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MARKETING ORDERS

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Marketing orders represent a policy for changing or affecting behavior in the marketing of fruit, vegetable and specialty crops or of milk. They alter the effective structure of the marketing system. These are long-standing programs, authorized in the Agricultural Marketing Agreement Act of 1937 and administered under an ongoing series of changing rules and regulations over the years. Many orders have been promulgated or amended since 1937.

Regardless of the changes, many of the existing features are modifications of those originally included to deal with 1937 marketing system issues. Consolidation of orders, particularly for milk, and additions of new orders and termination of some existing orders for fruit, vegetable and specialty crops represent efforts to deal with structural change, business practices and competitive forces in the evolving marketing system over the years.

Questions related to marketing orders and how effectively they serve their purposes to alter behavior in today's marketing system deserve attention. Competitive pressures and societal issues can impact the ability of marketing orders to accomplish their intended purposes.

Influential Trends

Structural change in a global economy may have ongoing implications for market-

ing orders and how they operate. Large, multi-market firms may interact differently with producers organized under marketing orders than do smaller, more localized and less international firms. International trade negotiations and practices may require adjustment of marketing order policies and operating mechanisms.

Since at least 1980, government regulations have been under fire from both a budgetary and philosophical perspective. While marketing orders are not costly programs when costs are measured as treasury outlays, they do represent a regulatory burden on handlers and can involve consumer costs. Several reports provide insights concerning issues and analyses of their impacts (Armbruster and Jesse; Heifner, et al.; Powers 1990; Polopolous, et al.; and U.S. Department of Agriculture). However, the primary motivation for deregulation in the case of marketing orders is ideological. Market control and price discrimination provisions in marketing orders are viewed by many as antithetical to free markets. Despite a change in administration, deregulation pressures are likely to continue.

As noted earlier, marketing order provisions and their implementation reflect competitive conditions existing at one point in time. As these conditions change, orders may impede or accelerate regional shifts in production unless the orders are

amended accordingly. For example, some citrus growers in California's central valley have argued that weekly fresh market pro-rates have been allocated to the advantage of southern California growers and have stifled growth in their region. Some upper Midwest dairy interests contend pricing provisions of federal milk marketing orders have stimulated growth in dairying in the southwestern United States. Factors other than marketing order regulations may affect regional shifts. Nonetheless, there are internal, as well as external, challenges to marketing orders.

Technological change involving biotechnology, information, management and measurement may have implications for the marketing of agricultural and food products. Continuing development of these technologies may necessitate adjusting marketing order provisions. On the other hand, research, promotion and information generated through marketing orders may enhance the effectiveness of technological changes and facilitate their adoption.

Consumer issues and changing consumer demands may also impact marketing order provisions and the effectiveness of those provisions. Concerns about possible chemical residues in fluid milk, dairy products and produce are examples. Changing consumer demands and efforts by marketing firms to segment markets and target products to consumer demands for convenience and health concerns may also have implications for marketing orders.

Do the changing institutions serving agriculture and the food sector imply the need for significant changes in the legislative policies and administrative practices involving marketing orders? Are marketing orders institutional structures that have

outlived their usefulness, or are they flexible enough to be an important element in today's dynamic marketing environment?

Questions to Address

In light of the above trends, are direct intervention programs of marketing orders designed to implement the orderly marketing philosophy still relevant and effective? The following sections address operational questions and policies for marketing orders related to the above general trends. Some specific subjects and issues requiring attention are identified.

Structural Change

In the increasingly global economy, food marketing firms – from commodity processors and handling firms through retailers – have changed ownership, grown in size and expanded international subsidiaries and ownership. Marketing of food and agricultural products has changed significantly. Will marketing order provisions come into conflict with, or reduce the opportunities for, sales of U.S. products because of the structural changes and evolving methods of doing business?

For fruit and vegetable marketing orders, are minimum size standards as meaningful as they once were? As firms increasingly segment markets, is there increased market demand for the smaller sizes of produce that are excluded from fresh markets under current marketing order provisions? Can research on consumer preferences be used to determine features to be incorporated into the minimum size standards and keep them abreast of market changes?

Section 8e provisions under fruit and vegetable orders require imports to meet domestic grade and size standards. But in the past, Mexican producers have asserted

that the minimum size requirements for Florida tomatoes discriminate against imports. The North American Free Trade Agreement (NAFTA) provisions provide that any measure regarding classification, grading or marketing of a domestic agricultural product will also apply to like products imported from the other country for processing. What might be the implications if the General Agreement on Tariffs and Trade (GATT) negotiations reach a successful conclusion? Will harmonization of sanitary and phytosanitary measures have implications for the use of grade and size standards to regulate marketing into fresh market outlets in the United States? Will development of international sanitary and phytosanitary standards through such organizations as the Codex Alimentarius Commission have any implications for the use of grade and size standards in domestic marketing orders?

