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The 1990 Farm Bill: Its Core Provisions and Expected Effects

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Although commonly referred to as "The 1990 Farm Bill," the farm legislation passed in late 1990 is a combination of "The Food, Agriculture, Conservation and Trade Act of 1990" and "The 1990 Budget Reconciliation Act." The latter act, aimed at reducing the federal budget deficit, made subsidy and other budget cuts totaling $13.6 billion for the same 5-year period (1991-1995) covered by the primary farm legislation. This budget reconciliation legislation reduced estimated costs of agricultural programs from $54 billion to about $40 billion.

The 1990 legislation highlighted three goals: (1) reducing the federal deficit, (2) improving agricultural competitiveness and (3) enhancing the environment. This legislation in its entirety includes 25 individual titles ranging from those for commodity programs to those for conservation, rural development, trade, research, credit, food aid and global climate change. Despite the continuing reference to this "farm bill," the 1991 appropriation for domestic food programs, such as food stamps, ($27.6 billion) is more than three times as costly as commodity agricultural program expenditures ($8.4 billion).

The following sections examine some of the major provisions of the 1990 legislation and speculate on their likely effects. Throughout this publication, the term "farm bill" refers to both "The Food, Agriculture, Conservation and Trade Act of 1990" and "The 1990 Budget Reconciliation Act."

Commodity Programs

The commodity titles of key importance in Minnesota are those dealing with general commodity provisions and with provisions for dairy, wheat and feed grains, oilseeds and sugar.

Dairy

The farm bill sets a floor support price at $10.10 for 3.67 percent fat-corrected milk through 1995 and continues the implementation of this support through government purchase of manufactured dairy products (butter, cheese and dry milk). A minimum increase in support of 25 cents per hundred-weight is mandated if Commodity Credit Corporation (CCC) purchases are projected at less than 3.5 billion pounds of milk equivalent annually. If purchases are projected at more than 5 billion pounds, a support price reduction of between 25 and 50 cents per hundred-weight is mandated.

In an effort to curb dairy program costs, producers will be assessed 5 cents per hundred-weight for milk sales

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Upper Midwest Challenges to the Federal Milk Marketing Order Program

Jerome W. Hammond

Federal Milk Marketing Orders were challenged on two fronts in 1990. First, the Minnesota Milk Producers Association (MMPA), representing a large part of Minnesota milk producers, filed a suit in the Federal District Court challenging the validity of order provisions that establish trade barriers to milk product movements and the methods used in fixing milk prices. Second, the USDA asked for proposals to consider these issues in a national administrative hearing on federal orders. A group of Minnesota and Wisconsin dairy cooperatives, farm organizations, and state agencies submitted proposals at the national hearings for significant changes in all federal orders. These continuing efforts represent a coalescing of dairy interests in these two states. This article reviews some of the ways in which upper Midwest milk producers are adversely affected by current federal milk order regulations and describes some of the proposals that have been made to correct these problems.

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in 1991 and at least 11.25 cents for 1992-1995. Producers who do not expand production in any given year will have that year's assessments refunded in full. The refunds will be covered by additional assessments to all producers in succeeding years. Also, beginning in 1992, if CCC purchases are projected to exceed 7 billion pounds annually and if Congress does not choose to enact legislation to limit surplus milk production, additional producer assessments will be levied to cover the government's cost of handling the excess production.

The Minnesota and upper Midwest dairy industry defended their interests during recent national hearings to modify federal milk marketing orders. The 1990 farm bill does not directly address those interests except to instruct the Secretary to implement by January 1, 1992 any changes in the methods of fixing milk prices resulting from the hearings. The milk marketing order hearings are discussed in a companion article in this publication.

Wheat and Feed Grains

The previous system of programs are continued under the 1990 Farm Bill: loans, target prices, deficiency payments, acreage reduction programs (ARP) and the so-called 0/92 program which permits producers who do not plant wheat and feed grains to receive 92 percent of the calculated deficiency payment. New provisions include a so-called "triple base" plan aimed at reducing program costs.

