Marketing Orders

Breakout Session 2, Friday, January 14th, 1994, 1:00 pm
Moderated by Walter Armbruster, Farm Foundation

Major papers:

Designing Marketing Order Programs for the Future
James Duncan Shaffer, Michigan State University

Lessons and Questions from 50 Years of Milk Marketing Orders
Andrew M. Novakovic, Cornell University

Observations on Fruit and Vegetable Marketing Orders: Perceptions and Realities
Gary F. Fairchild, University of Florida

Discussants:

Chuck Brader, Agricultural Marketing Service

Lon Hatamiya, Agricultural Marketing Service

Jay Holford, Seald Sweet Growers

Harry Kaiser, Land O'Lakes, Minneapolis

Designing Marketing Order Programs for the Future
Paul G. Christ, Land O'Lakes

Designing Marketing Order Programs for the Future[1]

James Duncan Shaffer[2]

This paper examines issues concerned with the design of possible marketing order programs for the future. The emphasis is on conceptual issues of institutional design using marketing orders to promote orderly marketing. The paper discusses changes that would substantially expand and modify existing legislation authorizing and regulating federal marketing orders. I briefly argue the case for a variety of possible program options to be considered for future legislation. I believe there will be great pressures to shift farm program costs from the government's budget, and there are good reasons to do so. The food system is in transition, and problems of disorderly commodity markets remain to be solved. The question of this session is what is the potential role of marketing orders in the marketing system of the future.

First: A list of the major changes in marketing order legislation to be considered in the paper:

1. Make a wide range of marketing order options available to producers of all farm commodities, facilitating the design of commodity programs by producers.
2. Authorize programs that allow management of production rather than limiting authorizations to management of commodities already produced.
3. Phase out all price and income support programs while providing farm groups assistance in design of commodity programs authorized by marketing order legislation.
4. Authorize three new options under the marketing order legislation:
   A. Exclusive agency collective bargaining,
   B. Full participation markets in contracts for future delivery,
   C. Full participation crop insurance programs.
5. Define the regulatory functions of the Secretary of Agriculture to include:
   A. Regulating supply-restricting practices that contribute to return on investments by the 100 largest sellers of a commodity in excess of returns on investments by the 500 largest U.S. corporations, or some similar operational criteria for dealing with possible advantage from market power.
   B. Establishing procedures to assure democratic governance and protection of minority producers' interests in the operation of order authorized programs. These procedures would include arbitration to assure swift and fair decisions in disputes among producers.

---

[1]Research contributing to this paper was funded by the Michigan Agricultural Experiment Station. Past research related to the topic has been funded by the Agricultural Cooperative Service and the Agricultural Marketing Service, USDA.

[2]I wish to thank D. Ricks, H. Riley, J. Staatz, L. Hamm, D. Hinman and M. Weber for commenting on an earlier version of the paper. I acknowledge the influence from my participation on a taskforce concerned with evaluating marketing orders. See USDA, 1987. Relevant references for this paper are too many to list. See the publication by The Food And Agricultural Marketing Consortium FAMC 93-1, *Food and Agricultural Marketing Issues for the 21st Century* for many references I could have properly included.

Most importantly I acknowledge the contributions of my graduate students who have done research on topics related to this paper, including: J. Uhl, G. Campbell, M. Lang, C. Chase-Lansdale, L. Hamm, J. Skees, C. Kramer, D. Kauffman, I. Dalziell, J. Holleran, J. Staatz, D. Trechter, L. Berger, J. Jacobs, A. Borst, C. Henry, L. Ables Allison, L. Geis and D. Hinman. I have learned much from their work and make liberal, although highly selective, use of it. Of course, I alone am responsible for the conclusions and positions taken in the paper.

6. Put greater reliance for market service functions on commodity groups organized under marketing order authorizations. These functions would include grades and standards, information for outlook, and commodity-specific research.

Nature and *Purpose* of Commodity Marketing Order Enabling Legislation

A marketing order authorizes collective action, requires participation by all within a designated class, and sets up the rules for both organization and operation of activities under the order. Initiative in the design of the programs of collective action is with an organization of producers. Within this context of a potential producers' do-it-yourself farm program, this paper looks at possible revised enabling legislation.