One of the alternative outlets for products prohibited from the fresh (primary) market under reserve pool and market allocation provisions may be export markets. If such exports were interpreted as harmful to producers in other countries, would they be challenged under GATT rules? In the past, the reserve pool for raisins and almonds has been used to subsidize exports for the sake of long-term export market development. Though such market differentiation is a sound business practice under existing legislation, international competitors may view such activities as export dumping.

Important questions related to milk marketing orders involve the effect of orders on the balance of market power in fluid milk markets. A primary purpose of milk orders was and is to provide dairy

cooperatives countervailing power in their negotiations with proprietary fluid milk handlers. Given the regionalization and enlargement of cooperatives over the last twenty years, has the balance of power shifted to cooperatives? Does over-order pricing by cooperatives imply that the cooperatives have supplanted federal orders as price-setting devices? Can cooperatives assume other marketing functions that are now being accomplished by orders?

International Trade

Federal milk orders neither impede nor promote international trade directly, but they do have a few trade distorting effects. They regulate Grade A milk only, which is defined by local health authorities who enforce the Pasteurized Milk Ordinance. Grade A milk is U.S.-produced milk since it is defined by U.S. rules. If raw milk were to be imported from Canada, Mexico or elsewhere, it would not be Grade A milk and, therefore, would not be eligible for use in fluid (Class I) milk products. Consequently, producers of such imported milk could not participate in federal milk order pools.

It can easily be argued that federal milk orders have price enhancing effects. If milk orders do, in fact, set minimum prices that are higher than necessary to attract "an adequate supply of pure and wholesome milk for fluid use," then they constitute a domestic subsidy for milk producers. As such, they are subject to any required reduction in domestic subsidies negotiated under the GATT. However, since the phase-in period for any negotiated changes will probably be lengthy, this concern or potential impact may be minimized.

Technological Change

Biotechnology, information, management and measurement technologies all continue to evolve in ways that may directly or indirectly affect federal marketing orders.

Under fruit and vegetable marketing orders, money may be generated to fund research. If new technology from research supported by marketing orders means larger economies of scale and further consolidation in the industry, who will benefit from the research? Should public policy consider distributional impacts of production and marketing research? This question also applies to research funded from public sources outside the marketing orders.

Do new technologies being developed to measure ripeness or maturity for fresh produce challenge the need for minimum grade and size standards? Certain of these standards are established to reflect minimum acceptable maturity to maintain a good quality image and thus consumer demand. Will marketing orders need to deal with new measurement technologies to replace current grade and size standards? Can such measures provide better information for management decisions and be better indicators of quality, reducing the usefulness of minimum grade and size standards?

Federal milk marketing orders have frequently been criticized for not changing in response to technological change. Extended shelf life of packaged milk products makes it possible to maintain longer supply and distribution lines and reduce frequency of delivery. Yet most milk orders regulate marketing areas that are much smaller than

what are technologically feasible distribution areas for handlers. In other words, marketing areas are often being determined by regulation rather than economic efficiency. Do the number and geographical coverage of milk orders make sense in light of current transportation and refrigeration? Though handlers are free to purchase milk from whatever source they wish, pricing provisions of milk orders effectively encourage local self-sufficiency in fluid milk. This may have been relatively efficient when long distance shipping of milk was not feasible. But does self-sufficiency induced by regulation make sense in light of current transportation and refrigeration technology? Are the specified transportation differentials required to be paid under orders consistent with market efficiency?

With reverse osmosis and low temperature evaporation technologies, reconstituted milk – fluid milk produced by adding water to concentrated or dry milk ingredients – has been commercially feasible for years and is sold in many countries. Transporting milk in concentrated form would substantially reduce hauling costs and further diminish the need for self-sufficiency in regions with high milk production costs. But federal marketing orders employ pricing rules that essentially close out reconstituted milk in the United States. How does this economic prohibition affect consumers? How has it influenced the location of milk production? Does reconstitution diminish the perishability of fluid milk enough to obviate the need for milk orders?

Measurement technology also affects federal milk orders. Milk pricing provisions reflect limitations to measuring milk characteristics, both components and quality. Currently most orders price milk

volume and butterfat, characteristics that have been easily measurable since the inception of orders. But protein and other non-fat solids are more important and more valuable than fat in the current mix of dairy products and can now be easily and inexpensively measured. Should the slow process of shifting to multiple component pricing under orders be accelerated in light of current measurement technology? Should milk orders attempt to price measures of quality as well as quantity? Does equity require that producers be paid on the basis of solids-not-fat, or protein, content of their milk?

