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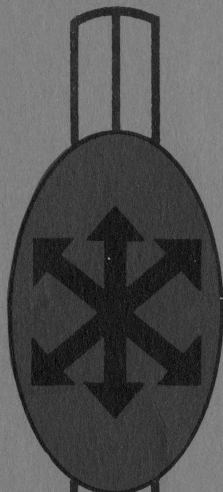
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*Marketing of farm products*

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# Staff Papers

Staff Paper 73-2

April 1973

STATUTORY AND ECONOMIC CONSIDERATIONS  
IN ESTABLISHING COOPERATIVE  
SERVICE PAYMENTS

John B. Roberts

**Department of**  
**Agricultural Economics**

University of Kentucky  
College of Agriculture  
Lexington 40506

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STATUTORY AND ECONOMIC CONSIDERATIONS IN ESTABLISHING  
COOPERATIVE SERVICE PAYMENTS

by

John B. Roberts\*

INTRODUCTION

It would be impossible in a limited statement to trace out the history and development of marketing services performed by cooperatives in the United States. Most cooperatives formed in the 1800's were organized on a local and community basis for the purpose of assembling, grading, processing, selling and shipping products on consignment to the open markets. The services were performed at cost for members and any savings were shared accordingly. In the early 1900's there emerged numerous centralized cooperative marketing agencies that represented producers in terminal markets. The terminal marketing associations conducted business for individual members and/or member cooperatives and their affiliates. Products were sold both outright and on consignment. Within certain limited geographic areas, central marketing agencies received, handled and delivered at cost as a service to members. During the 1920's a number of national sales agencies were set up. These agencies represented terminal marketing agencies and various forms of federated cooperatives. The stated objectives were: to bring together a large volume of a commodity under the control of one management in order to improve sales efficiency, avoid

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\* Professor of Agricultural Economics, University of Kentucky. Kentucky Project 91, a working paper contributing to objective II of Regional Project NC-101. Alternative Solutions to New Problems on Dairy Marketing Cooperatives.

duplication of facilities, and eliminate competition between cooperatives. Cotton, fruits and vegetables, livestock, grain, wood and pecans were cited.<sup>1/</sup>

Details of the enabling legislation, and history of cooperative marketing development are beyond the scope of this paper. Yet, it must be emphasized that from the beginning, farm groups have been frustrated in their efforts to organize effective and efficient marketing systems.<sup>2/</sup> They have been confronted by difficult economic, institutional and legal barriers. Throughout history, small local associations lacked the size and resources to command attention and give maximum services, while the larger organizations were discriminated against in the market place and hampered and challenged under public law.<sup>3/</sup>

Congress expressed its concern in February of 1922 by passing "an act to authorize associations of producers of agricultural products -- the Copper-Volstead Act, 67th Congress." The Act gave persons engaged in the production of agricultural products authority to act together, with wide latitude in marketing, processing and handling products for the mutual benefit of members. The law provided for "marketing agencies in common" but placed limitations on their monopolizing or restraint of trade. In March of 1927, the

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<sup>1/</sup>Ward W. Fetrow, "Cooperative Marketing of Agricultural Products," Farm Credit Administration Bulletin No. 3, February 1936, pp. 3, and 1-6.

<sup>2/</sup>For a condensed background, see Agricultural Adjustment 1937-38, a report of the activities. USDA AAA Report C86, 1939, Chapter I, pp. 1-9.

<sup>3/</sup>Reference is made to: (1) the Interstate Commerce Act of 1887, (2) the Sherman Act of 1890, (3) the Clayton Act of 1914, (4) the Federal Trade Commission Act of 1914, and (5) their amendments and innumerable less well known statutes.

69th Congress approved Public Law 450 which established a cooperative marketing division and in the same year passed Public Law 802, "to prevent discrimination against farmers' cooperatives by boards of trade and similar organizations, and for other purposes."<sup>1/</sup>

Other landmark legislation included (1) the Agricultural Marketing Act of 1929, (2) the Agricultural Adjustment Acts of 1933 and 1935, and (3) the Marketing Agreements Acts of 1937. All of these statutes contained provisions designed to establish the legal and economic status of farmer-owned cooperatives. All provided guidelines of acceptable performance as between cooperatives, proprietary business and the public interest.

#### MARKETING AGREEMENTS AND ORDERS

The Agricultural Adjustment Acts declared it to be the policy of Congress "to establish and maintain such balance between production and consumption of agricultural commodities, and such marketing conditions thereof, as will re-establish prices of farmers at a level that will give agricultural commodities a purchasing power with respect to articles farmers buy, equivalent to the purchasing power of agricultural commodities in the base period."<sup>2/</sup> The Act further provides milk and dairy products are a basic commodity vested in the public interest and eligible for adjustment payments through agreements

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<sup>1/</sup> Elmer Lewis, Laws Relating to Agriculture, U.S. Government Printing Office, Washington, D.C., 1938.

<sup>2/</sup> The Agricultural Adjustment Act, Public No. 10, 73rd Congress, Title I, May 1933.

with producers or by other voluntary methods. Provisions were made for the issuance of marketing agreements and licenses.

The agreements were voluntary contracts between handlers or processors of basic commodities and the Secretary of Agriculture. The terms of the agreements were contained in regulations drawn up by the affected industry and put into force by the Secretary of Agriculture through licensing provisions. In 1935 the marketing agreement section of the Agricultural Adjustment Act of 1933 was changed. Orders were substituted for the licensing provisions. Instead of being a voluntary program enforced by revocation of handler licenses, orders provided for full compliance by all handlers. The enforcement was shifted from the Secretary of Agriculture to the courts.