Legislation starts with a statement of purpose that carries with it implications for the specific provisions of a bill and for its implementation. My suggestion for a statement of purpose in a bill to revise the 1937 Agricultural Marketing Act, in respect to content, not wording, follows:

> The purpose of this legislation authorizing marketing orders is to enhance market performance by providing the means for growers to promote activities leading to orderly markets and to otherwise deal with problems of market failure in agricultural commodity subsectors within a set of obligations designed to protect against potential abuse of power by growers acting collectively under the rights specified in the legislation.
>
> With orderly markets, supply and demand of commodities are consistently matched at prices reflecting the costs of producing and marketing them by typical well-managed firms. Matching supply and demand refers to both quantities and attributes and applies at every transaction point in the vertical system of production and distribution. Costs include a normal return to investment and management. Matching supply and demand allows for actions to modify demand to match supply as well as adjusting supply to an existing demand. The definition reflects two pragmatic goals based upon commonly accepted beliefs:
>
> (1) Resources should not be used to produce something that isn't worth what it costs to produce it, and, conversely resources should be used to produce something which is worth more than it costs to produce it.
>
> (2) Rewards for economic contribution should be fair. Returns to investment, management and comparable labor inputs in well-managed firms should not vary greatly across industries.

This statement of purpose and definition leave much to be worked out. There are problems in defining costs, problems of identifying a typical well-managed firm or identifying an acceptable workable proxy for the equity and efficiency performance criteria, problems of adjusting to technological change meeting both the resource allocation criteria related to costs and the equity criteria at the same time. Most importantly, economic outcomes are fundamentally unpredictable. Thus, supply and demand cannot be perfectly matched. In any case, the purpose of the legislation is to enhance market performance by promoting orderly marketing, not to guarantee it.

At the same time, we know there are problems that lead to disorderly markets and poor market performance. Most important of these is the use of incomplete information and misinformation in making economic decisions. There is uncertainty about demand and supply, making it difficult to predict prices and quantities that can be sold. Supply uncertainty derives from natural events such as the weather and from not knowing what other producers will supply to the market. There are also problems resulting from externalities, public goods, and free and unwilling riders. These are problems of interdependencies where the actor does not capture the benefits of an activity or suffer the consequences of it. The result is some goods are not produced even though their value exceeds their costs, while other goods are produced even though their costs, including costs to others, exceed their value. The purpose of marketing orders is to provide an institutional means to reduce the problems leading to disorderly markets.

There is no question that agricultural commodity markets have plenty of room for improved performance. It is seldom that supply matches demand at prices consistent with costs of production and marketing. Price instability is the norm in commodity spot markets.

My argument at this stage takes the existence of the problem of disorderly agricultural commodity markets as given and proceeds to the questions of design of legislation consistent with the objective of promoting orderly marketing.

Holford: I'm not at all sure that "orderliness" of marketing is all that important to growers, despite its being the founding rationale for marketing orders. After all, there are dollars to be made out of the opportunities presented by disorderliness. However, those with long-term investment in permanent plantings are more likely to prefer orderly marketing than are growers with annual crops. Lettuce growers, for example, can sometimes benefit from a volatile market.

The discussion of marketing order issues follows from pushing the concepts and definitions of the statement of purpose to their logical conclusions. Conclusions favoring offering farm groups marketing order program options also rests on the more general conclusion that markets will not meet these performance standards without specific, politically sanctioned institutions designed to deal with the problems created by genuine uncertainty, actions taken based upon misinformation, interdependencies, and economic power.

The Right to Require Participation

The issue of required participation in order programs is often posed as one of freedom of choice. But the issue is *whose* preferences count. A marketing order establishes a system that produces outcomes different from what would have existed without the order. Not having an order restricts the freedom of those who seek those outcomes. The choice is between systems, and the legislative question is: Should producers have the right to make the choice among systems?

In either case there will be unwilling riders. The issues in establishing a marketing order have to do with choices among competing interests, of justice and tradeoffs, and judgments about the level and distribution of benefits and costs. They are questions of market performance. Because there are unwilling participants (with and without an order program), the strict application of the efficiency criteria, requiring that no one be made worse off as a result of a policy change, is not useful. Nor is it feasible to compensate for losses to those who claim to be losers from an order. Based upon comments at hearings, compensation for depriving some growers of the right to do as they please with their commodities would come at a very high price. Logic would suggest that, in the interest of equal justice, if growers were compensated for losses resulting from an order program, compensation for losses from not having an order would also be required.

Recognizing the difficulty of the problem of unwilling riders and the fact that any voting rules less than full consent will leave a dissatisfied minority, the enabling legislation needs something like the Bill Of Rights of the U.S. Constitution. This is important, it needs to be worked out, but I do not have a proposal.

Making Marketing Orders A Core Farm Policy by Including All Commodities

The farm price and income support programs for major commodities, as operated, have not achieved orderly marketing. In addition to failing to match supply with demand at prices reflecting costs, they have become an unreasonable drain on the budget, and the distribution of payments transfers income from taxpayers who on average are much poorer than the great majority of those receiving the payments.