The triple base plan allocates the cropland of program participants into three categories: (1) the annual acreage reduction program (ARP) percentage of land, (2) the acreage on which program crops are planted and eligible for deficiency payments (payment acreage) and (3) 15% (with 10% more at the farmer's option) of their land which is not eligible for payment. Any program or non-program crop, except fruits and vegetables (and potatoes and dry beans), can be grown on this third category of land and is eligible for any applicable loans. The net effect of these new program options is to modestly increase planting flexibility for producers while reducing the acreage eligible for deficiency payments.

The 1990 farm bill sets a floor under target prices by freezing them at their 1990 levels of $4.00 per bushel for wheat and $2.75 per bushel for corn with target prices for other feed grains tied to corn as in the past. Loan rates are set at 85 percent of the previous five-year moving average of market prices, excluding the high and low years. And, any decline in the basic loan rate is limited to a maximum of 5 percent per year. Annual acreage set-aside percentage requirements (ARPs) for wheat and feed grains are based on the amount of existing surplus (as defined by the ratio of marketing year ending stocks to total disappearance for the preceding market year). Required ARP percentages are shown in table 1.

Oilseeds

One of the significant changes in the 1990 Farm Bill is to restructure the price-support loan program for soybeans and other oilseeds. Producers may repay this loan at the world market price when that price is lower than the loan rate. Such so-called marketing loans were already in effect for rice and cotton under previous legislation and continue under the 1990 Farm Bill. The soybean loan rate is set in the legislation at a constant $5.02 per bushel and other oilseeds at 8.9 cents per pound for the 1991-95 period. Producers receiving loans must pay a 2 percent loan origination fee. Eligibility for the loan program for oilseeds does not require producer participation in production adjustment programs.

Sugar

The 1990 Farm Bill maintains the existing loan rate to sugar processors of 18 cents per pound for raw sugar. The bill sets the beet loan level on the basis of weighted producer returns for sugar beets relative to cane over the most recent 5-year period. A marketing fee of 1% of the loan rate is required for the 1991-95 crops. This fee will be paid by the processors and shared with growers. Minimum import levels for sugar are set at 1.25 million short tons a year and a "tariff rate" quota system is authorized to replace "absolute" import quotas. This tariff rate quota uses economic incentives to limit imports.

Other General Commodity Provisions

Along with the previously mentioned options for planting flexibility and triple base, several other commodity related provisions are included as General Commodity Programs, such as payment limitations and commodity reserves. Of particular note are provisions which: (1) maintain the current $50,000 limitation on direct payments and deficiency payments, and add a new $75,000 limit on total marketing loan payments and so-called Findley payments that result from lowered loan rates. The effective cap on total payments is reduced by half, from $500,000 to $250,000; (2) extend the long term Farmer-owned Reserve (FOR) and require reserve levels of 300 million to 450 million bushels of wheat and 600 million to 900 million bushels of feed grains. Eligibility for storage under the reserve requires prices less than 120 percent of the loan rate and minimum surplus-to-use ratios of 37.5 percent for wheat and 22.5 percent for feed grains; (3) establish expanded spending authority for export promotion and abolish minimum ARP and spending cut requirements (those set to meet deficit-reduction targets) in the event that the U.S. does not enter into an agreement under the General Agreement on Tariffs and Trade (GATT) by specified dates.

The Secretary of Agriculture has announced that spouses will be considered "separate persons" for payment limitation purposes for the 1991-1995 crop years.

Table 1. ARP Requirements for Wheat and Feed Grains

Commodity	% of Surplus	% ARP Required	Minimum % ARP
Wheat (1991)	--	15%*	--
Wheat (1992-95)	more than 40%	10-20%	--
Wheat (1992-95)	40% or less	15% or less	5-7%**
Feed Grains (1991-95)	more than 25%	10-20%	--
Feed Grains (1991-95)	25% or less	12.5% or less	7.5%

**the 1991 ARP level of 15% for wheat is set in the legislation.*
*** 6% in 1992, 5% in 1993, 7% in 1994 and 5% in 1995.*

Trade

The trade-related items of primary importance in the 1990 Farm Bill are export enhancement and food aid.

The regular export enhancement program (EEP) is authorized at a minimum funding level of $500 million annually. In addition, export efforts are supported by a Market Promotion Program authorized at $200 million annually and Annual Export Credit Guarantees at $5.5 billion, of which $5 billion is for short-term and $500 million for intermediate-term credits.