The 1933 Act provided the statutory basis for adjustment programs in the dairy industry. Under the law the Secretary of Agriculture, after due notice and opportunity for hearings, could implement marketing programs and through broad executive powers, carry out provisions set forth formally in various proposed marketing agreements. Experience in operating market programs under voluntary agreements subsequently demonstrated that voluntary participation under permissive authority was inadequate. The reason is that the minorities which abstained from participation were able to benefit disproportionately and to disrupt orderly marketing procedures and render controls unstable. Obviously, statutes requiring universal participation of all producers and all handlers would be needed.

#### Federal Orders

In response, statutes which redefined and expanded the basis for market controls were passed in 1935 as a new act. Authority for market controls was



de-emphasized; the parity price ceiling was defined; administrative powers were clarified; provisions were made for exemption, review and promulgation. In the case of milk, special conditions including parity prices and permissible and required administrative practices set order programs quite apart from those of any other commodity. The fact that the fluid milk industry had already developed a specialized system of marketing, including public surveillance, placed this industry in a unique position for implementing programs under the Agricultural Adjustment and Marketing Agreements Acts and under numerous state laws that were enacted at about the same time. These statutes gave the producers, processors and other industry groups primary responsibility for designing their own marketing programs. Wide latitude was given and an effort was made to provide comprehensive marketing plans acceptable to the interested parties and conforming to local and special needs.<sup>1/</sup> The Secretary of Agriculture and/or state officials jointly or separately were parties to and responsible for the review and final approval of the marketing programs to be implemented under the respective laws. Universally, the program proposals "set out" in writing definitions, market coverage, rules of conduct and regulations covering prices and acceptable trade practices.

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<sup>1/</sup>The following documents are noteworthy and comprehensive treatments of the diverse problems: (1) Gaummitz and Reed, "Some Problems in Establishing Milk Prices," USDA Dairy Section, Market Information Series DM-2, 1937; (2) W.P. Mortinson, "Milk Distribution as a Public Utility," University of Chicago Press, Chicago, Ill. 1940; (3) John M. Cassels, "A Study of Fluid Milk Prices," Harvard University Press, Cambridge, Massachusetts: 1937; (4) Roland W. Bartlett, "The Milk Industry," The Ronald Press Co., New York: 1945; (5) John D. Black, "The Dairy Industry and the AAA," The Brookings Institute, Washington, D.C., 1935.

### Public Interests and Regulations

Before an order could be put into effect, it was necessary to hold public hearings. The purpose of these hearings was to establish the need, review marketing agreement proposals, and submit proof and evidence that the issuance of an order would further the declared policies of Congress. One of the purposes of orders was to stabilize marketing conditions and prices through agreements and self-regulations for specified products, but no order could be issued that did not have the support of producers or handlers or both.

Details of this support varied, but for fluid milk, no order could be put into effect until 50 percent of the handlers by volume had signed an agreement, or after the Secretary of Agriculture had made the following determinations:<sup>1/</sup> (1) that the issuance of an order was favored by a required two-thirds of the milk producers by number and volume; (2) that non-compliance by handlers would tend to prevent achievement of the purpose of the Acts; and (3) that order regulations were the only practical way to advance the interest of producers.

Under the marketing agreements and federal order legislation, it was the handlers and not producers who were subject to regulations. Yet, few handlers were proponents, and most were neutral or negative in their support. Historically, producers' organizations provided almost all of the leadership in requesting market order programs. They also provided the

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<sup>1/</sup> Agricultural Adjustment 1937-38, a report of the activities. USDA AAA Report C86, 1939, pp. 70-73.

votes and necessary support to put order programs into effect. Nevertheless, handlers have taken an active part in federal order hearings and in working out acceptable terms and regulations. The results of federal orders actually proved beneficial to most producer and handler organizations. Despite this, there were many economic and legal conflicts.

Between 1934 and 1937 the marketing sections of the Agricultural Adjustment Acts had been revised or amended 81 times.<sup>1/</sup> This early experience led Congress to pass the Agricultural Marketing Agreements Act in 1937. This Act incorporated most revisions and amendments of the previous laws and clarified the intent of Congress. For example, paragraph 601 (Declaration of Conditions) states, "It is declared that the disruption of the orderly exchange of commodities in interstate commerce impairs the purchasing power of farmers and destroys the value of agricultural assets which support the national credit structure and that these conditions affect transactions in agricultural commodities with a national public interest, and burden and obstruct the normal channels of interstate commerce."<sup>2/</sup> Paragraph 608b (Marketing Agreement, Exemptions from Antitrust Laws) states that, "the Secretary of Agriculture shall have the power, after due notice and opportunity for hearings, to enter into marketing agreements with processors, producers, associations of producers, and others engaged in the handling of any agricultural commodity or product . . . in interstate and foreign commerce in such commodity or product thereof. The making of any such agreement

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<sup>1/</sup> Ibid. , p. 200.