Consider instead a core farm program based on program options offered under a general marketing order act available for all commodities. The legislation would not have commodity exclusions; it would be up to the farm groups to determine the appropriate order programs for their commodities. At the same time the types of programs authorized by the legislation could be expanded, providing producers with the means to manage supply and influence demand, consistent with the market performance and orderly marketing purposes of the legislation. Price and income support programs and some other programs related to orderly marketing would be privatized in the sense that producers would be responsible for designing their own programs within the constraints implied by the purposes of the legislation.

Managing Supplies

Existing order programs deal almost exclusively with already produced commodities,[3] thereby dealing, by and large, with mitigating the consequences of excess production. Of course, the price signals and anticipated market allocations resulting from these programs do modify production plans, often contributing to orderly marketing. Unfortunately, at times, price signals result in incentives to produce more, when orderly marketing would require less.

Brader: In order to effectively manage supply, an order must have control of all sources of supply. The tart cherry order didn't work because it didn't cover the entire industry. This gets even more difficult in the international arena. International cartels seldom work because it's hard to get cooperation from foreign governments.

As programs are designed, the emphasis is on dealing with the income consequences of producing more than the market will take at profitable prices, while limited attention is paid to creating incentives to supply sufficient quantities to meet the orderly marketing criteria. Flow to market controls and reserve pools attempt to shift already produced commodities from periods when they are in excess supply to better match supplies with demand from season to season and from year to year. Also, the seasonal pricing plans in dairy have the objective of modifying production to better match demand.

The programs dealing with already produced goods may be useful in mitigating the price and income instability consequences of unpredictable variations in production due to the weather, a major cause of variability for many commodities. Programs designed to improve the predictability of net revenue will contribute more to orderly marketing than those focusing on enhancing prices during periods of excess supply. An example of the former is the reserve pools' smoothing

[3]The only current exception is a supply adjustment option in the raisin order that allows vine removal and vine trimming.

supplies between years. A program combining storage and the subsequent year's production could also help deal with problems in managing stocks.

Revising enabling legislation to explicitly authorize production management, including investments in commodity-specific assets, would improve the capacity of commodity groups to design order programs to meet the objectives of orderly marketing without government funding.

The Agricultural Adjustment Act of 1933 (AAA) included production control provisions. Reducing the supply of food when people stood in food lines turned out to be a major political problem. The killing of little pigs to reduce the supply of pork created an uproar, even though the cost of feeding them turned out to exceed their value on the market. Marketing order legislation directly descended from the AAA has avoided explicit authorization of production controls. If the program in the 1930s had managed the pork supply through birth control, perhaps the outcome would have been different. The very expensive dairy cow buy-out program in the 1980s is another example of an attempt to control production *after* an investment in capacity. Could the over-capacity problem have been avoided with production control provisions in the dairy orders? Similarly, there has been an attempt by cherry growers to organize a cooperative to collectively uproot excess cherry trees. Again, could an order influencing plantings have solved this problem at a lower cost?

Quality Standards

The basis for quality standards regulations arises from the combination of an information problem, an externality, and opportunistic behavior. The information problem is that important quality characteristics are not obvious to consumers, but selling products with quality defects has a negative effect on the future demand for the commodity. An opportunistic producer may, for example, get a high price by beating others to the market with immature fruit, thereby reducing demand for that type of fruit for the rest of the season. This results in consumers' losing twice—once getting the poor fruit at first and then by their being turned off by that type of the fruit and not buying it later when it's mature. The reputation of a commodity is influenced by many factors, and there is a common interest among producers to build and protect the image and reputation of their commodity.

Quality standards regulations may also be used as a quantity control to enhance price, but their use is more complex. Disposing of low quality products before shipping may contribute to orderly marketing, or it may deprive a group of consumers access to a low cost product and some growers of a profitable market. A rule of reason is required.

While there are problems, I believe the case is strong enough to include quality standard options for all commodities, but with specific procedures to settle disputes and regulate abuses.

Brader: Minimum quality standards are clearly in demand. Conceptually it's possible to control quantity with these standards, but I don't feel that this is done much. In the early 1970s, it may have been more prevalent than it is today. Yet the media (e.g., *The Wall Street Journal*) nearly always critiques marketing orders' using quality control as a supply management tool (for example, by keeping small plums and nectarines away from consumers). Yet quality aspects have been important for a long time. After all, Eve didn't say to Adam, "here, try this little green apple." And economists should realize that taking 2-3 percent off the nectarine market is not going to amount to supply control.