Food for Peace (PL 480) is authorized under three separate titles: Title I, credit sales, Title II, commodity donations through private volunteer organizations, and Title III, a government-to-government grant program. Annual funding limitation for Title II is $1 billion, unless more is necessary to meet urgent humanitarian needs. At least 75 percent of PL 480 funds must go to the poorer developing countries of the world. The legislation renews a cargo preference requirement that 75 percent of PL 480 shipments must be transported on U.S. flag vessels.

Conservation

Resource conservation is promulgated under the 1990 Farm Bill through reauthorization of Sodbuster and Swampbuster programs, through creation of an Agricultural Resources Conservation Program (ARC), through encouragement of rotation of crops and through support of programs enhancing stewardship of private forests.

Among the key features of the above-listed conservation programs are (1) expansion of the list of federal benefits denied for farmers for not adhering to Sodbuster and Swampbuster provisions, (2) triggering of Swampbuster provisions for denying federal benefits at the time when land is drained, not when it is cropped as previously required, (3) continuation of the Conservation Reserve Program (CRP) with a 40 to 45 million acre target by 1995 and (4) creation of new programs for wetland preservation and water quality incentives. Up to one million acres could be enrolled in the wetlands reserve and a 10-million acre target is specified for the approved water-quality program.

Rural Development

The 1990 legislation establishes a new Rural Development Administration to collect programs within USDA and authorizes new programs to promote economic development and improve water supplies, health care and schools in rural areas. Key appropriation authorizations include: (1) loans for water and sewer systems, including water and sewer treatment facilities, (2) grants to encourage and improve use of telecommunication and computer networks and (3) creation of a Rural Business Incubator Fund and grants or low-interest loans to support the operation of business incubators.

This rural development legislation is designed to improve the infrastructure of rural communities, especially in relation to economic development and quality of living. It **does not** authorize major new program thrusts for rural development and authorization does not guarantee appropriations in authorized amounts.

Food and Nutrition Programs

The basic food stamp program for the needy is continued for the 5-year duration with benefits kept at 103 percent of the Thrifty Food Plan (a market-basket value of common foodstuffs). The existing $410 minimum monthly benefit for single and two-person households is continued subject to inflationary (cost-of-living) increases each October. The excess shelter expense ceiling is kept at $177 per month.

Emergency food assistance is reauthorized for five years with spending minimums of $175 million in 1991, $190 million in 1992 and $220 million a year for fiscal years 1993 to 1995. In addition, distribution of commodities to soup kitchens and food banks is reauthorized (at a minimum level of $32 million annually) as is the commodity supplemental food program.

Credit

Some key credit provisions of the 1990 legislation are those to: (1) authorize the Farm Credit Administration to oversee the financial condition of the Federal Agricultural Mortgage Corporation (Farmer Mac) and create a secondary market for FmHA loans through Farmer Mac, (2) require FmHA to dispose of its land inventory within one year, instead of three, giving lessees of this property first chance at purchase and (3) provide increased interest-rate subsidies (to 4 percent) for certain guaranteed loans.

Research

The 1990 legislation authorizes continued spending for research and extension and adds several new programs to the authorization. A summary of budget authorizations is included in table 2. Of particular interest to research institutions and to advocates of more "environmentally friendly" agriculture are authorizations for a much expanded Competitive Grants Research Program and funding authorization for up to six regional centers for alternative agriculture. As indicated

Table 2. Spending Authorizations for Research and Extension

Item	FY 1991 Spending Authorization (in millions of dollars)
Federal Research	850
Research Facilities	50
State Experimental Stations	310
Extension	420
Food and Nutrition Education	63 *
Animal Health and Disease Programs	60
Higher Education Grants and Fellowships	50
Competitive Research Grants	150 **
Sustainable Agricultural Research	40
Alternative Agriculture	10 ***

*Increased to $83 million by FY 1995

**Increased to $275 million in FY 1992, $350 million in FY 1993, $400 million in FY 1994, and $500 million in FY 1995

***Increased to $75 million by FY 1994

previously, however, spending authorization does not insure appropriations in authorized amounts for individual fiscal years.

Direction of Farm Legislation

Relative to the period covered by the previous farm bill (1986-90), the 1990 legislation will: (1) reduce the commodity subsidy levels for farmers, (2) provide increased cropping flexibility on farms with program-crop base acreage, (3) increase modestly the spending authorizations for non-commodity rural development programs, (4) increase incentives for environmental protection and (5) reduce the national budget exposure to farm program costs.

