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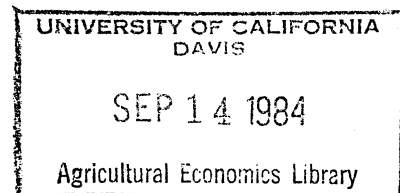
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DO CHANGES IN FARMER-FIRST HANDLER EXCHANGE

ELIMINATE THE NEED FOR GOVERNMENT

INTERVENTION?



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Milk - Prices

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INTRODUCTION

At the last meeting of this Association, the fiftieth anniversary of the Agricultural Adjustment Act of 1933 (AAA) was commemorated by a session in which the history of the Act and its legacy were discussed. In many ways this paper is a continuation of that discussion, focusing on public intervention in milk pricing. The Federal dairy price support program is the principal program responsible for the level of milk prices; dairy import quotas play an auxiliary role. Federal milk marketing orders, similar State controls, and to some extent Federal policy toward dairy cooperatives relate primarily to pricing practices. This paper is not intended to evaluate these specific programs and policies. Rather, our objective is to generally explore the justification for and purposes of government intervention in milk and dairy product markets and to discuss whether current or expected conditions warrant the continuation of these programs or suggest substantial changes in their structure.

The historic record in New York state during the early 1900s will be used to identify the forces and frustrations that gave birth to governmental involvement in milk marketing. While New York's marketing conditions were not identical to those in other major milk producing states, it is clear that many of the problems and pressures faced by New York dairy farmers, cooperatives, and milk dealers existed throughout the U.S. [Manchester, chapters 3 and 4]. We do not argue here that government intervention is warranted in a social welfare sense, but rather that it is as warranted today as it was in the 1930s.

CONDITIONS LEADING TO GOVERNMENT INTERVENTION

Early Pricing Practices

A perennial concern through all the reports we studied is the question of how farm milk prices are determined. Throughout most of the period from after the Civil War to before World War II, a common charge was that milk dealers set prices--oligopsony or a buyers' cartel existed. At some times between 1910 and 1930, some felt that producers monopolized the market through powerful cooperatives. Others felt that competitive forces determined prices.

On the matter of price fixing, a Connecticut farmer wrote a letter which appeared in the January 13, 1872 issue of the Rural New Yorker. He stated:

It is notorious that the majority of the milkmen in New York [City] are a set of swindlers, who pay only as it suits their convenience and pay just as little as they can. [Spencer and Blanford, p.47]

However, he follows this with:

The law of supply and demand rules the price of milk in New York. When milk is scarce, a good price can be received, but when plenty hardly anything; and when milk is plenty the milkmen will keep the cans back to prevent your sending more milk than they want. [Spencer and Blanford, p.47]

Although prices may have been made in light of market conditions, neither pricing efficiency nor equity seemed to prevail. A story in the

December, 1891 issue of the Milk Reporter emphasized the oligopsonistic nature of milk markets in the 1870s.

...all milk not sold by special contract (and such contracts were comparatively few) was shipped without any understanding as to what producers would receive for it. On or about the tenth of each month--after the milk had been used and by many forgotten it had ever existed--the Milk Dealers' Union, succeeded by the United Milk Dealers, met and decided what they would pay for that received the previous month.... [Spencer and Blanford, p.139, cf. O'Malley Report, p.126]

In 1882, a dealer's organization called the Milk Exchange, Limited was formed. In 1891, the New York State Attorney-General stated that he believed the Milk Exchange, Ltd. to be "a combination to limit and lessen the supply of milk in the State of New York and to fix and control the price thereof" [O'Malley Report, p.8]. In 1895, the Milk Exchange, Limited was dissolved and six months later the Consolidated Milk Exchange was incorporated in New Jersey. It postured itself as a trade association, but it is clear that its major indeed almost its sole activity was to determine the "value" of milk.

Each director [of the Consolidated] was a member of the 'Committee on Values.' After an informal discussion of what the price of milk ought to be for the succeeding month, a ballot was taken, and as a result of that ballot the price was fixed.... [O'Malley, p.9]

The Milk Reporter for July 1913 stated that "...fully 75 percent of the dealers' purchase contracts were based on Exchange quotations" [Pitcher Committee, p.155]. O'Malley also pointed out that Borden's, the largest dealer in New York at that time, was not a member of the Exchange but that this made little difference.