Holford: I do think that there is a little supply management involved as some grades and sizes are eliminated, but it's not the main thing.

Inspection Services, Quality Assurance, and Food Safety

An effective quality regulation program requires an effective inspection service. Current marketing order programs pay for inspection services. Since quality assurance is of great importance to producers, influencing the reputation of their commodities and thus demand, reducing transactions costs, facilitating trade, expanding markets, and perhaps also reducing liability risks, it is in the interest of producers to support an inspection service to assure or certify quality, including food safety attributes. Since such services have a public good characteristic, some method of obtaining full participation may be required to obtain essential levels of support for effective inspection programs. Marketing orders provide an institutional means to at least partially privatize these services, putting them under the control and management of representatives of producers who have a strong incentive to see that they are performed well.

Advertising, Promotion, and Market Development

There is a free-rider problem associated with commodity advertising, promotion and market development. Successful programs expand the demand for the commodity whether or not a producer contributes. However, since producers have differential opportunities to take advantage of expanded demand and different assessments as to the value of promotion, full participation programs are contentious.

A strong case can be made for promotion programs during periods of surplus caused by either temporary excesses of already produced goods or an over capacity based upon fixed commodity-specific assets. Orderly marketing in these cases would be facilitated by an effective promotion program adjusting demand to more nearly match supply at prices consistent with costs.

The procurement and merchandising practices of food processing and distribution firms play an important role in shaping the demand for farm commodities and limit the capacity of prices to achieve orderly marketing. Purchasing and merchandising plans are made before the size of crops is known. Standard operating procedures lock in on standard situations, and there is a cost to management in changing them. Given the way the modern food system is organized, the responsiveness of consumer sales to merchandising, and the relatively weak response to unpublicized price changes, promotion programs may be in a position to contribute significantly to matching demand with supplies. Well-done and well-timed promotions can influence consumer responses directly but, more importantly, can make the marketing system more responsive to changing conditions of supply and demand.

My conclusion is that promotion and market development programs should be authorized as marketing order options for all farm commodities. Commodity groups will need to invest in analysis in order to benefit from using this option. It seems reasonable to leave the investment in commodity promotion up to producers. The same principle applies to export promotion, rather than subsidization.

Research and Information Services

Because of the public good characteristics of research and information, much of it has been financed by government. Budget pressures, changes in political preferences, and lack of direct control result in less investment in research and information than would potentially serve the interests of some groups of producers. Commodity research focusing on identifying commodity attributes desired by commercial buyers and consumers, combined with timely research to develop economic methods to produce such attributes, would clearly contribute to the objectives of orderly marketing. The same is true of information about current supply and demand conditions designed specifically to meet the needs of the commodity producers.

A particularly interesting option would be information collection and distribution designed to provide the basis for individual decisions leading to improved collective outcomes in regard to plantings, breeding, and other capacity investments. Such information, with appropriate analysis, distributed not only to producers, but also to lenders, has the potential to reduce mistakes leading to excess investment in capacity.

Brader: Of course, advertising, promotion and research provisions could be carried out without marketing orders. But these are important, widely-used features. Another is the generation of information. When the California plum order was voted down, the immediate concern was information loss. California-Arizona citrus and other orders have suspended their main provisions, but all continue activity in collecting and disseminating information.

Other Options

Information about what other producers are going to do, and thus predicting supply, is inherently difficult to generate. It takes special institutional designs to produce it. The following options seek to deal with that problem.

Exclusive Agency Bargaining

A comprehensive marketing order act could provide the framework for exclusive agency bargaining by commodity groups. The basic concept is similar to other order options: A grower association would define a bargaining unit, the definition and representation would be subject to vote, and an elected association would bargain for all producers within the unit. Buyers would be required to bargain with the accredited association in good faith. Purchases from the producers in the unit would have to be consistent with the collectively-bargained terms of trade.

Michigan Public Law 344 sanctioned exclusive agency bargaining for fruits and vegetables until the exclusive agency provision was voided by the U.S. Supreme Court, based upon the argument that the federal government preempted the right to grant such authority. The court's decision means that it is legal only for the federal government to authorize exclusive agency bargaining for farm commodities.

My conclusion after eight years of close observation of Michigan's collective bargaining experience is that exclusive agency bargaining is administratively feasible and can work to contribute to the objectives of orderly marketing. (My observation point was as chair of the Michigan Agricultural Marketing and Bargaining Board, the agency responsible for implementation and regulation under the bargaining act.) I was particularly impressed with the potential of last-offer arbitration to achieve reasonable settlements in a timely manner, which is a critical consideration for perishable commodities. The bargaining process was most important in setting prices at harvest for perishable commodities. Both growers and processors were better informed about supply and demand conditions. While hold-up strategies could have provided short-run benefits, they were not adopted because both the growers' associations and processors knew they would meet again and knew their future profits depended on each other's survival. In any case, under bargaining, growers were less vulnerable to forced sale situations, less likely to make mistakes due to lack of information, and enjoyed prices modestly better on average than would have been received without bargaining.