<sup>2/</sup> Compilation of Statutes Relating to Marketing Activities, including research, service and regulatory work. USDA Agr. Handbook No. 130, p. 117.

shall not be in violation of the anti-trust laws of the United States, and any such agreement shall be deemed to be lawful."<sup>1/</sup> Under different paragraphs and subsections, the 1937 Act spells out the terms, conditions, manner of regulation, enforcement, termination, etc. The provisions of (e) section 8(c) numbers 14 and 15 refer to the violation of orders and the opportunity for relief through appeal and rulings by the Secretary of Agriculture and the courts, and (b) section 10(c) authorizes the Secretary of Agriculture, with the approval of the President, "to make such regulations with the force and effect of law as may be necessary to carry out the powers vested in him by this title."<sup>2/</sup> Furthermore, the Agricultural Marketing Act of 1937, separated the marketing control sections from the production control programs. Accordingly, market regulations could be designed to regulate handlers and trade practices, but not the supply.

#### Constitutional Authority

Significantly, the Acts declared agricultural marketing to be affected with the public interest and therefore subject to control. The new act was intended to establish and permanently maintain orderly conditions in marketing. The marketing control programs were, accordingly, removed from relief and adjustment context of earlier laws. Thus, a long time market control program was contemplated to function for the benefit of producers quite apart from the

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<sup>1/</sup>Ibid. , p. 119.

<sup>2/</sup>Ibid., p. 364.

relief and adjustment laws.<sup>1/</sup> Furthermore, the courts have supported this position. It is noted that the "legislative history of the Agricultural Marketing Agreements Act of 1937 shows that 'these provisions [for marketing orders and marketing agreements] are and were intended to be effective independently on the production adjustment provisions' which were invalidated by the Buler case . . . . Marketing orders and marketing agreements were regarded by Congress as being within the plenitude of its power to regulate commerce . . . ." The Act sets forth the purpose of price fixing under marketing orders, the manner in which orders may be issued, the terms and conditions which may be included in the orders, and provides for their enforcement. Provision is made in the statute for administrative relief and judicial review of administrative action.<sup>2/</sup> Other pertinent points made in Brooks' study are noteworthy because they are closely associated with the problem of marketwide services and cooperative payments to be discussed later. First, "a sale by a producer to a dealer or handler of milk is a part of the flow of commerce, and Congress is empowered, under the commerce clause, to undertake the stabilization of commerce through the process of price fixing by an administrative agency."

"The use of an equalization pool or producer settlement fund, as provided for in a milk order for marketwide pool, is reasonably adapted to allow

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<sup>1/</sup> G.L. Mehren, "Agricultural Market Control Under Federal Statutes," Giannini Foundation of Agricultural Economics, Report No. 90, University of California College of Agriculture, Berkeley, October 1947, p. 10.

<sup>2/</sup> Mel Brooks, "The Pricing of Milk Under Federal Marketing Orders," Reprint from a symposium on the regulatory functions of the Department of Agriculture, The George Washington Law Review, Vol. 26, January 1957, No. 2, Washington, D.C., pp. 187, 188.

regulations of milk marketing and is not in violation of the due process clause of the Fifth Amendment to the Constitution. The fixing of prices is not an impingement on the due process clause even if the value of the property is thereby reduced. The fact that regulation based on the commerce clause may demonstrably be disadvantageous to a person is not enough to constitute a violation of the due process clause. It has been pointed out many times that the exercise of the federal commerce power is not dependent on the status quo; the Fifth Amendment is no protection against a Congressional scheme of business regulation otherwise valid merely because it disturbs the profitability of methods . . . of a business concern or persons subject to regulation."<sup>1/</sup>

This author further illustrates by saying, "Milk that is priced under a milk marketing order is at times in competition with milk from the same production area, which is not priced by a milk marketing order. There is, however, no requirement of uniformity in connection with the commerce power and the Fifth Amendment does not require full and uniform exercise of commerce power. This legislation is notable, in that respect, for providing that the administrative agency may weigh relative needs and restrict application to less than the entire field." The final section by this author states, "It has been said that the success of the operation of such congressionally authorized milk control must depend on the effectiveness of its administration. A part of the administration of the program relates to the enforcement of regulatory provisions in the proceedings court. Issues of basic legal importance have been resolved in establishing and maintaining

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<sup>1/</sup>Ibid., pp. 190-191.

the validity of milk marketing orders.<sup>1/</sup>

Between 1933 and 1957 the Supreme Court ruled on 21 cases involving state and federal regulations of fluid marketing. From these landmark cases, several issues with respect to the rights of cooperatives to represent milk producers have been settled. Among those of special interest to this paper are: (1) the right of contracts between cooperative organizations and their individual members, (2) the legal authority for boards of qualified cooperatives to block vote on specific questions, (3) the approval for repooling of sales and revenues in order to equalize costs and payments for members' milk, and (4) the right of cooperatives to receive payments for marketwide services and the authority for assessment and the transfer of funds under federal order jurisdiction to pay cooperative organizations for services that benefit all milk producers equally. These payments were technically defined as "cooperative payments" and approved for the New York-New Jersey order in 1953.

The question of the authority for such payments was raised in 1939 by a defendant-handler in the Rock Royale case, and by a series of litigations after that date. The issue was finally settled in 1956 by the Supreme Court.<sup>2/</sup> But the question of individual rights, the scope of reimbursements, and the responsibility of non-members and cooperative minorities who do not choose

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<sup>1/</sup>For a condensed summary 1933-57, see Gertrude G. Foelsch and Hugh L. Cook, "An Analysis of Federal Court Decisions Relating to the Marketing of Fluid Milk," Wisconsin Agricultural Experiment Station Research Bulletin #200, January 1957.