For programs frozen at 1990 levels (e.g., commodity target prices and loan rates for oilseeds), the real value of benefits will decline with future inflation as will the economic "safety net" for farmers. Deficiency payments to farmers will vary with the ebb and flow of ARPs. The level of food assistance for the needy is protected by cost-of-living adjustments. As mentioned earlier, the cost of food assistance programs dwarfs the projected costs of farm commodity programs.

Effects of the 1990 Legislation

Will the size and structure of farms change?
Tightened payment limitations and increased attention to sustainable and alternative agriculture are cited as possible deterrents to further increases in farm size. These factors may reduce incentives for further growth in farm size but will probably have little impact on either the size or organization of existing units. On balance, U.S. farm numbers will probably continue their long-term decline of more than 50 years, albeit at a slower rate.

How will the profitability of farming and land prices be affected?
Other things being equal, future farm profits will be based less on government subsidies and more on market demand and prices. Similarly, the 1990 legislation reduces the farm subsidy underpinning for land prices and increases exposure of land prices to changes in commodity market prices. The reduction in amount of cropland eligible for deficiency payments limits the effective "floor level support" for land prices coming from government programs. Wheat growing areas with limited cropping alternatives could suffer significant reductions in land prices, resulting in a smaller capital base for agriculture in these areas.

What will happen to U.S. farm programs if GATT negotiations result in less agricultural protectionism?
The first stage in providing an answer to this question will come with congressional action on any GATT agreement. At a minimum, there will probably be an effort to shift farm program benefits to minimize their "trade distorting" effects. If this happens, the sugar program will probably be under the greatest pressure for subsidy reform. Although GATT negotiations collapsed in late 1990, they have now been resumed. Prospects for a broad agreement are probably not great, however.

Will U.S. farmers be more competitive in world markets?
Freezing "target prices" for commodities will help to contain future government budget exposure, but should not severely limit U.S. trade competitiveness as some claim. Also, setting support prices at 85 percent of recent year market prices appears to augur well for retention of a reasonably competitive market position for program commodities. Moreover, increased planting flexibility should encourage farmers to move more production to "where the market is."

What will be the affect on the economic vitality of rural areas?
The legislation intends to strengthen the rural infrastructure but its provisions probably do not provide a sufficient basis for a healthy rural economy. Some communities will utilize the expanded programs to strengthen their non-farm economic sectors, but the most rural of rural communities probably cannot or will not.

Will environmental quality change?
Any reduction of environmental degradation (e.g., water quality and other adverse effects of agricultural chemicals, etc.) resulting from this legislation will probably be minor. Major improvements will require regulatory policies or economic incentives stronger than the provisions contained in this legislation.

In summary, the farm legislation enacted in 1990 does not mark a sudden change in direction. It reflects only a gradual shift toward reducing commodity subsidies, and enhancing environmental protection and economic vitality for rural areas.

Upper Midwest Challenges to the Federal Milk Marketing Order Program

(Continued from page 1)

Nature of Federal Order Regulation

The legislative purpose of the orders is to stabilize prices to producers, attain parity prices to producers, assure adequate supplies of milk, and cover production costs for milk that meets fluid market requirements. To achieve these objectives, federal milk orders apply two mechanisms to milk pricing. First, they establish "classified prices" that must be paid by processors of dairy products. The prices are determined according to how the processor will use the milk. Secondly, they specify how the revenues from raw milk sold to processors of dairy products will be distributed to the milk producers.

Milk marketing orders and their precursors, marketing licenses and agreements, began in 15 fluid-milk markets in 1933. The current enabling legislation for the federal milk orders is the Agricultural Marketing Agreements Act of 1937. There are now 42 of these orders and they regulate about 70 percent of all milk produced in the U.S. Much of the remaining milk is priced under similar state milk-market order programs.