The option of exclusive agency bargaining over contracts for commodities prior to specific production decisions is especially promising. Agreeing on contracts offers the possibility of avoiding mistakes about quantities to produce of products with specific attributes. It provides the potential for much more explicit signals about the values buyers place on quantities with different characteristics, including such attributes as time of delivery and practices to follow by both sellers and buyers to avoid losses. Exclusive agency bargaining generates a much more complete and reliable set of information than open bargaining. However, the rules to deal with possible abuse of power and important problems of articulation of individual producers' and buyers' preferences would need to be worked out.

Full Participation Contract Markets

I propose authorizing full participation markets in contracts for future delivery as an order option. A number of design variations are possible, and different rules may be desirable in adapting to various commodities.

I suggest a design that starts with a double auction in contracts traded electronically. To deal with unpredictable supplies available to a producer committed to deliver according to a contract, settlement rules would first emphasize moving commodities to meet the contractual terms of all buyers, to the extent feasible, given the total production. For crops significantly larger or smaller than contracted, settlement rules would be established to assure that farmers as a group would receive revenue equal to the sum specified in their contracts. Settlement rules assuring net revenue to the sellers as a group are important in order to avoid reducing the incentive to meet the contract. (The moral hazard problem is real!) Individuals could improve their chances of achieving a target revenue through crop insurance. Similarly, contracting buyers would be assured of receiving their proportionate share of the total contracted quantities. Presumably only growers who farm as a recreational activity will contract to produce a crop they know will result in revenue less than their variable costs, including the opportunity costs of their time and assets. Since the auction is completely transparent and the double auction is efficient, it would be expected that this market would work out matching supply with demand at prices consistent with the costs of production. (See Shaffer 1990 for a more detailed description.)

Partial contracting fails to generate complete information about aggregate production and purchasing plans. Complete information about production plans and first handler demand generated by a complete contracting system goes to the heart of the coordination problem of matching supply and demand. It reduces uncertainty and volatility in prices. But with less than full participation contracting, the volatility of the residual spot market is likely to increase as the percentage of the total market handled by contracting increases. The uncertainty and volatility of the spot market cause additional problems for the contract markets. Spot market prices substantially different from contracted prices create incentives to void or cheat on contracts and add substantial risk to the contracting firms, thus reducing the incentive to contract and lowering the quality of information for future planning.

The full participation contract concept is based on the facts that producers are in a better position to judge the costs and probabilities of delivering commodities to a buyer in the future than buyers are and that buyers are in a better position to judge the demand for commodities in a future period than growers are. Revealing this information, in the form of commitments to buy and sell, produces not just information about the future but shapes the conditions of supply and demand to conform with that information.

No matter how good the economists or the resources invested in data collection and analysis, no outlook system can produce information and guidelines for production and marketing comparable to those produced by a full participation transparent contract market.

Full Participation Crop Insurance

Crop insurance has major problems from market failure due to adverse selection and moral hazard. Farmers clearly know their risks better than the insurer, leading to an insurance pool including a disproportionate number of higher risk contracts. This increases the cost of insurance and makes crop insurance either unavailable at sound risk-related rates for the lower risk farmers or requires subsidies, or both; this seems to be the current situation. The problem of adverse selection is eliminated by full participation. Moral hazard can be minimized by basing the payoff on group performance rather than individual outcomes. Combining crop insurance with a forward contract system would minimize the moral hazard by maintaining individual incentives to meet the terms of the forward contract and would provide the possibility of dealing with individual crop failure with crop insurance. A combination of full participation contracting and full participation crop insurance, along with the elimination of crop insurance subsidies and a well advertised and believable policy eliminating crop disaster relief, would surely provide farmers with more predictable outcomes, promote improved use of resources and reduce the budget deficit.

Market Power and Undue Price Enhancement

Current legislation sets parity prices for farmers as a goal and prohibits use of orders to achieve undue price enhancement. Achieving "parity prices" based on historical parity indexes is clearly an unrealistic goal unrelated to equity. Undue price enhancement requires an operational definition.

Brader: We can never know if we have undue price enhancement, or that we've reached "parity," because nobody could ever agree on what that would be.