<sup>2/</sup>Ibid., pp. 36-37.

to support the efforts of majorities on price and marketing efficiencies from which they become beneficiaries is not entirely clear. In fact, some of the issues are yet not resolved after nearly 40 years, as will be shown.

#### MARKETWIDE SERVICE PAYMENT FOR PRODUCER BENEFITS

Early attempts to stabilize milk markets and regulate the terms of trade by state intervention are illustrated when in April of 1933 the State of New York created a State Milk Control Board, and in September of 1933 when the State of Ohio signed into law the Burk Act. Both states gave broad powers to a milk commission and both contained sections dealing with compulsory compliance. Regulations established by the milk commissions contained numerous regulatory authorizations such as: the control of trade practices, market supply, contract obligations and price pooling. The following statement taken from the official order of the Ohio Milk Marketing Commission whose authorization was the Burk Act is significant.<sup>1/</sup> It focuses on the problem of producer payments for marketwide services.

"Cincinnati Production Shed" means and includes farms and areas, map and description of which is attached hereto and made a part hereof and marked "Exhibit 2."

"Control Committee" means the committee hereinafter provided in Section 4.

1. The schedule governing the prices at which, and the plan governing the terms and conditions under which, milk shall be purchased from producers by distributors shall be that set forth in Exhibit 3, which is attached hereto and made a part hereof.

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<sup>1/</sup>Ohio Research Bulletin 678, Ohio State University, 1948, pp. 8-9, 16-17.



From money due the producers for milk purchased according to such schedule of prices, the distributor shall deduct and pay for each one hundred pounds of base milk, or all milk so purchased, as follows:

To the Control Committee one cent per cwt. on all milk, except that the Control Committee may reduce this rate per cwt.

To the Dairy Council one cent per cwt. on base milk.

To the Producers Association of which the producer is a member, three cents per cwt. on all milk provided, however, if said producer is not a member of either of the Producers Associations, then said sum of three cents per cwt. on all milk so deducted shall be paid over to the Control Committee. The sum so paid shall be kept as a separate fund by the Control Committee for the purpose of securing to such producers not members of a Producers Association, benefits similar to those which are secured by members of the same by virtue of their like payments to such Producers Associations. The Control Committee shall disburse such funds for the purpose hereinabove provided and the Control Committee shall keep separate books and records, in form satisfactory to the Commission, pertaining to such funds.

The distributor shall make payments as aforesaid (simultaneously with making payment to the producers) for milk purchased and such payments shall respectively be deemed a part of the price paid to the producer.

The distributor shall, in addition to the payment provided above, also pay to the Control Committee one cent per cwt., on all milk except that the Control Committee may reduce this rate per cwt. by the same amount as the reduction made from the producers, and to the Dairy Council one cent per cwt. on base milk purchased from producer and make such payment simultaneously with making payment to the producer, but such amounts shall not be deducted from the purchase price paid to the producer.

2. The Production Control plan governing the marketing of milk shall be that set forth in Exhibit 4, which is attached hereto and made a part hereof.

Each Producers Association shall permit producers who are not members of it to become members on an equal basis with existing members similarly circumstanced, except as otherwise provided in Exhibit 4.

3. The schedule governing the minimum prices at which, and the terms and conditions under which, milk and milk products shall be distributed and/or sold by milk dealers shall be that defined and set forth in Exhibit 5 which is attached hereto and made a part hereof.

The Burk Law clearly sets forth the principle of equity and equal sharing of costs of marketwide services by deductions from the producer settlement funds. Such deductions were spelled out as a part of the producer price to be used for the benefit of all producers as stated in #1 above.

Failure of the Burk Law and noncompliance with its provisions led subsequently to the Cincinnati Milk Order in 1937. Failure of the federal order to resolve the question of equitable sharing of market costs as between producer cooperatives and non-cooperating producers remains among the central issues of milk marketing not yet resolved. However, there has been a precedent set by which non-members do pay a direct assessment to the market administrator for services that might not otherwise be available. "They constitute a special set of services described by Congress in the Agricultural Marketing Agreement Act. The services are those rendering market information to producers and verifications of weight sampling, and testing of their milk deliveries."<sup>1/</sup> Each of the special services are described in some detail along with the statutory authority and eligibility qualification.

The "marketing service deductions" discussed vary somewhat for individual markets, but they have become standard procedure in federal order

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<sup>1/</sup>H.L. Forest, "Criteria Applied in Qualifying Cooperatives in Federal Order Markets," Talk, Southwest Milk Marketing Conference, College Station, Texas, March 18, 1965, p. 4.

markets. Both the maximum authorized and the actual deductions as of January 1971 are shown in the summary of federal order provisions. Actual rates paid range from zero in some markets to 7 cents in Mississippi.<sup>1/</sup> What is important is the recognition that deductions from the market pools are justified, and methods of payments for member and non-member participation are established for the specified items as spelled out in the order. It is also important to note that the rates are deductible from all producers who benefit, but differ as between markets with the circumstances and service coverage. Actually, for the New York-New Jersey marketing orders, no marketing service deduction is made. This does not mean no services are performed and no charges are made. In this order, they have taken a somewhat different format which is known as "cooperative payments" which have been in effect in the New York marketing area for nearly 2 decades.

