 90.

111. USDA tends to incorrectly equate "an adequate supply of milk" with "an adequate supply of local milk." Cf. MILK PRICING PROBLEM, *supra* note 40, at 1. (emphasis added).

112. Milk for the three Florida Orders comes from Florida Orders and those called Chicago, Georgia, Memphis, Minneapolis-St. Paul, Ohio Valley, Des Moines, St. Louis-Ozarks, Southern Michigan and Appalachian. The largest such source is naturally Georgia. Georgia in turn purchases its outside milk from the Orders called Appalachian, Chattanooga, Indiana, Louisville-Lexington-Evansville, Nashville, Paducah and St. Louis. The bulk of this comes from Indiana. Indiana's outside milk comes from 9 orders, and the bulk of that comes from what we have defined as our Upper Middlewestern area. This uses Oct. 1973 as an example. See Forest memo, *supra* note 24, at 26-29.

113. See note 102 *supra*, for actual milk flows consistent with this explanation.

114. In the findings establishing the Upper Midwest Federal Order (68) the USDA states:

A reserve supply plant should be given credit for its shipments to other plants because the Upper Midwest area also serves as a reserve

needs more milk and purchases it from Illinois creating an Illinois "shortage," the void can swiftly and economically be filled. This logic continues as a domino effect down to Florida. With a lower Florida Class I price, Georgia milk may have to be called upon, but a lower Georgia price means that Georgia milk would be economically viable. If this creates a Georgia "shortage," then Tennessee milk, also with a lowered price, would be available. Thus, by lower prices everywhere, the lowered Florida price would not lead to any actual shortage or inadequate supply unless supply was also inadequate in Georgia, Tennessee, Kentucky, Indiana, Illinois and Wisconsin. Massive reserves have already been seen, however, in Wisconsin. In addition, reserves are high in Kentucky, Tennessee and throughout most of the United States.

Another factor that could essentially assure adequate supplies at significantly reduced prices is reconstituted milk mixed with fresh milk. Reconstituted milk is made from dried milk. The dried milk may be produced with grade A or grade B milk and can be inventoried for heavier use in the fall months or for low production years. Currently there are laws that make factory reconstitution for mixing with fresh milk either expensive or illegal. In particular, the Federal Order system itself subjects milk produced in this fashion to a "tax" that makes it more expensive than fresh milk. This is done to protect the Class I price, which is much higher than the price of reconstituted milk by up to possibly twenty-five cents per gallon in Florida.

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supply area for other parts of the country. [And if milk leaves the area, this *will not* cause] hardship for the Upper Midwest Market since it has a vast supply of reserve milk available to it.

And:

The Minnesota-Wisconsin area represents an alternative supply area for virtually all markets east of the Rockies. *For this reason, it is imperative that Federal Order Class I prices be appropriately aligned so that the milk will move only when necessary.* A Class I differential for the proposed marketing area that is too low would cause local milk to seek more remunerative distant outlets. 41 Fed. Reg. 12452, 12461 (1976) (emphasis added).

The USDA logic is thus to price this milk high enough to make it uneconomical as a steady source for other areas unless the area has a chronic shortage. But then in the other areas, because this milk is non-economic for steady use, the Class I price must be raised high enough to avoid any shortages of local production. High prices are needed in distant markets because they must carry their **own supplies**. Because upper middlewestern milk is not available, high prices are needed to keep its milk from going to these areas.

Such circularity cannot be justified on the basis of maintaining adequate supplies for consumers.

115. *E.g.*, in each Federal order: "A special situation exists with the use of nonfat dry milk in fluid milk products. The handler who uses nonfat dry milk to reconstitute fluid skim milk or to fortify other fluid products is accountable for the full fluid equivalent added to the skim solids." U.S. DEP'T OF AGRICULTURE, SUMMARY OF MAJOR PROVISIONS IN FEDERAL MILK MARKETING ORDERS, 7 (Jan. 1, 1976).

Translated into simple terms, a handler may use powdered milk in his fluid products, but whenever the handler adds any additional fluid (*i.e.* water mixed with the skim milk powder) he must pay an amount to the government for each *cwt* of water equal to the difference between the Class I and Class II prices in his market. This will make reconstituted milk more expensive than fresh milk.



A common statement from defenders of the status quo is that reconstituted milk tastes "burned," so consumers would not accept it.<sup>116</sup> Thus, we must have enough fresh milk for all fluid needs plus twenty percent in the fall months. Clearly, if a product that was ten percent or twenty percent reconstituted were acceptable, necessary fluid reserves could be considerably reduced. Does reconstituted milk taste so bad that consumers would not drink a product that had a small percentage of reconstituted milk in it? Obviously it was fear of exactly the opposite that led the USDA to tax the product to protect the Class I price.<sup>117</sup> In fact, many consumers are consuming milk powder, with the alleged unacceptable taste, on a daily basis. The most efficient process of making skim milk removes some milk solids as well as fat. For this reason, most states permit "fortified skim milk," skimmed milk with milk powder added to replace the solids that were removed with the fat.<sup>118</sup> That product is not rejected by consumers. Other evidence is disclosed by observing violations of this law. One processor, until caught, was able to illegally sell a partially reconstituted product in New York. In that case, it was whole milk that had some reconstituted milk added. Cows may produce a product that is, for instance, four percent butterfat, but whole milk is a three and a half percent fat product. One method of arriving at the desired fat level is to mix in skim milk. (A four percent fat raw product would then be a three and a half percent final product made with twelve and a half percent skim.) This processor used skim milk produced from milk powder. It would not have done so if consumers would not drink the product, and consumers did drink it.