Nonetheless, attention needs to be paid to the concern for abuse of market power based on market order restrictive practices. A reasonable indicator of abuse of market power would be evidence that growers, as a result of restricting marketed supplies, were receiving returns to investment higher than those received in other industries. The criteria could be made more specific by relating returns to investment in commodity enterprises covered by a specific order practice by the 100 firms selling the largest quantities of the commodity, to returns to investment by the 500 largest firms in the country. The 100 largest sellers under an order are likely to have good records, and supplying the information could be made a requirement under the order. Similarly the returns to investment of the largest 500 firms are available. Nonetheless problems remain. How is the relationship between market-restricting activities and returns to investment to be analyzed? Returns to investment are due to many factors, so simply finding high returns would not necessarily be evidence of abuse of market power. Particularly difficult is determining how to value the investments. The problem is that the value of some assets is a function of the returns to that asset. For example, if all benefits of the use of market power were capitalized into the value of the land used to produce the commodity and the right to produce the commodity was tied to the ownership of the land, no excess returns to investment would be indicated.

A set of conventions would need to be worked out to avoid this problem. Most of the options discussed do not create the potential for abuse of market power. The enabling legislation could reduce the potential for abuse of market power by placing the burden of proof on the grower associations. That is, for a list of restrictive practices, an association would be required to present a convincing case that prices resulting from the practice did not violate the criteria for prices consistent with costs of a typical well-managed firm.

Les Myers, Virginia Tech: Your proposal for bringing most or all agricultural commodity production under market orders includes the authority to control supply. You would regulate the abuse of this authority by monitoring returns on investment for 500 of the largest producers. Given that most agricultural commodities have inelastic demands at the farm level, there are strong incentives to limit production. I do not believe that monitoring returns on investment is a feasible way of preventing undue price enhancement because of regional differences in production costs, inability to collect accurate and consistent data, and other reasons. How would you deal with the practicality of enforcement of the undue price enhancement provision for market orders?

Shaffer: Myers asks an important and difficult question. It is unlikely that my attempt to answer the question will prove satisfactory. Farm management is not my field, but I believe farm management specialists would be able to provide the needed technical information to show that returns to investment in a particular commodity enterprise are in excess of those of major industrial firms. And they would be able to relate the earnings to the enhancement of prices due to restrictions in output. If not, how can they advise farmers about investing in the commodity enterprises in question? How can bankers make judgments about lending for investments in farm enterprises if such estimates cannot be made? My guess is that VPI would bid on the contract and would deliver the goods! My argument is that the problem of dealing with the undue price enhancement provision in current order legislation follows from the absence of a definition of the concept. (It may also be that orders have not resulted in undue price enhancement.) Given a careful definition, the rules of evidence and an incentive to enforce, it would be technically possible to made practical judgments based upon the preponderance of evidence. Agricultural economists are capable of providing the evidence.

Shaffer paper continued

Rules of Representation and Jurisdictional Boundaries

There are important issues of representation and jurisdictional boundaries to be worked out. How are order jurisdictional boundaries to be determined? Who gets to vote? How are votes to be weighted? What is subject to participant vote? What is to be specified in the enabling legislation? What can be settled by arbitration and what should be left to the Secretary?

Past policy seems to be one of limiting the scope of marketing orders in respect to geographic location and use of the commodity. The logic of orderly marketing, however, argues for the fullest participation possible, consistent with a community of interests.

For example, full participation contract systems, including all uses of a commodity produced or sold in the United States, would be most effective. There are good reasons to include exports and imports. That is, exporters would be required to contract to purchase just as any other purchaser. Although it complicates the rules of representation, it would be reasonable also to require importers to sell by contract across the forward contract markets. This type of order offers no potential for abuse of market power and minimizes conflicts of interest in regard to restrictions on choice, other than the one requiring all sales to be by contract across the transparent auction.

The scope of bargaining orders has more potential for dispute. It has potential principal-agent and unwilling-rider problems reducing the scope of community of interest. The rules for participant initiative to alter policy and practices of the association management need attention. Increased scope improves the capacity of the association to achieve the objectives of orderly marketing but, at the same time, creates greater opportunity for abuse of market power. My reading of the problem is that a combination of reasonable requirements for open entry and judicial oversight would enhance performance more than attempting to curb the scope of the bargaining order.

The same logic applies to the supply management orders. I see no basis for specifying the scope of geographic or use inclusions in promotion, quality assurance and standards, or research and development orders. The problems of organizing a community of interest to support these types of orders are limiting enough.

While extending the geographic boundary to deal with international trade is relatively easy and straight-forward in the case of full participation contracting, international trade creates a potential problem for other order options. In principle, the law should not restrict entry of commodities that meet the criteria set for domestic producers, but regulations should be established to protect participants under orders from market disruptions from imported commodities not meeting standards or selling below their total costs.