#### Cooperative Payments Under Market Orders

The concept of cooperative payments, which essentially set out deductions from the producer settlement funds and used these funds to pay qualified cooperatives for services performed for the benefit of producers on a market-wide basis, was adopted in October of 1953. It has survived 21 hearings, 12 suspensions, and numerous intensive litigations. Between 1965 and 1967 the cooperative payment procedure underwent extensive hearings and determination with respect to its statutory and economic justification. A "Discussion on

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<sup>1/</sup> USDA Dairy Division, Summary of Major Provisions in Federal Order Milk Marketing Orders, January 1, 1971, USDA, Washington, D.C., Table 10.

Proposed Amendments to Tentative Marketing Agreements and Order for Milk in the New York-New Jersey Marketing Area" was published in the federal register of August 1968. It is noteworthy that the plan of cooperative payments which had existed for many years (with some modification) should be continued.<sup>1/</sup> Accordingly, an examination of the status of the New York-New Jersey recommended decisions and the basis for their administrative support is logical. For this purpose reference is made to Docket No. AO-71-A46 [notice of recommended decisions and opportunity to file written exception] based on the hearing records of July and August 1965. The pertinent ruling has to do with the material issue on record of the hearing which is listed as No. 1 and as follows: "Whether the basis for and rates of payment from the producer settlement fund (commonly referred to as "cooperative payments") to qualify to perform specified services of benefit to producers on a market-wide basis should be modified or revoked."

The findings and conclusions in summary state that (1) under present structure of the market, some payments to qualified cooperatives from the producer settlement fund should be continued to encourage the efficient performance of their activities, i.e., those that are necessary to orderly marketing and for effective operations of the regulatory program.<sup>2/</sup>

It is further pointed out there are "benefits which results affect all

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<sup>1/</sup> Reference is made to [7CFR Part 1002] Docket AO-71-A46, et al. See Federal Register Vol. 33, No. 149, Thur. August 1, 1968.

<sup>2/</sup> Docket No. AO-71-A46, June 11, 1965, 30 F.R. 7839, p. 6.

producers, members and non-members alike." For example, cooperative efforts to raise the level of Class I prices because of changed marketing conditions, if successful, affect the uniform price received by all producers. In the absence of some means of sharing the costs involved, the whole burden of providing these services to all producers falls on the members of the cooperatives that undertake these tasks. Relevant statutes indicate congressional intent to foster the growth of cooperatives and not to place them at a disadvantage. Within this framework of stated public policy and of public interest, payments to cooperatives for performance of marketwide services have long been utilized in the regulatory process and to correct inequity. Payments are made from the producer settlement fund to qualified producer organizations that maintain adequate size, personnel, and facilities to perform the needed services.<sup>1/</sup>

Furthermore, in #2 and #3 of page 8 of the same docket, statements are made to show why payments are valid and necessary and statements note specifically those services which support the contention that the marketwide benefits have been derived from such payments.

It is stressed on page 7 that the limited resources of individual producers do not permit him to maintain the necessary staff and facilities to keep abreast with changes -- participate in the hearings.

While organization of producers can and does provide the vehicle for pooling of the resources needed for this purpose, the decision makes a further statement that follows:

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<sup>1/</sup> Docket AO-71-A46, op.cit., pp. 7-8.

A relatively large producer cooperative whose membership is drawn from the whole milkshed tends to represent a cross section of order producers. The marketwide nature of the order is thus recognized. The existence of several such organizations further insures that any divergent producer views will have ample opportunity to find capable expression in the order process. Without large and broad-based producer organizations, however, this valuable expression of the view of the producers would be lost to the order program.

Effective efforts by cooperatives on behalf of the interests of producers require heavy expenditures of time and money. On past experience personnel trained in economics, law, public relations, field services, and other specialties are all needed to provide the basis for alert, independent, and informed expression of the producer viewpoint. Under some circumstances the expertise and facilities provided by ownership and management of cooperative milk processing facilities provide a basis for specialized marketing knowledge. Maintenance of an adequate technical staff and facilities can be supported only by substantial producer organizations.

The record also indicates that the qualified cooperatives have performed the marketwide services required by the order in the past. These services include: (1) analyzing milk marketing problems and their solutions, conducting market research and maintaining current information as to all market developments, preparing and assembling statistical data relative to prices and marketing conditions, and making an economic analysis of all such data; (2) determining the need for the formulation of amendments to the order and proposing such amendments or requesting other appropriate action by the Secretary of the market administrator in the light of changing conditions; (3) participating in proceedings with respect to amendments to the order, including the preparation and presentation of evidence at public hearings, the submission of appropriate briefs and exceptions, and also participation by voting or otherwise, in the referenda relative to amendments; (4) participating in the meetings called by the market administrator, such as meetings with respect to rules and regulations issued under the order, including activities such as the preparation and presentation of data at such meetings and briefs for submission thereafter; (5) conducting a comprehensive education program among producers -- i.e., members and nonmembers of cooperatives -- and keeping such producers well informed for participation in the activities under the

regulatory order and, as a part of such program, issuing publications that contain relevant data and information about the order and its operation, and the distribution of such publications to members and, on the same subscription basis, to nonmembers; and (6) under certain circumstances, the operation of marketing facilities.

However, in view of problems with the present provisions indicated by the hearing evidence, modification of the provisions is in order at this time. The proposed revisions and supporting reasons are discussed below.

Subsequent hearings on this matter on July of 1965 and April and May of 1967 did not basically change the concepts noted and, in fact, gave substantial detailed evidence in their support.<sup>1/</sup> It did, however, cover details and modification with respect to particulars and payments. Accordingly, the position of the Secretary and the terms and conditions for cooperative payments seem to be clear and to have valid general application. On the basis of the statutes and on the basis of the decisions made by the Department of Agriculture and the courts' ruling relevant, the Secretary of Agriculture can authorize deductions from the marketwide pool and payments to producers' cooperatives for specified services where it can be shown the benefits accrue to all producers.