The result was that a producer desiring to sell milk in the New York market was compelled to sell either at Borden's or the Exchange prices, which were practically identical, and if not satisfied with either of these, he was compelled either to manufacture his milk into butter or cheese, or market it with unknown and oftentimes irresponsible dealers. [p.10]

(Many dairy cooperatives would argue that this is more or less the choice they face today.) Nonetheless, many argued that this price setting was a legitimate and necessary function and did not mean that milk prices were not based on competitive factors [cf. O'Malley Report, pp.97-98 and p.126]. O'Malley decided that the pricing practices of the Consolidated Milk Exchange were unlawful and unwarranted; however, he felt that the evidence was too circumstantial to prosecute [p.17].

Attempts at Cooperative Bargaining

The formation of the Milk Exchange, Limited in 1882 was soon followed by a strike (or withholding of milk) in 1883 [cf. Pitcher Committee, pp.160-162]. Changes were made that mollified producers in the short run but the situation soon deteriorated again. The Exchange agreed to form a Joint Price Committee that included farmers, "but

during the second year the dealers sent back so far into the country for milk that they overwhelmed us with cheap milk" [O'Malley, p.89].

In 1889, farmers formed the Milk Producers' Union to set milk prices counter to those set by the Consolidated Exchange and Bordens. The Union had little success at bargaining. In an attempt to achieve a lasting solution, the Union incorporated the Five States Milk Company in October, 1890 to buy, handle, and dispose of all members' milk. In August, 1892, the Company was sold at a sheriff's auction and the Milk Producers' Union faded away.

In 1894, the Five States Milk Producers' Association was formed to work in cooperation with dealers in setting milk prices. It presided over a strike in 1900 which was broken with outside milk. This association faded away around 1907.

The Dairymen's League, Inc. was formed in 1907. By 1914, with 75% to 85% of all New York farmers as members, it was ready to assume a role of bargaining agent and price setter. Dealers rejected the League prices for Winter 1916-1917 and a strike commenced on October 1, 1916. By October 14, the last and largest dealers finally gave in and signed League contracts. At the height of its success in 1916, the Dairymen's League represented as many as 90% of the farmers in New York. League membership slipped to approximately 50% of New York producers over the next several years. This was due at least in part to efforts by the League to consolidate and extend its bargaining capability or advantage. Primarily the League lengthened the term of its member contracts from one year to five years and began acquiring country receiving plants. By 1921, the Dairymen League Inc.--a bargaining cooperative--had formally

transformed itself into the Dairymens League Cooperative Association--an operating cooperative. These changes were intended to improve the League's control of the milk supply and to garner new members. Instead the unheard of five-year contracts and high cost of acquiring plants alienated many producers, many of whom joined competing cooperatives.

The League and these other organizations became the subject of several attempts to unify producers during the 1920s. This was believed to be necessary to preserve and extend the gains that had been made in 1916 and to eliminate the duplication of services and facilities that cooperatives were fostering. In 1926 and 1927, the Milk Producers Program Committee on Unified Organization, also known as the Ten Eyck Committee after its Chairman, Peter Ten Eyck, heard from numerous speakers from all segments of industry, government and academia. Virtually all who testified agreed that one organization was clearly superior to many and that at least 75 percent of the producers in New York would have to belong to it if it were to effectively bargain with dealers. Despite this near unanimity of agreement on the solution, this effort too failed because the various groups could not agree on specific arrangements.

Two decades of cooperation and collective bargaining left a legacy of less than satisfying results in improving prices to farmers and added to a marketing system already burdened with excess plants and redundant services. In the eyes of many, collective bargaining and cooperation had failed. More active and direct government intervention appeared to be the logical next step; for many it offered the only hope for a long-term remedy.