As I see the enabling legislation of the future, procedures could be established to react to marketing order proposals drawn from this complete list of authorization options. The Secretary would provide guidelines and technical assistance, but it would be the responsibility of the farmer cooperatives, the commodity associations and other organizations of farmers to initiate proposals and organize support for them. The Secretary would then supervise elections. A reasonable requirement for the adoption of an order, or an amendment to it, would be the twin criteria that a majority of producers participate and that producers represent at least half of the previous year's sales of the commodity.

Brader: Under the rules, the marketing order must be confined to the smallest practicable area, for example, promotion of Ore-Idaho potatoes. And as I say elsewhere, for supply control the order must control all sources of, for example, cranberries.

Comment: In the past, milk marketing orders were over limited markets. Now the issues and their hearings are national in scope. This raises regional problems because some gain and some lose from changes.

Brader: Regarding nationalization, people are more interested in what's being done in other parts of the country. For example, a change in the Class I differential in Boston would have once been a Boston issue; now it's considered a national issue.

An Illustration of a Possible Combination of Order Options

Envision a combination of marketing order options adopted in the governance of a major sector of the food system. Start with hog finishers who opt for exclusive agency bargaining for contracts for future delivery. They may believe an auction market would be less effective in coordinating transactions between growers and processors because of the concentration in pork processing. They form the hog producers and marketing association, propose a bargaining unit to include all hogs sold for processing in the United States and, based on a referendum, are granted the right to represent hog producers in negotiations with processors. The association now has a big problem. It has to develop a method of identifying and aggregating the quantities of specific commodities farmers are willing to offer to sell at different prices and a method of meeting contract commitments to processors. This could be worked out through an electronic auction of contracts, with the association to supply particular lots of hogs consistent with processor articulated demand to the association.

In order to bid on contracts to supply finished hogs, producers would want to contract for at least two of the critical inputs—feeder pigs and corn. Feeder pig producers choose to contract with individual hog producers without a marketing order regulating that market, leaving the hog producers' association with the major functions of coordinating supply and demand. Growers in specific areas could find marketing through a feeder pig cooperative to their advantage. A second marketing order including all U.S. hog and pig producers could be instituted to provide a number of services consistent with the marketing order options. It could support research designed to identify the demand for specific quality characteristics of hogs and promote the development of breeds with such characteristics. It could provide information services, quality standards and inspection services, and promotion. It could provide research supporting all of these functions and, especially, research designed to generally contribute to the performance of the hog-pork subsector.

A strong case could be made for a complementary order setting up a market in contracts for future delivery covering all corn sold in the United States. Another order could provide crop insurance for corn growers. In order to serve the needs of the hog producers, contracts for delivery a year and more after agreement would be necessary. Careful attention to contingencies would be required. One of the associations would need to operate a storage program under the order, or institute rules facilitating storage by those willing to buy and sell corn, to assure supplies to the hog producers at contracted prices.

Clearly much thought would be required to work out the details of such a marketing system for the pork-hog-pig-corn subsector, but most likely not more than is now expended trying to work the current system.

Consumer and Taxpayer Interests

Consumers should be winners from the expanded use of marketing orders designed to promote orderly marketing. They would receive reliable supplies of food at prices reflecting the costs of production and distribution. Costs would be lowered because of fewer mistakes in resource allocation. Performance would be enhanced by improving the match of product characteristics with consumer preferences.

The proposal advocates the elimination of the farm price and income support programs. To the extent prices increased in the adjustment to the new system, costs would be shifted from the national debt to consumers. Similarly, a number of authorized functions of potential order options would eliminate the need for, or substitute for, services now provided by or subsidized by the government. Including the costs of producing and marketing commodities in their prices is generally consistent with common sense economics. I am not prepared to argue about the effects of any change in the national debt resulting from elimination of the price and income support programs.

Final Comment

If the objective of orderly marketing, defined as matching supply and demand at prices consistent with costs, is taken seriously, institutions designed to achieve the objective should be given serious attention. The governance system to achieve orderly marketing will not evolve through natural selection. It will require the participation of many specialists, including especially participants in the commodity systems, in working out the policies and standard operating procedures specifically designed to achieve the orderly market objectives. I suggest that allowing farmers to select from a number of marketing order options, working through their own organizations, taking into consideration their unique situations and preferences, offers an opportunity to develop workable commodity programs consistent with the objectives of orderly marketing. There would be need and opportunity for research, extension, and especially creative ideas in the process of working out the rules of potential orders. Research designed to deal with the possible problems associated with the use of supply-restricting practices is especially needed. It may be that development of the contracting and other options, with no market power abuse potential, would result in orderly marketing without the need for supply-restricting practices.