#### Performance Consideration for Cooperatives

It must be demonstrated to the Secretary that cooperatives receiving payments are able and willing to provide services and meet the tests. Besides being willing and able, it must be shown (1) that the activities for which

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<sup>1/</sup> Reported as Docket No. AO-71-A46, AO-71-A46-R01, Federal Register Vol. 33, No. 149, Thursday, August 1, 1968.

payments are made must contribute to the effective operations of the regulatory program and benefit all producers alike, i.e., producers who are not members of cooperative associations as well as those who are members; (2) that payments to cooperatives provide the means by which marketing efficiency is encouraged; and (3) by which inequities in cost as between producers who bear the marketing burden and those who do not can be corrected.

#### Producers' Benefits Must Be Proportionate

At issue is the determination of what the payments should be for, how much and who should be paid. In deciding such questions it is appropriate to recognize that all producers must have proportionate interests in the money deducted from the producer settlement fund since this reduces their price. It is equally important to recognize that any action that leads to an increase in the uniform price likewise increases the income of all producers. In this connection it must be emphasized that the later benefits cannot always be directly measured by costs. The actual expenditures for expertise, market management, and cost of administering marketing programs by cooperatives (for marketwide benefits) may be small as compared to its price benefits. It is possible that a fraction of a cent paid in securing markets, balancing supply, minimizing hauling costs or in negotiating prices and in improving federal order performance may net all producers many cents in terms of producer net blend prices. Yet, these are the very factors which must be recognized in updating federal order programs. Differences between prices received by those who perform the services that benefit all, and the prices paid those who perform no appreciable services, may be great. So



great, in fact, that producers can be tempted to withdraw or rival cooperatives not directly concerned with any particular market problem may disrupt and/or possibly destroy the effectiveness of the collective efforts of those attempting to maintain an efficient and effective marketing system.

## PART II

### ECONOMICS INVOLVED IN MARKETWIDE SERVICE PAYMENTS

Historically, it has been a relatively simple matter to identify "field service" and "check testing" programs and for market administrators to "set aside" from the producer settlement pool enough money to cover these costs and to pay out these monies to organizations qualified to receive them. But the benefits all producers receive from cooperative leadership in price negotiation, economic analysis and market management has not generally been recognized in federal orders.

#### Producer Equities

Cooperative organizations, who represent the majorities necessary to maintain federal orders, contend that their actions in establishing the price, servicing diversified needs of handlers, moving milk from low value to high value uses, and removing unwanted surpluses is a marketwide service they are forced to perform. They point out that all producers share in the resultant higher blend prices, in more stable market conditions. They maintain that federal order programs should be modified to take into account changes in the structure of the marketing system. They contend regulations should prevent the disruption of marketing by dealing with the question of marketwide services. Proponents of this position maintain the Secretary of Agriculture already has this authority.

A resume of some statutory authority for such a conclusion is found in Part I of this report. However, an examination of federal order hearing records have been generally limited to cost figures such as the pay for persons engaged in economic analysis or in field and laboratory services, in

traffic controls or in plant operations. This is too narrow a concept because economic benefits are not measured by, or proportionate to, these costs. Neither do costs require sharing of economic losses; nor do they measure the economic consequences of not maintaining minimum prices, and/or an efficient system of marketing. Costs are only a small part of maintaining programs consistent with the objectives of Congress and federal orders.

Furthermore, the aggregate cost of operating a comprehensive marketing and service program is substantial. Yet, the expenditures for payrolls, expertise and management personnel may be small compared to producer benefits. It was pointed out that a fraction of a cent paid in securing markets, balancing supply, minimizing hauling costs or in negotiating prices and in improving federal order performance may net all producers many cents in terms of producer net blend price. It cannot be denied that so long as disparities in costs and price benefits exist and so long as individual producers, handlers, or associations assume different responsibilities and/or are disadvantaged by the economies involved, a potentially unstable situation is created. Economic conflicts between those who pay for comprehensive marketing programs and those who benefit without sharing equally in the costs and risks can destroy otherwise sound marketing procedures. Within competing groups the issues are what payments should be for, how much, and who should share the incidence of costs and benefits. These questions directly relate to the marketing programs of cooperatives and the structure of markets being serviced.

#### BACKGROUND OF DYNAMICS

Market service programs of cooperatives have traditionally developed three specialized areas: (1) market management, including the economics

of bargaining, the price and terms of sale, financing and operations and information services for members; (2) central testing and quality control laboratories; and (3) field services and membership relations. Accounts generally identified the components and personnel in the laboratory and field services for budgeting purposes, but the category of market management and operations was considered as general overhead. Prior to World War II, except for guaranteeing producer payments, most cooperatives took little responsibility toward balancing the supply and demand, and assumed only nominal responsibility for the disposal of market surpluses. Characteristically, cooperatives provided highly visible individual member services, but assumed relatively little risk. During the 1950's and especially in the late 1960's this situation changed as more and more responsibility for marketing shifted. New institutional and competitive structures emerged.