Farmers' Dissatisfaction With Price Level

However farm milk prices were determined between 1900 and 1933, the most common complaint among farmers was that prices did not cover costs or yield a fair return. The 1910 O'Malley investigation found that prices paid producers were "unreasonable and unprofitable" [p.10]; dairy producers clearly agreed.

Following the Dairymen's League milk strike, a joint committee of the New York State legislature, chaired by Senator Charles Wicks and referred to by his name, was charged to investigate pricing concerns in dairy markets. Their preliminary report alone contains 100 pages of evidence on just the cost of producing milk. The testimony all pointed in one direction--the price farmers received for milk was less than what it cost to produce milk [p.38]. Fifteen years later another joint legislative committee, chaired by Senator Perley Pitcher, was still hearing these complaints [Pitcher Committee Report, p.46]. It would appear no one could be found who would admit to making money by milking cows, viz. the following testimony of Mr. James Stark to the Pitcher Committee:

Q. You say your 25 or 30 cows are good ones. What do you mean by that?

A. I mean the past four years our herd has made a world's record average on production.

Q. Now do you find that notwithstanding that efficiency, that you have shown, that the cost of producing milk is above what you are able to get for it?

A. ...I found under present conditions a man cannot make ends meet....

Leroy A. Van Bomel, then Vice President of Sheffield Farms Co., the second largest milk dealer in New York, stated before the Ten Eyck Committee:

I do not feel that...a price can be paid for any commodity that will provide a profit for everybody that produces it.

[February 14, 1927]

While such a statement may make eminent sense to the outside observer, it must be recognized that it does little to diminish the strong feelings farmers held (and still hold) on the subject.

Inefficiencies in Marketing

The second principal theme of the Wicks Committee investigation had to do with excessive marketing costs and the duplication of services that derive from the nature of competition in milk markets.

There is no milk trust controlling the purchase and sale of market milk in...any town or village of the state.... Instead there is sharp and bitter competition.... There is too much capital already invested in the business of handling and distributing milk and trying to pay, and in many cases successfully paying, dividends upon this capital. Here, then, is the waste and the loss, because all these things are a burden upon the consumer and upon the producer. [p.604, cf. p.578]

This theme also features prominently in the testimony heard by the Ten Eyck Committee. A Dairymen's League spokesman reported that only about 75 of their 184 plants were operating economically. He stated that this

was common among processors due to lack of milk [Ten Eyck Committee, March 5, 1927]. Five years later, the Pitcher Committee also found "competition in the business of milk distribution in the cities of the state is keen to the point of being wasteful and destructive" [p.16].

THE NEED FOR GOVERNMENT INTERVENTION

The essence of the recommendations of the Wicks Committee (1910) was that government could and should play a more aggressive role in assisting cooperative efforts by providing them with up-to-date information, analyses, and other assistance. The Ten Eyck Committee (1927) pressed for greater unity among competing cooperatives and saw little role for government beyond facilitating that goal. The Pitcher Committee (1933) recommended bolstering of cooperatives as a long-run solution. However, they also suggested direct government intervention in the short run [p.18]. Spencer writes that the Pitcher Committee did not even contemplate public price fixing when they began their work in May 1932. It gained public support as the situation worsened [p.771].

An important role in the early move toward government intervention was the almost universal view of fluid milk as a necessity of life. "A milk supply is as much a daily necessity and even more so than either gas or electricity" [Wicks Committee, p.578]. The report of the Pitcher Committee refers to milk as "an essential food" [p.38]. It also states that "the production and distribution of milk in this state is a paramount industry..." [p.13], a claim supported by the need to maintain sanitary standards and an ample supply of milk to consumers. It was widely agreed that prices had to provide sufficient returns if farmers were expected to deliver a healthful product [Wicks Committee, p.72].