References

Shaffer, James D. 1990. "A Farm Policy Proposal: Full Participation Markets in Contracts for Future Delivery." *Choices*, First Quarter, pp. 12-15.

U.S. Department of Agriculture. 1987. *Criteria for Evaluating Federal Marketing Orders: Fruits, Vegetables, Nuts, and Specialty Commodities.* A report prepared by an independent marketing order study team consisting of Leo Polopolus, Hoy Carman, Edward Jesse and James Shaffer sponsored by the Economic Research Service and Agricultural Marketing Service of the USDA, and published through the facilities of the Economic Research Service. U.S Government Printing Office: 180-917/60005.

Kaiser: The implicit judgment in Shaffer's paper is that marketing orders seek to match supply and demand to manage price to cover costs; this is a producer-oriented position. Paul G. Christ prefers a consumer-oriented stance. Consumers are the end-users of the commodities. They ultimately pay the bill for any institutional design that will improve the market performance. Well, what do consumers want? They want value. They are entitled to the lowest production, distribution, marketing costs compatible with an adequate supply. Programs that favor high-cost production areas over low-cost ones or those that enhance producer prices are not justifiable.

Shaffer: One crucial thought was behind my paper: There is a belief that the federal government is going to withdraw from price and income support programs, so we need to figure out what should be done. My response may not be the right one—but we'd better think of something!

Randy Torgerson, Agricultural Cooperative Service, USDA: Today everything is budget driven. I have been hearing statements made at the Farm Bureau and other meetings by representatives of FAPRI (Food and Agricultural Policy Research Institute) that we are only one budget reconciliation bill away from rendering farm programs ineffective. By comparison, one of the virtues of marketing order programs is their low administration costs relative to other forms of government farm programs.

Holford: For example, the inspection programs have been examined. The government role here has been found to be cost effective. Users are charged the direct cost of inspection. But the hope is that this will not be loaded up with charges from other departments.

Holford: I'd like to present some differences between today and yesteryear; these changes have had enormous impacts on the marketing order system:

Before:	**Today:**
•Many family farms and a way of life.	•Fewer and larger corporate farms and a way of business.
•Low-tech management.	•High technology, including computers and modern equipment.
•Terminal markets—pack and send, without an owner or even knowing the price.	•Inventories kept at home, never rolled to market without an owner.
•Wholesaler dominated.	•Chain store dominated.
•Auction markets.	•Firm sales.
•Rail shipments without owners.	•Just-in-time delivery; customers want smaller amounts delivered several times a week; it has to be in inventory.
•Relatively slow communications.	•Very fast (immediate) communication—faxes, Electronic Data Interchange (EDI), Universal Product Code (UPC), etc. For example, one has immediate knowledge of how a product is moving from the grocery store.
•Local cooperatives.	•International cooperatives.
•Little export/import activity.	•Expanding global markets.
•A relatively small amount of processing.	•A great many processing options and alternative markets.
•Few rules.	•Now the Perishable Agricultural Commodities Act brings a mature system that helps reduce some of the risks.
•Few competing commodities	•A plethora of competing commodities.
•Few advertised brands.	•Many advertised brands.
•Few package types.	•Many packaging types.
•Bare-bones, bulk commodity shipments.	•Value-added products.
•Not much service offered with the products.	•Heavy on services offered; fast response time between consumer demand and producer response.

Shaffer: There's no stopping the momentum toward the industrialization of the food system. We need to think seriously about what kind of system is needed and about the kinds of options that can be provided to farmers to deal with their problems.

John Nichols, Texas A&M: With regard to the changing market: These changes are particularly dynamic in the retail sector—in the growth of retail power. In former days, because of the great mental distance between buyers and sellers, quality standards, for example, were needed. Otherwise, without an order, some would be led to sell "junk." Now there is less need because of closer contact between marketing levels. Retailers are using fresh produce as a strategic marketing tool. The big buyers define the quality they want.

Holford: Partnering is becoming common—buyers select three or four suppliers that they can count on.

Fairchild: Can marketing orders exhibit enough flexibility to meet changing conditions and new problems? With increased flexibility, there's more opportunity for abuse. There is a good deal of concern about cheating—when one power group excludes another—or, for example, keeps someone from developing a niche market because of size or pack regulations. But I agree with Holford, there may be less need today for formal marketing orders. But without orders, market discipline may be more harsh on some, especially on those exiting the industry.