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Minnesota



Farm Business

Notes

PRICE AND TRADE REGULATION IN THE DAIRY INDUSTRY

R. D. Knutson, J. W. Hammond, and E. F. Koller

All 50 states have laws which, directly or indirectly, regulate price and/or trade practices of fluid milk processors, wholesalers, and retailers.¹ Producer prices on about 90 percent of the milk eligible for fluid use are established by 76 federal milk marketing orders and 23 states.

This article's purposes are to: (1) describe conditions underlying extensive regulation of dairy prices and trade practices, and (2) explain regulations that were developed to cope with the problems.

CONDITIONS LEADING TO REGULATION

Price and trade practice regulations in the dairy industry resulted from economic and technical developments during the last 50 years. In the early 1900's, milk producers for some major consumption centers formed cooperatives to bargain with processors on price and other terms of trade. During that period, inadequate transportation and refrigeration facilities made market supply areas relatively small and isolated. As a result, initial efforts of cooperatives were relatively successful in raising producer returns and creating market stability.

Over time, bargaining efforts of cooperatives were undermined by movement of milk between markets. Improved methods of refrigeration, transportation, and quality control increased the mobility of milk. Numerous producers and producer organizations competed for sales in most fluid milk markets. Competition for the high return fluid markets became intense in the late 1920's and early 1930's when falling consumer incomes depressed the demand.

In addition, price wars frequently developed as processors and distributors

tried to maintain their sales volumes in spite of shrinking demand. Producer organizations could not prevent low prices from being passed back to producers. To protect themselves from intermarket competition and to prevent this competition from driving prices to ruinous levels, these groups sought state and federal price regulations of the fluid milk industry.

Today, improved transportation, processing techniques, and packaging materials continually expand the optimum size of milk plants and the areas served by each plant. Milk now can be moved long distances with little change in quality. Therefore, no market is completely isolated from out-of-state milk supplies.

Since the demand for milk has not kept pace with increases in optimum plant size, competition for available business has increased. This competition often results in unfair and destructive practices and price wars.

Shifts in milk distribution methods and the predominance of food chains in retailing have introduced additional problems. Until the 1940's, milk usually was distributed on home delivery routes. Today, about 70 percent of the milk in federal order markets is distributed through stores. Not only has there been a shift from home delivery to store purchases, but an increasing share of all dairy products is being distributed through supermarkets of large chain organizations.

These changes in grocery merchant-

dising and consumer buying habits have greatly affected the relative bargaining power of processors and distributors. Many large chains can efficiently operate their own processing facilities and supply all their stores in a several state area.

Chains also contract with processors to package milk under the chain's private label. Such accounts may constitute a substantial proportion of the processor's total sales volume. Therefore, the threat of withdrawing the chain's business from a processor constitutes an important bargaining tool. Other processors, desiring to utilize excess plant capacity, may use questionable means to lure the chainstore's business to their plants.

Current emphasis upon trade practice laws indicates that much dairy industry legislation is designed to regulate trade practices of processors and large retailers of fluid milk.

PRICE FIXING

The most direct method of preventing disruptive competition or unreasonably low prices in the dairy industry is the establishment of prices at one or more market levels. Currently, 25 states give either the state department of agriculture or a special administrative agency the power to establish prices at the producer, wholesaler, and/or retailer levels of the trade (see the table). In addition, the federal government regulates producer prices in 76 market areas throughout the nation.

The state's power to fix producer prices is considerably more limited than the federal power. In an important Supreme Court decision (*Baldwin v. Seelig*), it was decided that a state cannot fix the price paid for milk purchased beyond its borders. In markets such as New York City, surrounding states are important supply sources. This decision meant that any attempt to increase prices paid to New York producers could be undermined by processors seeking lower priced milk from New Jersey and Pennsylvania.

This situation helped bring about federal legislation allowing the establishment of the federal milk marketing order system. Where federal orders cannot be obtained, state producer price fixing may still be desirable for intrastate markets.

As shown in the table, 20 states have the power to fix wholesale and 18 have the power to fix retail prices for fluid milk. Most of these states are in eastern, southeastern, or western parts of the country.

Resale (wholesale and retail) prices are not as easily undermined by interstate sources of milk as are producer

¹Information on regulations was obtained by surveying state statutes and federal anti-trust laws. Information on cases was taken from Federal Trade Commission decisions and the *United States Supreme Court Reports*.

prices. Consumers can go into nearby states to buy milk. Although the regulating state cannot prohibit distributors in nearby states from selling milk in its market, it can require that this milk be sold at the established prices.