Obviously, a simulated milk product of one hundred percent reconstituted skim milk filled with soy oil rather than butterfat will not taste natural. An appropriately labelled twenty percent reconstituted product with no soy oil, however, could make the Class I price necessary to assure sufficient milk to meet Class I demands at a much lower price. Further, since presently USDA regulations make this process generally unprofitable, we suspect that an even more realistic product would be developed if there were the incentive to do so.

One USDA publication states:

Unrestricted use of nonfat dry milk in fluid milk prod-

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116. *E.g.*, "current levels of technology have not produced an acceptable tasting reconstituted product." Memo to R. Torgerson from Roof & Phillips, entitled Critical Review of Paper, "The Social Costs of Federal Regulation of Milk," by Ippolito & Masson, Department of Justice, (November 28, 1975).

117. This diametrically opposed explanation seems closer to the truth. In one memo it is stated as: "If reconstituted fluid milk was fully acceptable to consumers its classification as a Class II product would tend to place a ceiling on the price of Class I milk at about \$1.25 a hundred-weight above the [Class II price and] completely wreck the Federal milk order system." G.C. Tucker, Memo to R. Torgerson from G. Tucker entitled Ippolito & Masson paper, "The Social Costs of Federal Regulation of Milk," January 1976, (April 1, 1976).

118. Because no water is added in this process this use is not penalized. *See* note 114, *supra*.

ucts (Class I) would undermine the mandate of Congress that expressly provides for a classified pricing system. Thus, the basic issue raised by the report is whether the equalization payment should continue to be charged for fluid milk products that have been reconstituted from nonfat dry milk.

Unrestricted use of nonfat dry milk in Class I (fluid milk) products would create economic pressure to reduce the Class I price differential. If reconstituted milk were permitted by State regulations and were fully acceptable to consumers, the Class I prices could approach the price for milk used in manufactured products plus costs of making powder, transporting powder to the fluid market area, and reconstitution. Lower Class I prices of such magnitude would likely reduce the number of producers in those Federal order markets that currently have the higher Class I differentials. This would be expected to cause a rise in the price of all dairy products, including nonfat dry milk, and partially offset hypothesized reductions in retail milk prices.<sup>119</sup>

In reaching this conclusion, the USDA has misinterpreted the Congressional mandate. The mandate is to *achieve an adequate supply of milk*. If consumers prefer a partially reconstituted product at a lower price and consequently do not require as much milk, then the high Class I prices are not needed to assure an adequate supply of milk. Virtual outlawing of reconstituted milk can only assure an adequate supply of milk at higher prices. By similar logic, if soft drinks and wine were also prohibited by the USDA more milk would have to be supplied and the price raised even more. Reconstituted milk is like any other beverage; its prohibition makes the milk supply less adequate. If consumers like partially reconstituted milk, the Act would appear to require its implementation because it would enable the maintenance of adequate supplies of milk at lower prices. The Act should be interpreted as stating: "The public interest is served by an adequate supply of milk at a reasonable price."<sup>120</sup> If the current price is higher than another price that could be obtained while still assuring an adequate supply, then the current price is not "reasonable." The ability to use the mandated classified pricing is not threatened; only the degree of monopoly-type price elevation is threatened.<sup>121</sup>

The next question is what extent of price lowering can this logic justify. To explain how much of a price decrease might be possible while meeting the criteria of the Act requires extensive technical

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119. *Comments, supra* note 22, at 13. In this statement the USDA obviously misconstrues the DOJ expectation that consumers would be willing to buy a *partially* reconstituted product as we have stated here as well.

The DOJ REPORT, *supra* note 2, at 399-414, 522, notes the cited "partial offset" of its hypothesized price reductions for any of its proposed alternative policies.