#### Technological Changes Shift Marketing Risks

In the 1970's it will no longer be practical to view fluid milk marketing and federal orders within the economic and institutional framework of the past. Milk marketing has already undergone a technological revolution in processing and distribution. Plants have become increasingly specialized, larger and more selective buyers. The processors demand milk when and where they want it and in the amounts to meet changing customer needs. Retail food chains, through centralized buying and private label contracts, and through their operation of integrated systems, are a relatively new and centralized dimension in marketing. Also, the emergence of large regional cooperatives within the last 5 years has for the first time in the history of the U.S. provided farmers with a vehicle for improving the organization and structure

of marketing on a coordinate basis. The legal, economic and institutional framework in which marketing and competitive prices converge involves wider and wider geographic areas.

Besides the internal market-by-market problems, economic pressures for inter-regional and even national market sharing are breaking down the traditional ways of doing business. Cooperative marketing associations have increasingly taken full responsibility for all fluid milk surpluses in extended market areas. Thus, buyers no longer are obligated to receive milk from all shippers on a continuous basis. Instead, many buy their supply on an f.o.b. or plant delivery basis and receive only the milk they need to meet day by day and weekly sales. The responsibility for matching the supply with fluctuating sales rests primarily with the major producer cooperatives. Costs of cooling, storage, rehandling and marketing of both short time and longer time surpluses are variable and may be very expensive. Universally, nonmembers are also beneficiaries without sharing either the responsibility for balancing the markets, or the related costs.

#### Economic Impacts

In order to reduce costs and improve pricing efficiency, cooperative associations have worked independently and through federations. They have (1) negotiated prices above federal order minimums, (2) undertaken programs to coordinate market movements, and (3) expanded marketing services, and (4) supported product improvements and market promotions. The consequence has been that responsibilities for total marketing programs that once rested with milk processor-buyers have been largely transferred to producers and especially to cooperatives who have assumed leadership. Excess supplies that

in earlier years were handled by processors are now forced backwards and into the hands of cooperatives to make whatever disposal is most feasible. Furthermore, the amount of surplus to be managed by the fluid milk cooperatives has expanded: (1) by rapid conversions from manufacturing to fluid grade milk, (2) by contractions and centralization in the manufacturing industry, (3) by high mobility and changes in procurement for specialized uses.

Moreover, the availability of supplies, economies in processing and distribution are now such that handlers tend to be concerned with plant efficiencies rather than with procurement. The demand of buyers includes services as well as raw materials, while at the same time avoiding risks in handling unwanted surpluses. The economies involved are subtle and complex and well beyond the reach of individual producers.

### PART III

#### COOPERATIVE SERVICES PROGRAMS

A survey of 19 major milk marketing cooperatives in the central and southeastern United States in 1971 showed that almost universally the cooperatives provided complete marketing programs for their members. Besides bargaining for prices and terms of sale, the cooperatives supported advertising and promotion, paid for the field services, maintained laboratory and quality control programs, kept the records, paid their members, supervised bulk tank and farm collections, coordinated supply movements and paid for the transportation and disposal of market surpluses. Some organizations also handled outside and irregular orders, split loads, allowed shrinkage, standardized butterfat and provided other special services.

Besides the mechanics of providing members with comprehensive farms to market service programs, almost all cooperatives negotiate prices, maintain central offices and operate comprehensive marketing and management programs. Some cooperatives have developed market service charges to processor-buyers on the basis of the service rendered. Others have no specific program. The cost of providing marketing services can be very expensive or nominal depending upon the circumstances. Likewise, the cost of providing market management, handling facilities and price negotiations can be high or low depending upon the scope of the programs. The fact remains that not all producers and not all handlers receive equal benefits or share equally in the costs.

#### Some of Operational Realities That Cost Cooperatives

One of the problems when one attempts to define service charges is

that accounting must deal with gross figures and in some way allocate highly variable and perhaps fixed and overhead costs. A second problem is that many factors such as risk, market coordination, and non-routine managerial functions in price negotiations and federal order or other regulatory matters tend to defy quantification.

### Studying the Problem

Nevertheless, a committee studying the problem feels that an enumeration might suggest areas for a possible consensus or in some cases provide items where accountants could give supporting data. The following is a suggested point of departure.<sup>1/</sup>

#### I. Some of the Costs Transferred

Full Supply Contracts - the association becomes the only supplier of milk. Its obligations include:

##### 1. Delivery of milk, to specifications

##### A. Any and all requirements for Class I

- (1) Make dairy weekly delivery schedules to coordinate with buyer processing and distribution schedules.
- (2) On notice divert any and all milk not wanted to whatever market can be found.
- (3) Assure the buyer that the quality, temperature and handling will conform to health standards.
  - (a) Farm weights and tests
  - (b) Maintaining producer records, individually
  - (c) Laboratory quality analyses

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<sup>1/</sup>"Milk Marketing Services and Class I Price Alignment Considerations," A report to the Directors of Great Lakes-Southern Milk, Inc. Professors Carley, Jacobson, McBride and Roberts. Reproduced at Department of Agricultural Economics, Michigan State University, East Lansing, Michigan, August 1971, pp. 18-19.