Consumer Issues

Consumer concerns regarding nutrition, health and safety and changing patterns in demand are potentially in conflict with marketing order provisions.

Federal grade standards for fresh fruits and vegetables, and marketing order minimum levels of product grades that may be marketed into fresh markets, have been criticized for specifying low tolerances for external attributes and thus being "cosmetic grade standards." It is argued that such low tolerances stimulate heavier use of pesticides than necessary to maintain yields and assure nutritious and consumer-desired attributes in produce. They thus increase potential chemical residues.

There are several relevant questions. Do growers use certain chemicals for purely cosmetic purposes? Do growers use pesticides to increase the portion of the crop that meets marketing order size and shape minimums? Do growers use more chemicals to increase the cosmetic quality of produce (and thereby receive a higher price) when volume control regulations limit quantities shipped to market?

While the policy issue of "cosmetic grade standards" continues to receive some attention, little empirical evidence directly related to the question exists. A workshop to be co-sponsored by the Agricultural and Food Marketing Consortium will address the question of the levels of chemical use in the produce industry and the relationship to grade standards. That workshop will explore the knowledge base about consumers' preferences for quality attributes; the research base related to producer production practices in response to grade standards; and any empirical evidence linking chemical residues with amounts and types of pesticides used to control factors related to appearance as embodied in grade standards. Research progress has been made recently on some of these questions.

Consumer demand changes as they may relate to marketing order provisions deserve scrutiny. Increasingly, products are being marketed rather than commodities. Grade and size restrictions on produce going into domestic markets could come into conflict with increased attention to segmenting markets to satisfy different consumer preferences. Do we have an adequate understanding of the distributional impacts of minimum grade and size restrictions? Is there a greater demand for products in different size categories than assumed under a blanket regulation? Has recent research progress related to consumers' willingness to pay for certain food product traits provided useful insights on this question? Have marketing orders been adjusted in response to market signals?

Advertising and promotion under fruit and vegetable marketing orders have grown in recent years in response to grower requests. During the same period, the

U.S. Department of Agriculture (USDA) has de-emphasized growers' use of volume control regulations. Whether the two trends are closely interrelated is debatable. It may be argued that commodity promotion under marketing orders partly offsets the promotion activities of competitors and maintains market share. More empirical research is needed to better understand the net market expansion of marketing order promotion programs. Ongoing research in this area, conducted under the leadership of the NEC-63 Committee on Commodity Promotion and by its participants, can help shape public policy toward marketing order promotion activities in the context of the various changes taking place in the food and agricultural marketing system.

Control of quantities through market flow provisions in citrus may have implications for retail-F.O.B. marketing margins. Rigid retail prices are of concern to growers and shippers of fresh produce. "The retail-F.O.B. marketing margin appears to widen when F.O.B. prices decrease because retail prices are rather inflexible over a two- to four-week period. Maintaining a more even weekly F.O.B. price by stabilizing flows might result in smaller average marketing margins and benefit growers and consumers. Do marketing orders have a role in helping growers and shippers maintain a more even F.O.B. price? What are the potential benefits (and costs) of doing so?" (Powers 1992).

The recent round of regulatory action dealing with California citrus marketing orders and suspension of market flow regulations reflects a changing policy climate. Will the use of market flow provisions be eliminated as a tool for stabilizing prices within a season? Given the structural changes in the marketing

system, are such market flow provisions as effective as they may have been in a time when more numerous and smaller entities made independent marketing decisions? Are marketing decisions better coordinated from the retail level back to the first handler/shipper under today's market structure? Is there less correlation between fresh retail and F.O.B. prices than previously and, if so, does this impede the effectiveness of flow controls?

Federal milk orders may restrict consumer choice by employing pricing provisions that promote the use of whole milk in producing fluid milk products. How can pricing rules be modified to expand consumers' choices while still retaining the desired stability features of orders?

Under milk orders, Grade A milk is classified according to the use to which it is put. Through classified pricing (charging handlers different prices for milk according to how the milk is used), milk orders may indirectly promote some products at the expense of others. For example, if one product is classified as Class I while a close substitute is classified in (the lower price) Class II, competing handlers would have different raw product costs.

Classes of utilization are based on traditional product definitions formalized in standards of identity. Consumer preferences are changing, however, and many new dairy products are being offered that do not conform to traditional product definitions. It becomes difficult at times to decide whether a specific product should be included in Class I, Class II or Class III use.