Given the perceived importance of an ample supply of pure and wholesome milk, numerous investigations in the 1917-1919 period flirted with (and some even endorsed) the notion of treating fluid milk distribution as a public utility. A large appendix to the Pitcher Committee report explored public intervention based on law pertaining to public utilities. Many argued that fair trade practice regulation alone was insufficient and ineffective. [cf. O'Malley, p.17 and Wicks Committee, p.578]

THE BEGINNING OF GOVERNMENT INTERVENTION

In New York, as previously noted, the Wicks, Ten Eyck, and Pitcher Committees largely rejected public regulation, at least as a long-term policy. Not all farmers agreed. As Charles McLaury, a dairy farmer, testified before the Wicks Committee:

If you will appoint a commission to handle the milk product for us farmers and fix the price so we can make a profit the same as other corporations, we will be satisfied and you will be doing us a great favor.... [p.221]

The Great Depression clearly precipitated the final decision to regulate the marketing of milk and other agricultural commodities. Following the recommendations of the Pitcher Committee, New York passed its Milk Control Law in 1933. One month after the New York Milk Control Law was passed, President Roosevelt signed the Agricultural Adjustment Act (AAA); many states soon followed suit. "Ostensibly, the act [AAA] is almost solely of emergency intent", but from the beginning it was clear that "others have believed that the arrangements developed during

the 'emergency' period are certain to be continued" [Black, p.10]. Dairy leaders were most likely in the latter group for they consistently moved the AAA and subsequent modifications during the 1930s in the direction of a permanent public control program along the lines they had been discussing for two decades.

The marketing agreements and licensing provisions of the AAA seemed to give farmers what they wanted.

These appealed to the milk producers' associations, particularly as they seemed to provide that the government would come to the support of their arrangements with dealers in the matter of prices, buying plans, and the like, and put an end to the price cutting and other alleged evils which were said to be 'demoralizing' the milk markets. [Black, p.23]

An alliance developed between cooperatives and large milk processors to secure such government programs [cf. Black, p.230], and consumers were effectively shut out of the pricing decisions under marketing agreements between producers and dealers [Black, pp.128 and 241].

Higher prices to farmers was the key plank of the AAA, but, as dairy groups shaped policy to conform more closely to their interests, dairy policy also was developed to confront the problem of excessive marketing costs and destructive competition. The rationale for this is supported by Black:

...competition has failed in this field of activity, as in numerous others, to attain its supposed objectives. It has no doubt served as a stimulus to improved methods and

greater internal efficiency; but the gains from these have not been realized by producer, distributor, or consumer except in limited measure. They have been mostly absorbed in supporting an increasing number of milk dealers.

[p.232, cf. p.191]

Black also recognized the problem of destructive competition and noted that the early efforts of the AAA did not eliminate this problem [p.191]. The weak enforcement of the early marketing agreements and licenses no doubt invited such abuse. Stricter and more tightly controlled measures were sought and eventually led to the Federal milk marketing order system.

The efforts of the 1930s helped to alleviate the problems of low prices, destructive competition, wasteful and redundant marketing services and facilities, and the like but as is true for all of agriculture, no complete or totally satisfying solution, particularly to low prices, was found before World War II.

The situation after the war was not much improved from the dairy producer's point of view. Cook writes:

When the war was over we had a great deal of pent up consumer demand, but this did not reflect itself in milk prices as the economists had expected. We soon saw that we needed a price support program...we saw a great need for expansion of the federal milk marketing orders...price wars among dealers broke out all over the country and price cuts were being passed back to producers. [p.2]

This point of view was by no means universally held, but such thinking and a half century of producer complaints about price levels finally resulted in the dairy price support program under the Agricultural Act of 1949 and in the growth of the Federal order system. Thus were the components of the milk marketing system developed and nurtured: the price support program elevated prices for all milk producers and marketing orders reduced destructive and wasteful competitive practices and protected prices in fluid milk markets.

CONCLUSIONS ABOUT THE FUTURE OF GOVERNMENT INTERVENTION

Do Structural Changes Obviate the Need for Government Intervention?

Costly surpluses, resulting in large part from high support prices under the dairy price support program, and technological and other changes in the unique characteristics of the milk industry have led many to question the need for further public involvement. Most common is the remark that dairy cooperatives have attained a sufficiently large stature and scope to protect their own interests without Federal assistance. We could return to collective bargaining and this time it would work.