Two or three use-class prices are established for each federal order milk market. The Class I price applies to milk used in fluid beverage products. The Class II and III prices apply to milk used in manufactured dairy products. The monthly price charged to processors in all orders for milk used in Class III products (or Class II products where there are only two classes) is fixed at the average price that is paid by manufactured dairy product plants in Minnesota and Wisconsin that are not regulated by federal orders. This is known as the "M-W Price" and is computed from reported milk prices in the two states and published monthly by the U.S. Department of Agriculture. The price charged to handlers for milk used in Class II manufactured dairy products in markets with three classes is usually 10 to 15 cents per hundred-weight above the M-W price. Class I milk prices are fixed at substantial differentials over the manufacturing milk base. In all markets east of the Rocky Mountains, the differentials increase with distance from the upper Midwest. Herein lies one of the major areas of contention in federal order pricing. The individual market regulation and distribution of returns on a market by market basis has resulted in huge disparities in returns to milk producers throughout the U.S.

The pooling provisions of federal orders specify how the revenues from the classified prices charged to handlers are to be distributed to producers. In all but two orders a uniform market-wide blend price is paid which is a weighted average of prices paid by all handlers for all milk in all uses. Obviously, the higher the proportion of milk used in fluid (Class I) products, the higher the producer price relative to the M-W price.

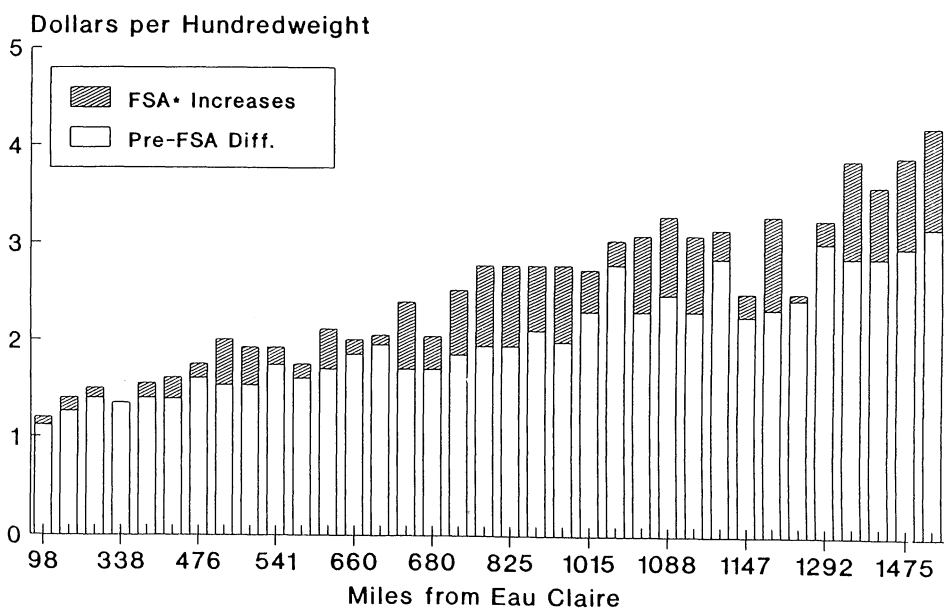
Adverse Impacts of Federal Milk Orders on Upper Midwest Milk Producers

A majority of dairy farmers and their organizations have vigorously supported federal milk-order regulations over the years. Nevertheless, many dairy interests in the upper Midwest have long argued that the regulations have been utilized in ways that adversely affect the dairy industry of the upper Midwest. These arguments are reflected in the MMPA lawsuit and proposals by upper Midwest dairy representatives in the national administrative hearings. The two major concerns are that: (1) the methods used to establish the fluid use (Class I) prices in each of the 42 federal orders unduly enhance milk prices in eastern and southern U.S. milk markets at the expense of producers in the upper Midwest and (2) that the compensatory payment and down-allocation provisions of federal orders illegally prevent concentrated milk products from being used for reconstitution into fluid-milk products in high price milk markets. The following discussion examines these concerns in detail.

Class I differentials in federal orders, the amounts that are added to the base manufacturing milk price to fix Class I prices, are tied to a single basing-point, Eau Claire, Wisconsin. The differential is currently about $1.00 per hundred-weight with the individual market price increasing by approximately $.21 per hundred miles from Eau Claire. This results in an upper Midwest Class I differential of $1.20 per cwt and a Southeastern Florida price of $4.18 per cwt. Figure 1 illustrates this general price increase for 35 federal order markets. This geographic structure of prices was established by the Department of Agriculture in the 1960s with the differentials reflecting, approximately, the costs of moving fluid milk from the upper Midwest to the eastern and southern U.S.