Prices established by state agencies are generally minimum prices which are to be charged by distributors to wholesale and retail customers. The laws make it illegal to charge any lower price than the established one or to use any practice by which a lower price is either directly or indirectly accomplished.

Several methods are utilized by state agencies to establish the levels of prices and price differentials for different types of customers, types and sizes of containers, and quantities of sales. These methods vary from specific economic formulas and cost studies to simply basing prices on trends in milk production and consumption and trends in aggregate costs and returns.

Probably the greatest state resale price-fixing problem is that of price administration. Although prices are established, competitive pressures of consumers and other processors often result in schemes to avoid established prices, particularly if prices do not reflect the differentials and margins existing under competitive conditions. For example, by integrating into processing, a grocery chain can negate any effect of established wholesale prices on its operation.

REGULATION OF TRADE PRACTICES

Trade practices, other than direct price regulation, are controlled by either general state and federal trade practice and antimonopoly laws or by state dairy industry trade practice laws.

Dairy Industry Trade Practice Regulations

Minnesota and 13 other states have laws that regulate trade practices of processors and distributors in buying or selling milk (see the table). Prohibited practices may be grouped into three general classes—price discrimination, sales below cost, and other trade practices.

Price discrimination in selling milk—selling a product of like grade and quality to different customers at different prices—is prohibited in 12 states. Certain types of discrimination are legal or justified while others are illegal or unjustified.

Price and trade practice regulations in the dairy industry, by type of regulation and by state, 1966

Price-fixing regulation						State trade practice regulation in the dairy industry			General trade practice regulation	
Producer		Wholesaler		Retailer		Price discrimination	Sales below cost	Other	Price discrimination	Sales below cost
Ala.	N.J.	Ala.	N.J.	Ala.	N.J.	Colo.	Colo.	Colo.		
Alaska	N.Y.					Idaho	Idaho	Idaho		
Calif.	N.C.	Calif.	N.C.	Calif.	N.C.	Iowa		Iowa	Ark.	Ariz.
Conn.	Oreg.							Kans.		Conn.
Fla.	Pa.	Fla.	Pa.	Fla.	Pa.	Ky.	Ky.	Ky.	Del.	
Ga.		Ga.	R.I.	Ga.	R.I.	Minn.	Minn.	Minn.	Hawaii	Hawaii
La.	S.C.	La.	S.C.	La.		Mo.	Mo.	Mo.	Ind.	
Maine		Maine	S. Dak.	Maine		Neb.	Neb.	Neb.	Kans.	Md.
Mass.	Utah	Mass.		Mass.		N. Dak.		N. Dak.	N. Mex.	
Miss.	Vt.	Miss.	Vt.	Miss.	Vt.			Okla.		N. Dak.
Mont.	Va.	Mont.	Va.	Mont.	Va.	S. Dak.	S. Dak.	S. Dak.	Oreg.	Oreg.
Nev.	Wyo.	Nev.	Wyo.	Nev.	Wyo.	Tenn.	Tenn.	Tenn.		Tex.
N.H.		N.H.		N.H.		Utah		Utah		Utah
						Wis.	Wis.	Wis.	Wash.	Wash.

Most laws, including Minnesota's, allow discrimination if it can be justified by cost differences due to quality or quantity of product sold, transportation costs, or competition in a particular market. A quantity discount schedule with a lower price for larger volume deliveries is legal if it reflects actual cost differences in delivering different quantities of milk to different customers.

The importance of allowing such price differences cannot be overemphasized. Besides promoting the adoption of new, efficient processing and distributing technologies, these price differences allow the advantages of such technologies to be passed on to producers and consumers. Quantity discounts have, for example, encouraged fewer and larger deliveries of milk to wholesale and retail customers, thereby increasing the efficiency of distribution systems.

Illegal discrimination is discrimination which cannot be justified by cost or competition.

However, since most laws prohibit discrimination in terms of price or service, equality of price does not indicate the lack of discrimination. A distributor may discriminate by offering certain retailers special services such as advertising allowances, display equipment, or other indirect price concessions.

Unjustified price discrimination can materially damage other distributors in the market because of resulting losses in sales volume. Moreover, certain retailers are given an unjustified price advantage over others. If allowed to continue, this discrimination may lessen competition substantially at either the distributor or wholesale level.

Sales below cost for milk and other dairy products are illegal in nine states

including Minnesota. Cost, as defined in Minnesota and most other states, includes all costs of the processor plus overhead expenses.

Several states have developed uniform accounting methods by which costs can be adequately determined. Cost to the retailer may be determined either by direct computation as for processors or by a specified minimum markup provision by law. In Minnesota, the minimum markup is 8 percent over the processor's list or invoice price.