The recommended decision resulting from the 1990 national hearings attempts to

address this emerging problem by establishing classification on the basis of how the product is expected to be used by a consumer rather than on the basis of the composition of the product.

Most observers would agree that consumers prefer greater price stability rather than greater price instability. Do federal milk orders foster price stability? Could they do a better job? What milk orders do is maintain a reasonably stable relationship between class prices, so that Class I prices are higher than Class III prices nearly everywhere, nearly all the time. From time to time, proposals arise to improve the price stabilizing influence of milk orders. A recent proposal would establish a minimum basic formula price for setting Class I prices that would be higher than the Minnesota-Wisconsin price some of the time.

A final consumer economic question is whether federal milk orders foster the subsidization of manufactured product consumers by fluid milk consumers. Class I prices, which apply to fluid uses of Grade A milk, are significantly higher than Class III prices, which apply to manufactured uses of Grade A milk. The blend price received by Grade A dairy farmers is a weighted average of the use value of all the milk in the market. The blend price, being higher than the Class III, or manufacturing milk price, encourages greater production than would be attracted by the manufacturing price. Additional production ends up in manufactured dairy products. To what extent do the premium prices paid by fluid consumers result in a greater abundance of, and therefore lower price for, manufactured dairy products?

Institutional Change

Institutions serving agriculture and the food marketing system are evolving. Agribusinesses and private sector methods of doing business continue to change and impact the marketing of agricultural and food products. The institutions involved in marketing food products from the farm to the consumer must adapt.

Fruit and vegetable marketing orders operate through boards that represent various industry segments and their relative economic influence within the industry. Do marketing order boards operate to thwart or encourage change to keep abreast of the trends in the above areas? Structural change in production, input, processor and marketing firms may imply needed changes in marketing board composition and operating approaches. Do established procedures assure that boards represent current industry composition and evolving issues? Is bloc voting by cooperatives in the best interests of the industry and its producers? Are procedures for changing fruit and vegetable order provisions flexible enough to accommodate today's dynamic marketing system?

Federal milk orders are normally modified through a hearing process. Critics of milk orders argue that the process of amending orders has become politicized, with supporters and opponents of proposed changes lobbying Congress and the Secretary of Agriculture. The process can also be very lengthy. A hearing completed in November, 1990 awaits a final decision more than two years later. Can the Secretary of Agriculture adhere to his mandate to protect the public interest in light of this pressuring? Should the secretary be

more aggressive in seeking changes in orders that serve efficiency rather than political expediency? Can the process of amending orders be speeded up to match the speed of industry changes?

In some respects, federal milk marketing orders promote structural change in the dairy industry. In other respects they retard it. The most conspicuous structural consequence of milk orders is the growth of dairy cooperatives in size and power. Fundamentally, milk orders provide a mechanism by which a dairy farmer, or his cooperative, can capture some of the revenues from the fluid market without becoming a captive supplier of the fluid processor. In this environment, cooperatives have a limited ability to influence the terms of trade, either directly through negotiations with the fluid buyer, or indirectly by seeking favorable provisions in the local milk order. By associating with a cooperative, Grade A producers fare as well, and maybe better, as they would by shipping directly to a fluid processor.

Milk orders also promote orderly structural change in the milk processing sector. Since minimum class prices set by orders are uniform among regulated handlers, these handlers compete with each other on the basis of operating efficiencies and marketing skill and not on the basis of skill in reducing the cost of raw milk. Thus, success and structural change are more likely to accrue as a result of economic performance rather than on the basis of market power and the ability to reduce prices to dairy farmers.

There are other ways that federal milk orders retard structural change. They do not directly impede the movement of milk in either bulk or packaged form. Indirect-

ly, they impede the inter-order transfer of bulk milk by assigning a portion of the transfer to Class III, and they reduce the attractiveness of market expansion by fluid processors by offering the risk of being regulated by another, less favorable market. These impediments arise because federal milk orders have not consolidated fast enough to encompass the feasible procurement and distribution areas of large fluid processors.

Conclusion

There are numerous policy and operating questions about the usefulness and effectiveness of marketing orders in today's marketing system. Structural changes, technological developments, consumer concerns and demand shifts continue to evolve. Have the trends and developments significantly reduced the need for, and effectiveness of, marketing orders as they currently operate? Have the trends increased the usefulness of marketing orders and created an expanded role for them? Are modifications in orders desirable to make them more useful tools in today's marketing system?

The trends identified herein call for thorough analysis to determine their implications for marketing orders. Answers to many of the questions posed would be very useful in helping inform the discussion on the policy issues involved.

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