Though not mandated by the Agricultural Marketing Agreements Act of 1937 or by an announced policy of the USDA, the pricing structure implied that: (1) demands by all fluid-milk markets east of the Rocky Mountains could not be filled by local suppliers and these deficits are filled by milk shipments from the upper Midwest and/or (2) costs of milk production increase with distance from the upper Midwest. Although some of these markets do need seasonal imports of milk, all are self-sufficient in fluid milk supplies for part of the year and some are totally self-sufficient. Only 44 percent of all federal order milk was used for fluid-beverage products in 1985 when the Food Security Act (the "farm bill") increased the Class I differentials in 35 of the 44 federal order markets. The amount of increases generally increased with distance from the Eau Claire basing-point (figure 1). Proponents of the current pricing system argue that these increasing differentials are necessary to cover higher costs of milk production, that they reflect the basic supply-demand conditions in those markets. Furthermore, they argue, current Class I differentials do not result in fluid milk movement from the upper Midwest to

Figure 1. Federal Order Class I Differentials vs. Distance from Eau Claire, Wisconsin



Eastern Orders only
* FSA : Food Security Act of 1985

Source: USDA/AMS, FMMO Statistics

other fluid milk markets in the U.S. Consequently, reduced differentials would make it even less attractive to ship milk from the upper Midwest into distance markets. Neither of these arguments is valid, as shown below.

Estimates and annual reports from the USDA indicate that milk production costs bear little if any relationship to distance from the upper Midwest. Figure 2 illustrates how full production costs by region of the U.S for 1987-89 change with distance from the upper Midwest. Note that only the Southeast and Southern Plains have higher costs than the upper Midwest. Yet, except for the Pacific region, which is dominated by California where milk prices are not federally regulated, the average producer return per hundred-weight of milk consistently increases with distance. Consequently, for the three years, milk production in the upper Midwest generated net profits of only $.61 per cwt, while Southeastern producers realized $2.53 and Northeastern producers realized $1.46 per cwt. These returns are largely generated by the class pricing structure of the federal order system. The immediate question is: Why should this system be used to generate such different returns to producers throughout the U.S.?

Significant inter-market price consequences of Class I pricing are the source of objections raised by upper Midwest milk producers. This can be illustrated with a hypothetical, although not unlikely, illustration. Suppose that all six order markets in the Southeastern region of the U.S had increased their Class I prices by $1.00 per cwt in 1989 while Class I differentials in all other federal order markets remained unchanged. The actual 1989 market statistics for the six markets are indicated in table 1.

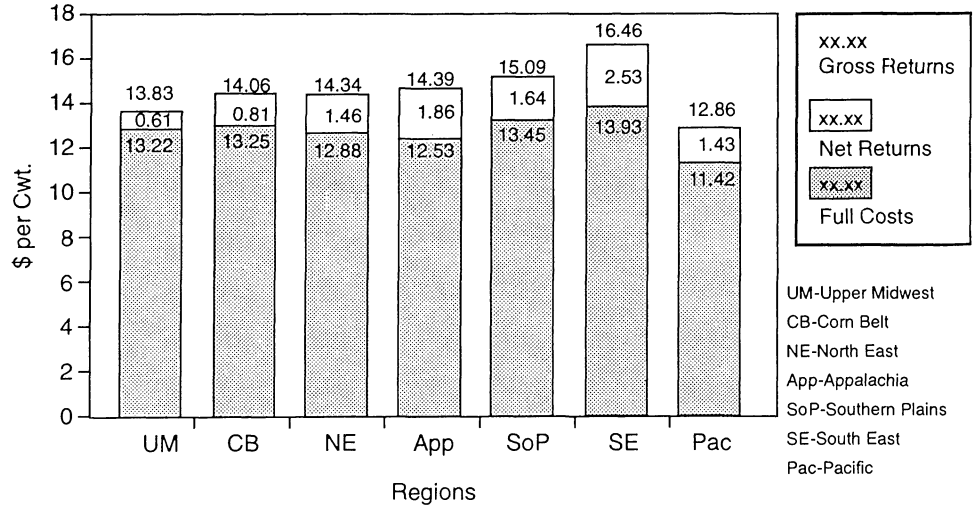
The immediate impact of the Class I differential change without any supply or demand changes would have increased the producer blend price in the South Atlantic orders from $15.30 to $16.14 per hundred-weight. However the price change would have generated several additional price and quantity responses in the Southeast and the remainder of the U.S. First, using generally accepted supply and demand elasticities for milk, Southeast milk producers would have increased milk production by 150 million pounds because of the higher price. Southeast buyers of milk would have reduced purchases of milk for fluid use by 30 million pounds