Sales below cost regulations help prevent price practices which bring about the same results as price discrimination. These laws prevent processors and retailers from injuring competition by selling one product, such as ice cream, to customers at an unreasonably low price while selling another product, such as fluid milk, at the market price.

Furthermore, these laws prohibit grocery stores from selling milk as a loss leader—a device to attract customers to the store to buy other items in addition to milk. They are thus important devices for preventing milk price wars.

Several trade practices other than price discrimination and sales below cost are generally prohibited by the dairy industry trade practice laws. Most of these practices are nonprice methods of competition. Of 14 states prohibiting one or more such practices, all 14 prohibit secret discounts and rebates, 11 prohibit giving advertising allowances to wholesale customers, 10 prohibit giving or selling display or refrigeration equipment for storing products at less than cost, and 9 prohibit giving loans or extending credit to wholesale customers for an unusual length of time at low cost.

The effect of these laws, if properly administered, is to eliminate several nonprice methods of competition and,

thereby, center competition on price. In addition, such laws probably increase the effectiveness of administration of price discrimination and sales below cost laws.

As in the case of price-fixing laws, administration is the major problem encountered in trade practice regulation. A law designed specifically for the dairy industry and administered by the state's department of agriculture may be more effective than the general laws discussed below. Nevertheless, the practices being regulated, such as secret rebates, are difficult to detect and abolish.

General State and Federal Trade Practice Regulation

Trade practices are regulated by the federal government under four major pieces of legislation: the Sherman Act, the Clayton Act, the Robinson-Patman Act, and the Federal Trade Commission Act. Since federal statutes apply only when trade involves interstate commerce, just large firms fall under federal jurisdiction.

The Sherman Act declares illegal contracts, combinations, or conspiracies in restraint of trade as well as monopolization or attempts to monopolize trade. The Clayton Act, section 7, prohibits mergers that may substantially lessen competition in the relevant market. Section 2 of the Clayton Act (also known as the Robinson-Patman Act) prohibits certain types of price discrimination. The Federal Trade Commission Act set up the Federal Trade Commission (F.T.C.) to enforce its provisions which generally prohibit ". . . unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce."

Since 1930, several regional and national dairy concerns have been charged with violation of these statutes.

In 1939, the Supreme Court decided (U.S. v. Borden) that distributors in the Chicago milkshed, a cooperative association, a milk drivers' union, and several municipal officials were guilty of a conspiracy and attempt to fix milk prices. The court rejected the defense that the Capper-Volstead Act exempts cooperative associations of producers from antitrust action.

In 1956, violations of the Clayton Act and the F.T.C. Act were brought against four national dairy concerns—Beatrice Foods Co., Borden Co., Foremost Dairies, and National Dairy Products Corp. The F.T.C. contended that a total of 289 mergers undertaken by these firms would substantially lessen competition. Although litigation is not yet complete, Foremost, Beatrice, and National Dairies were found guilty. Foremost was required to divert itself of 10 acquired concerns, and National Dairies of 2. National Dairies also was ordered not to acquire dairy firms for 10 years without F.T.C. approval. In the Beatrice case, a final decision on remedies has not yet been reached.

An important decision involving violation of the Robinson-Patman Act was recently handed down by the Supreme Court (F.T.C. v. Borden Co.). The F.T.C. charged that the Borden Co. was illegally discriminating by selling private label evaporated milk for less than its own brand and that these differences could not be justified by cost.

Borden contended that, even though the products were physically identical, they should not be considered of like grade and quality because of Borden's reputation for its product that had been built up through advertising. The Supreme Court rejected this argument, holding that the products were of like grade and quality and that any price differentials must reflect actual cost differences.

The implication of this decision for the private labeled dairy products is not entirely clear. However, unless the distributor can justify a low price for private labeled milk in terms of processing and distributing costs, he probably could be prosecuted for violating the Robinson-Patman Act or a similar state statute prohibiting price discrimination.

Since federal statutes apply only to firms dealing in interstate commerce, most states also have enacted statutes similar to the Sherman and Clayton Acts. In states having neither milk control laws nor dairy industry trade practice laws, dairy firms may be regulated under general sales below cost laws and price discrimination laws. Of

20 states not fixing resale prices for milk or having dairy industry unfair trade practice laws, 14 have either a general sales below cost law or a price discrimination law. In general, these laws have the same provisions as dairy trade practice laws. However, since these laws often rest on private enforcement and since no specific agency is responsible for applying the law to the dairy industry, many states have had to enact similar laws for the industry itself.