The general conclusion of this paper is that this is not the case. In many respects the decision on whether to involve governments in the regulation of prices and marketing activities is a subjective one. Economists cannot say unequivocally one way or the other is clearly better, there are no Pareto superior choices. Nonetheless, we would venture to say that if government intervention in dairy markets was

justified before, it can be justified today and in the foreseeable future. The conditions which gave rise to government intervention in dairy markets have not changed sufficiently to eliminate their use as justification for government intervention. Let us examine some of the key conditions separately.

Milk is no longer held up as the necessity of life upon which our childrens' health and the future of our nation rest. The nutritional and health-related aspects of milk and dairy product now have negatives and positives which more or less balance out one another. This is a justifying factor that has greatly diminished in importance since the early 1900s, but it probably should not be totally dismissed. Milk remains a staple food; it will enjoy a favored status on that basis alone. Moreover, the fact that milk and several other dairy products are frequently purchased staples will continue to support efforts to moderate frequent, seasonal, or cyclical price increases of any magnitude. The Wicks Committee noted the importance of consumer price attitudes for farmers:

...the price paid to the producer was largely determined
by the price which the consumer was in the habit of paying
without objection in the large cities....[p.291]

With respect to collective bargaining, we are persuaded that co-operatives cannot now and perhaps never will be able to effectively bargain with milk dealers without government assistance. Most persuasive to us in this regard is the history of the Dairymen's League. Even with 90% of the producers under their contract, they could not maintain an effective bargaining position. Despite the greater

concentration of the farm sector today and even granting the superiority of modern management ability, the fundamental threat remains: a small minority who do not find it to their benefit to join can undermine the effectiveness of cooperative bargaining (cf. Pitcher Committee pp.153-162).

A somewhat similar line of thinking with respect to competition among processors and distributors also leads us to conclude that the chronic problems of "destructive competition" and redundancy--and therefore higher costs--of marketing services and facilities would most surely reappear in the absence of regulation. It is true that even with government intervention these problems are only reduced not eliminated; this is particularly true in the case of excessive marketing costs and inefficiencies [e.g. Schulster and Pratt]. It does not, however, argue for elimination of public intervention.

Lessons for Future Policy

The historical record also gives us insights about policy changes that we ought to avoid and those we might seek. For example, there has been much discussion in the last ten years about using costs of production alone to guide public pricing decisions. That producer records of their costs are a good single indicator of what price ought to be or that prices should be sought to yield all or most producers a fair return is a hopeless proposition. That a majority of dairy farmers would ever agree with this statement is probably equally hopeless.

Milk producers in the past and today have held "a sense of property right in their local market" [Black, p.211, cf. statement by George

Sisson, Ten Eyck Committee, February 14, 1927 and Hoard's Dairyman]. This feeling grows stronger when local producers, by virtue of normal competition or efforts to bargain for higher local prices, face greater competition from more distant suppliers. This attitude will frustrate the necessary response of dairy policy to changing market conditions and technologies that will further expand markets geographically [e.g. Novakovic]. Federal orders in particular will need to face these supply adjustments to the geographic alignment of minimum prices that may now be too high in some regions relative to other areas [USDA].

Large and rapid gains in productive efficiency in the era of biotechnology and electronic wizardry will further necessitate and complicate adjustments in the dairy sector that producers and dealers would respond to fitfully and poorly at best without regulatory help [e.g. Novakovic]. Producer attitudes toward territorial rights and adequate returns and the competitive problems faced when surpluses are large will only be aggravated by these inevitable and, in the long run, welcome gains in efficiency.

Since their conception, Federal dairy programs have led to, perhaps fostered, a congenial relationship between large cooperatives and large processors, with a secondary role for consumer and public interests. The current legislative subcommittee system and administration by the Secretary of Agriculture is unlikely to change this.

The historical record is illuminating to those whose personal experience is fairly recent but in some ways it is also depressing; how little we have learned, what a short distance we have traveled. But if our thinking has not progressed very far, perhaps it is due in part to

the fact that very little has changed in any fundamental way. In the case of government intervention in dairy markets, as a society we may still conclude that the visible hand moves more surely, effectively, and efficiently than the invisible one.

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