The total of these two quantities, 180 million pounds or the increase in the amount by which local supply exceeds fluid demand, would be allocated to manufacturing milk uses because they are not needed or wanted in fluid markets. This change would have reduced the national average manufacturing milk price by $.12 per cwt if not moderated by the price support floor. The federal price support programs places a lower limit on the manufacturing milk price. If the price support floor is effective, CCC purchases would increase by 180 million pounds Since the manufacturing milk price is the base price mover in all milk orders through the M-W price, **all** class prices and **all** producer prices in **all** federal order markets throughout the U.S. would decline by $.12 per cwt. Yet the Southeastern region, after adjusting for its changes in Class I use has still increased its average producer price from $15.30 to $16.02 per cwt or $.72 per cwt Additional small adjustments to the Southeastern Class price I changes would continue until a final equilibrium is reached, but the net effect is reduced prices in all other regions of the U.S. This hypothetical example is not greatly different from the Class I price changes that were actually mandated under the 1985 FSA.

The amounts by which Class I differentials in all other markets exceed those of the upper Midwest are insufficient to cover costs of moving fluid milk to those markets in fluid form, currently estimated to be about $.35 per cwt per 100 miles. However, cost for milk that is first concentrated into powder or other milk concentrates, transported in concentrate form and then reconstituted for fluid use has been shown to frequently reduce cost below existing Class I differentials, including concentrating on recombining costs. Existing technology of milk processing and consumer taste panels show this technique to provide fluid products that are equivalent to regular, fresh fluid-milk products.

To protect the high Class I prices in each market from imports of milk from potentially lower cost sources of supply, federal orders impose down-allocation and/or compensatory payments on other source milk. Down-allocation provisions require that milk or milk products used for reconstitution to fluid products from other than regular local supplies be deducted from lowest use classes of a handlers milk before computing payments to local producers. This allocation, therefore, causes the handlers to pay the Class I price for an equivalent amount of local producer milk even though the milk was not used in that manner.

Figure 2. Regional Dairy Costs and Returns (1987-89 Averages)



Source: Economic Indicators of the Farm Sector, ECIFS 9-1, ERS/USDA

Table 1. Market Statistics for the Six Markets

Producer milk deliveries (million lbs)	5,548
Class I (fluid) use (million lbs)	4,622
All U.S. Manufacturing Milk price and Class II price per cwt	$12.37
Percent Class I use	83.3
Average 1989 Class I differential per cwt	$3.52
Producer blend price (Southeastern region)	$15.30

Compensatory payments are, effectively, variable import levies that must be paid on imports of some fresh whole milk and any milk ingredients used for reconstitution into fluid beverage products. For milk concentrates, the milk equivalent of these imports is assessed a per cwt charge that is equal to the Class I differential in the importing market. Thus, cost of these milk concentrate imports includes, at least, the manufacturing milk price plus the cost of processing into milk ingredients, the cost of reconstitution into fluid product, and the compensatory payment to the local producer payment pool. Both down-allocation and compensatory payments are structured so that costs of milk to the fluid processors is lowest for local milk supplies, regardless of the level of Class I differentials that may be established. Although the AMA Act of 1937 specifically states "No marketing agreement or order . . . shall prohibit or in any manner limit the marketing in that area of any milk or product thereof produced in any production area in the Unites States," these order provisions effectively foreclose competition from outside the marketing order areas.

Proposals to Ensure Equity among Producers in Federal Milk Order Regulations

The 1990 lawsuit filed by the MMPA and the proposals by various Minnesota and Wisconsin groups, including the Upper Midwest Coalition, contain several order modifications that proponents claim would lead to more equitable pricing procedures throughout the U.S. The modifications would make sure that Class I pricing and distribution of returns do not simply benefit producers who are fortunate to be selling in markets with high fluid use relative to total supply.