CONCLUSIONS

Many states have enacted some regulations on price and/or trade practices in the dairy industry. The persistence of disruptive conditions in the industry indicates that regulation is not likely to decline in the future. However, regardless of the type of regulation existing, these laws are limited in terms of both interstate commerce and the type of practices which can or should be regulated. Since such laws have an important impact upon economic and technical changes in the industry, improper administration of these laws can substantially harm overall industry efficiency.

RECENT PUBLICATIONS

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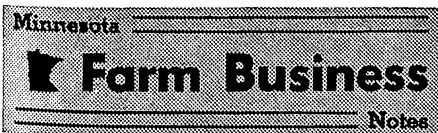
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the outlook corner

Milk Control Laws in Trouble?

J. W. Hammond and R. D. Knutson

Although state control of milk prices is widespread, both proposals to eliminate it and enforcement difficulties apparently are increasing. The *Dairy Record*, a good source of information on such developments, has contained several articles in the last 2 years indicating that control programs are being sharply criticized.

Efforts to Eliminate Controls

Criticisms of state milk price controls come from many directions. Some public officials at state and local levels propose elimination of wholesale and retail price fixing. Supermarket owners and their spokesmen often request elimination of price controls. Dealers and processors of dairy products take both positions. However, managers of small firms tend to favor price regulations while those of large firms tend to oppose them.

In recent years, in opposition to high milk prices, consumer groups in eight states have actively advocated repeal of resale milk pricing. The governor of New Hampshire (one of the eight states) is leading a campaign to eliminate retail and wholesale price fixing. But he supports price control at the producer level.

A New Hampshire Consumer's League continues to oppose the Milk Control Board. In February 1966, the Milk Control Board decided to remove all retail and producer price fixing. Several groups challenged the decision in the state's supreme court. The court delayed elimination pending a final decision.

In Pennsylvania, consumer groups, newspapers, and local governments are attacking the milk control program. Early this year, local governments and consumer groups petitioned the state court to rescind a milk price increase by the Milk Control Commission. The Commission was directed to show cause for the price increase and why the order should not be rescinded.

Pennsylvania's governor established a Milk Inquiry Committee to study the problems of milk control. The Committee split into three groups. One group proposed the following changes: (1) retail and wholesale pricing should be

permissive rather than mandatory, (2) dealers' records should be open, and secrecy in price fixing should be eliminated, and (3) government institutions should be able to buy milk on bidding arrangements. While the second group proposed that resale price fixing be eliminated, the third group proposed that present controls be strengthened.

In 1965, Pine Tree Milk Consumers, Inc., supported a bill in the Maine legislature to repeal price controls. Although the bill was defeated, it indicated increased organization of consumer groups.

Speakers at the International Association of Milk Control Agencies in 1964 stressed the need for consideration of consumer interests. They indicated that unless consumer interests are protected, the future of control programs is at stake.

Interstate Problems

States are unable to protect their producer milk price programs from out-of-state milk supplies. For example, a 1963 Oregon law allows for the establishment of class prices for milk according to use. It also provides for the establishment of quotas limiting the amount of milk used for high priced (Class I) fluid utilization.

However, quotas cannot be established on out-of-state producers. Dealers can buy milk in Washington, California, or Idaho at low prices and put it into Class I utilization. They thereby can decrease the amount of Oregon milk put to this use—a practice which depresses returns to Oregon producers.

The Oregon circuit court held that the control board could not require that milk received from out-of-state be allocated to use in the same proportion as milk received from Oregon producers.

Pennsylvania also has problems of interstate milk shipments. In the western area, including the large Pittsburgh market, low priced Ohio milk undermines the milk control program. According to some charges, Pennsylvania dealers are selling milk in Ohio and buying it back to avoid prices established by the Commission. A bill passed by the state legislature provided that dairies buying out-of-state milk at low prices pay the difference into a state fund, but the governor vetoed it.

Minnesota's Legislative Research Committee concluded that a state milk price control law would not be workable. Because so much fluid eligible milk is available in nearby states, a price control law probably would increase the quantity of milk from out-of-state sources.

In Summary

The previous comments point out problems of state milk control. However, proposals to enact milk price control programs are still numerous. As reported in the *Dairy Record*, nine states had proposals to institute price control programs in the last 2 years. South Dakota enacted a control law last year.

Recent developments point to several trends. Proposals to abolish and to enact milk price controls indicate that all states will continue to face this issue. The inability of a state to regulate interstate supply sources will limit its ability to raise producer returns.

Consumer organization and interest in eliminating milk control will increase the difficulty in establishing and maintaining these programs.

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