120. MILK MARKETING PROGRAM, *supra* note 31, at 27.

121. In *Comments, supra* note 22, at 14, USDA does state: "The Secretary does have discretion in deciding what the rate of equalization payment should be for milk products reconstituted into fluid milk. Upon request, the Department will consider holding a hearing to review the present rate of payment."

modeling, elasticities of demand and supply, etc.<sup>122</sup> A simple example may be used to explain the general magnitude that prices could be lowered while effectuating the goals of the Act. As was discussed with regard to the Upper Middlewest, a lowering of the farm price by one percent would lead to less than a one percent decrease in milk production. If in the Upper Middlewest the Class I price were equated with the Class II price, and the Class II price were to remain unchanged, the price received by farmers would fall by less than five percent.<sup>123</sup> (With a Class I price of about nine dollars, a Class II price of about eight dollars and utilization of forty percent Class I, the blend price is only \$8.40 under regulation.) With the subsequent decline of less than five percent in Upper Middlewestern production, vast surpluses would still remain. Production would have declined slightly and Class I sales increased slightly. With total supply down and Class I sales being satisfied at a greater level, then Class II sales must decline. The Class II price would have to rise due to the shorter Class II supplies. Thus, even if the Class I price were equated to the Class II price, but the Class II price was determined by competitive supply and demand, the fall in price received by farmers would be less than that from \$8.40 to \$8.00. Retaining the assumption of no reconstitution, by rough calculations it is estimated that if all Class I prices were maximally decreased, the average blend price would decline about twenty-five cents, only three percent. The Class I price would have declined about fifty cents in this eventuality.<sup>124</sup> Other areas near the Upper Middlewest would also have to lower their Class I prices by about as much or they would be inundated by lower priced milk being transported into their areas. Supply adequacy would be determined by the large surpluses most of these markets have as well as the potential for Upper Middlewestern milk to serve these markets. Still farther out markets will have prices that will be constrained by the ability of this nearer milk to be transported to their markets and so on. The system of Class I prices could still radiate out of the Upper Middlewest, starting at a lower level. In this case, by some distance from the Upper Middlewest the Class I price will have risen sufficiently above the Class II price that reconstituted milk will start to become an economically viable supplement to fresh milk. This would both further suppress the Class I price that could be

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122. Excluding the possibility of milk reconstitution we have estimated the maximum price decline consistent with this type of logic and with prices aligned out of the Upper Middlewest in *Social Cost*, *supra* note 74. This is a decline in the Class I price of about 60¢ to 65¢ and a consequent increase in the Class II price of about 35¢ to 40¢. The net farm blend price would thus fall about 23¢-28¢.

123. Actually, we would anticipate a Class I price about 25¢ above the Class II price. See *Social Cost*, *supra* note 74. This differential would reflect the additional costs of producing grade A milk above those necessary for producing grade B milk.

124. See note 74, *supra*. In *Social Cost*, *supra* note 73, the percent change is noted at about four percent. The difference reflected here is that the average blend price has increased since then, whereas the expected decline in absolute terms has not.

charged and assure supply adequacy.<sup>125</sup>

Following this story market by market leads to a conclusion that Class I prices could generally be lowered by fifty cents or more everywhere and still achieve supply adequacy. Orderly marketing would still be assured by the same blending procedures currently used, coupled with the fact that markets would continue to have adequate supplies.<sup>126</sup>

Finally, with considerably more detail,<sup>127</sup> this logic could support a phase-out of the price regulations in their entirety. Most of the orderly marketing problem of the 1930's can be solved by much larger market areas, milk transport, communication, cooperative marketing, etc. Supply inadequacy was a problem related to severely depressed farm incomes, poor transport, and poor communications between short markets and long markets. Current transport and communications technologies, more reasonable farm incomes, and reconstitution technology effectively eliminate most of this problem. Deregulated markets in lower production areas may face wider price variability, but the variability would be systematic and result in lower average prices. This interpretation may be found in detail in other works.<sup>128</sup>

#### CONCLUSION

The starting point in evaluating milk order regulations is an interpretation of the intent of Congress in passing the Agricultural Marketing Agreement Act of 1937. Using that interpretation and the example of the Upper Middlewest milk market, a *prima facie* case has been established for the proposition that most markets are not regulated in a manner consistent with the Congressional intent.

The explanation for this deviation from the original Congressional intent may be one of the following: (a) through forty years of administration USDA has lost sight of the massive changes in society and technology insofar as their impact on policy; or (b) although not evidenced by the legislative history of subsequent amendments, Congress has changed its intent and fully agrees with USDA's current administration of the Act.

Either of these alternatives requires action on the part of Congress and/or the USDA to eliminate the discrepancies. If Congressional goals have changed since 1937, Congress should make

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125. As was noted, *see* note 119, *supra*, this would tend to raise the Class II price further. This would create a new price alignment. The Chicago Class I price would not fall by a full 60¢, but the Florida Class I price might fall by \$1.00 or \$2.00.

126. An interpretation of "orderly marketing" that allows for regular seasonal price fluctuations along with some proposed methods of smoothing unanticipated changes.

127. DOJ REPORT, *supra* note 2, at 527-74; *Social Cost*, *supra* note 74.

128. DOJ REPORT, *supra* note 2, at 538-54; Masson, *supra* note 94.

clear its intention to tax poorer consumers in order to raise the incomes of richer farmers. On the other hand, if Congress still embraces its 1937 standards, USDA must, either on its own initiative or under congressional pressure, reevaluate its use of outmoded mechanisms in light of their effects today.