One proposal by the Upper Midwest Coalition is to establish a single Class I differential for all orders in the U.S. This differential would, at minimum, yield a producer blend price in any market which would be approximately, $.15 per cwt over the base manufacturing milk price. This $.15 has been estimated to be the additional cost of meeting the higher production standards necessary for milk used in fluid products. For the Chicago Order Market (which includes much of Wisconsin) and Upper Midwest Federal Order Market, a Class I (fluid) differential of $1.70 per cwt would be necessary to generate the $.15 on the average producer price. The minimum fluid use price to all handlers throughout the U.S. would be identical under this proposal—a flat $1.70 over the M-W price. However, producer blend prices would differ because of different proportions of milk used in fluid and manufactured dairy products in each market and as producers could negotiate above order prices with the handlers.

A standard Class I (fluid) differential continues the problems associated with individual milk market pricing. If the classified price systems represent price enhancement, and many analysts are convinced that they do, then simply establishing a standard Class I differential is an improvement on the current basing-point differentials, but benefits of the pricing system continue to be distributed unequally among producers. As described in the example above, the system would continue to cause producers in primarily manufacturing milk areas to take lower returns than in the absence of the programs.

Another proposal for more meaningful federal order reforms is to integrate the 42 individual milk markets into a single pool with respect to part of the Class I revenues. For illustration suppose that $1.00 of whatever individual Class I market differentials are established is pooled nationally and paid equally to all federal order producers throughout the U.S. With the current national utilization of 42 percent of all producer milk used in fluid products, each producer would be paid at least $.42 per hundred-weight regardless of location and individual market use of milk. In addition to this national fluid differential and distribution, an additional Class I differential would be fixed for individual federal order markets to reflect basic supply-demand conditions for fluid milk in the region and to provide incentives to transport milk to the major consuming centers in the regions. This component of the Class I differential should be distributed to firms or producers that are actually shipping milk to the fluid markets.

Down-allocation provisions for other source milk should be dropped from all orders. Other source milk, whether imported in fluid form or in the form of milk concentrates, should be allocated to class uses in the same proportion as local producer milk. In effect, allocation of imported milk for any buyer would be the same as for local producer milk in a federal order market. Compensatory payment provisions of federal orders should be dropped. If the costs of other source milk is less than the costs of obtaining local milk supplies, that is prima facie evidence that local milk prices are simply too high. This should require that the order prices be adjusted to reflect that competition, not that a tax should be imposed to eliminate the incentive for handlers to buy that milk. Federal orders should not be used to prevent use of the technology of reconstituted milk or any other technological improvements in costs of providing milk to consumers.

Conclusion

The upper Midwest lawsuit and the proposed administrative changes may be the most significant challenge to the federal milk order system since its development in the 1930s. Nevertheless, there are major impediments to change and courts have been reluctant to challenge any features of the regulation.

The district court in Minneapolis has already dismissed the suit filed by the MMPA, but it is now on appeal to the Circuit Court of Appeals. In 1963 the Supreme Court (in Lehigh Valley vs. U.S.) declared "compensatory payments" to be unconstitutional. The

USDA merely revised the method of calculating them. The apparent non-compliance with the decision was never challenged.

The national administrative hearing of the USDA on federal milk orders of 1990 was the first time that a hearing has been called to receive evidence and proposals on major contentious features of the regulation-namely the method of establishing Class I prices, compensatory payments and down-allocation. The USDA in now drafting the new regulations and must take into account the evidence that was presented in the hearing. The Upper Midwest arguments about the inequity of the current federal milk order procedures were strong and effectively presented, yet there was almost unanimous opposition by producer interests from other milk producing areas to the arguments and proposals for change.

The current system of federal milk order regulation is administered in a regionally divisive manner. It needs to be revised to reflect the national nature of the U.S. dairy industry, to provide incentives for milk sales to fluid markets when needed and to assure that milk is provided to markets in the most economically optimum manner. The proposed regulatory modifications would move regulation in this direction.

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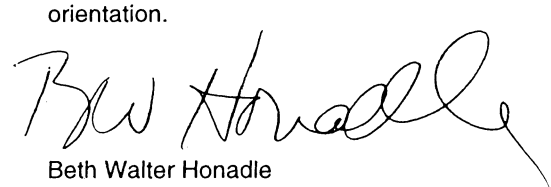

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