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# THERE MUST BE A BETTER WAY TO REPAIR MILK ORDERS

by W. D. Dobson

➤ The current effort to review and perhaps modify the government-sanctioned way milk and milk products are priced in the United States has many problems. Decisions are likely to be delayed and they may be unsound. Procedures for the current effort probably cannot be changed. But, now is the time to consider changes in the procedures so that alternative approaches are utilized the next time around.

Federal milk orders establish minimum prices for about two thirds of the milk marketed in the United States. Being basically price discrimination devices administered by the U.S. Department of Agriculture, the orders set minimum farm milk prices according to utilization of the milk. Milk under the 41 orders existing in 1989 was valued at about \$13 billion at the processing plants. Prices under the orders fall into three classes. Milk processors pay Class I prices for milk used for fluid (drinking milk) purposes. Prices for milk used for "soft" manufactured milk products (cottage cheese, yogurt and ice cream) are in Class II. "Hard" manufactured products (butter, hard cheeses and powdered skim milk) are priced, under the orders, in Class III. Producer cooperatives use price floors established by the orders to negotiate with processors for higher premium prices for Class I and Class II milk.

The orders, many of which were formed by merger of smaller orders established in the 1940s and 1950s, have been largely immune from fundamental change. However, in 1990, Agriculture Secretary Yentler agreed to hold hearings in the Upper Midwest, South and Northeast to consider amendments to the orders in response to industry concerns about the milk pricing system. Some 150 to 200 changes in the milk orders were on the docket for consideration, proposing everything from fundamental change to "fine tuning." In the former category is the idea of redistributing producer incomes by raising Class I differentials for the Upper Midwest and lowering them in the south and Northeast, in some cases through use of multiple basing points or a flat Class I differential. Another proposal would reduce the economic penalties levied on processors who make reconstituted milk from manufactured milk products. Producers in the South and East were alarmed by proposals to remove all price penalties on reconstituted milk. Such changes would permit processors to buy "condensed" milk products (probably in the Midwest), add water to them and sell them as fluid milk, undermining the basis for classified (discriminatory) pricing. Prices for fluid milk would drop.

The many "fine tuning" proposals defy easy classification. An example of such a proposal would change how kefir (a cultured, low-fat dairy drink of European origin) is classified. The effect would make kefir competitive with yogurt. The scale and sheer number of proposals, presented at the hearings, call for the most ambitious changes ever proposed for the milk orders.

The 1990 hearings were controversial, reflecting the regional economic interests involved and the complexity of the proposals. Demonstrators burned a Confederate flag outside the hearing room in St. Cloud, Minnesota, to protest what they felt was preferential treatment for Southern milk producers under the current orders. Farmer witnesses at the Eau Claire, Wisconsin, hearing—who thought they would simply present their preferences and quietly leave—found themselves subject to sharp and lengthy cross examination on marketing issues by attorneys representing dairy interests from other regions of the country. Attorneys also complained to the

presiding judge for the hearings that it was difficult to get important facts into the record and that it was hard to plan effective cross examination of witnesses because the hearing proposals were so sweeping and lacked specifics.

USDA marketing specialists will use the voluminous record generated at the hearings (fourteen thousand pages) to develop revised milk marketing orders. They must develop recommended decisions. Following an appeals process where affected parties file exceptions and seek changes, the revised orders will go into effect if approved by two thirds of the eligible producers in each marketing order. Given the lengthy delays in implementing far less complex proposals, many in the dairy industry predict it will be years before all order amendments based on the 1990 hearings are completed.

## Procedural Problems

The situation is ripe for long delays and unsound final decisions. The current system for amending the orders works well enough when changing the classification of kefir or doing similar "fine tuning." But lately the USDA needs more and more time to finalize complex regulations. About 1.5 years elapsed from the time public hearings were held on the Carolina milk order (in April 1989) until the new order became effective in September 1990. And, the issues in the 1990 hearings are much more complex than what was involved in establishing that one new order. To force a timely decision, the 1990 Farm Bill would require the USDA to complete, to the maximum extent practical, the order amendments by January 1, 1992. While this might move the process along, it does not guarantee sound decisions or ensure that national pricing issues would be addressed. Indeed, the capacity of USDA's marketing specialists has been limited by personnel cuts and budget constraints.

## Options

There are a number of ways to get around the problems associated with milk marketing orders including a proposal from the Justice Department to simply eliminate them. Since neither producers nor milk processors are prepared to throw out the orders, this option is unlikely to come to pass. There are two major options for improving the amendment process that should be seriously considered even if it is too late for the changes to affect the outcome of the 1990 hearings:

*Increase the size of the economic and legal staff charged with amending Federal milk orders.* The increase in staff should also provide capacity to develop an economic model with enough detail to meaningfully assess the impact of changing Class I differentials in Federal order markets on milk production, sales, producer incomes, and intermarket milk movements. A model is necessary since, at present, neither the USDA nor some proponents of such changes can accurately predict all major effects of introducing multiple basing points, a flat Class I differential or other changes in Class I differentials.

*Revise the Agricultural Marketing Agreement Act of 1937*—the enabling legislation for Federal milk orders—to speed changes in milk orders using procedures similar to those employed to change dairy price supports. This option—which carries the undesirable baggage of involving the Congress in regulatory minutia—might become necessary if conflicting regional interests gridlock over the issues. Problems with minutia could be reduced by replacing the existing orders with regional orders.

Of course, some will advocate doing nothing in response to the 1990 hearings or in the process for the future. Inflation then will erode the real value of Class I differentials and produce a milk order system where producer bargaining exerts even greater influence on milk prices. Certain pricing changes proposed in the 1990 hearings (e.g., hauling credits and measures to force delivery of milk to bottling plants for fluid needs) are probably too complex to be incorporated in the orders anyway and must be negotiated by producers. By doing nothing the USDA would avoid making changes which produce unforeseen and undesired results, but distortions and inefficiencies produced by the order system will remain. The USDA might also face lawsuits should interest groups try to force changes in the system via the courts.

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