- (d) School and train truckers, be responsible for their errors, affecting milk delivered, including off flavors.
  - (e) Pay truckers and deal with member relations, rates, services, etc.
- (4) Be responsible for shrink and "overages"
- (5) Pay producers - keep records - absorb all risk in delivery, finance, and collection and dispersement of funds.
- B. Handle the surplus and diversion operations for members and nonmembers situations.\* The problem is generated by the following factors:
- (1) Gain or loss of handler accounts
  - (2) Delivery schedule variations, daily and weekend to conform to handler requirements.
  - (3) Transport delays, weather, and other causes.
  - (4) Displacement losses to outside suppliers of bottled and/or bulk products.
- C. Assume risk burdens -- the cooperatives who negotiate the terms of trade, for markets assume possible marketwide loss.
- (1) If Class III prices are set to limit profits in manufacturing and operating losses result, the pressures mount to force the cooperative handling in unfavorable general market situations.
  - (2) If favorable profit situations develop, the handlers may want to take all available milk and manufacture and/or pass milk through to take advantage of margins of premium paid to get milk by other manufacturers. If cooperatives can show they handle only the loss end and displace handlers on the "up markets", they in practice assume more than pro-rata the risk.

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\*Plants with both member and nonmember milk favor the nonmember segment - force the cooperative to handle the surplus generated by both groups - there is no pro-rate.

## II. Some Cost for Expansion and Market Stability

Efforts to stabilize markets, increase consumption and limit price cutting and improve market efficiency have led cooperatives into added costs and expenditures not shared by all producers - some of this noteworthy is:

1. A. Operation of facilities on a standby basis to be used only when alternatives are not available. Provides an alternative.
- B. Pay to standby pool.
- C. Maintain price alignment.
- D. Coordinate trans-shipments from nearest points. This saves pressure of supply on nearest market, saves hauling, saves rehandling. Coordination and allocation of available supplies to the highest alternative use has widespread and important price effects from which all producers benefit.
- E. Bargain for and administer the agreed upon terms of trade.
- F. Control supplies -- help
2. Pay for advertising and furnish handlers with promotion materials. Promote dairy industry: through UDIA, ADA, Dairy Council, DRINC, etc.

Almost all of the cost of the services just noted under I and all of the operations listed under II contain elements of economic importance from which all producers stand to benefit. But in practice, not all individual cases share costs and benefits equally. Not all are alike in structure and resources.

### The Problem of Costing Service Charges

An analysis of the information secured from the survey schedules clearly points up the existing problems as well as the attitudes of managers with respect to market services. As extremes, some associations seem to have a non-aggressive policy, minimal operational expenses and perform

routine services at relatively low cost.<sup>1/</sup> In contrast, there are other associations whose programs are extensive, whose management is aggressive and leadership is strongly felt in local bargaining and in agricultural policy nationally. Time, effort and money spent by the cooperative leadership covering the interest of all dairymen is substantial. It has a different aspect than the routine of local field service activities. In fact, the dollars spent by some members of GLSM in support of expanding markets and supply management alone are several times that required by field services which was once their primary role.

For example, information from the survey schedules suggests that field services and laboratory services which are done by associations to maintain standards of quality in the product delivered to handlers may be in the neighborhood of 3 to 4 cents per hundredweight. But that special services such as maintaining daily, weekly schedules, involve storage and/or diversions may cost three to five times that amount depending on the volume and the competitive situations. Expenses in operating such programs as A.D.A., dairy promotion, research and the like for some GLSM, such as D.I., are more than double the cost of field services. Marketing services that require diversions and supplemental hauling in balancing supplies to keep the surplus pressures off of local handlers may again cost individual associations very substantial amounts, much more than is generally recognized.

The information secured by the committee suggests that the problems in handling supply variations, and surplus disposal differ within the GLSM membership but that the larger, more aggressive associations assume the

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<sup>1/</sup>A report to the Board of Directors, Great Lakes-Southern Milk, Inc., Ibid., p. 13.

leadership. Included in the beneficiaries are low cost cooperative membership in Great Lakes-Southern Milk, Inc., as well as nonmembers. The managers surveyed were well aware of the need for some method of equalizing marketing costs among all who benefit, but there were differences of opinion as to whether the payments should be through negotiation or through regulation. The following summary taken from the study committee report sets out the kinds of concerns managers had.

Handling of Service Charges:

Generally, managers agreed that service charges could best be handled by direct price negotiations rather than through market regulations. A listing of the reasons for agreeing with a direct price negotiation policy follows.

1. Have tried but can't get service charges built into orders; not permitted under present Federal legislation.
2. With changing market conditions, couldn't get changes made in orders quick enough - too much lag.
3. Regulations can't compensate for differences among markets, distances and timing.
4. Leaves control with cooperatives.
5. Orders can't accommodate changing market conditions.
6. Price negotiation policy good as long as have premiums.

There was disagreement expressed with direct price negotiations. The main idea stated was that cooperative payments within orders would be more ideal as everyone would be on equal terms. Such a method would also solve the nonmember problem as all producers would be sharing in the costs. In order to insure that the costs of services to handlers can be recovered it was suggested that a price negotiation policy should be backed up by cooperative payments written in the orders. Also, whatever policy is followed depends on the policies being followed by other cooperatives.

The implications of the responses to the question of how best to handle service charges may be that managers could go along with cooperative payments in orders if they

could be made workable but under the present situation this is an impossible undertaking. Therefore, it is best to handle service charges by direct price negotiation.

Should service charges be an "add on" to the announced prices of GLSM or are such charges a matter of internal cooperative accounting and of no concern to the determination of raw product prices, were two other questions asked managers. There was a clear-cut agreement, though not unanimous, that service charges should be added on and were of considerable concern in the determination of establishing the price of milk. Managers indicated that add-on charges give a clear-cut picture of prices, this is the only way to recover service costs, and cooperatives should follow the policy in order to eliminate the disparity in prices among cooperatives using the add-on policy and some not using it.

Caution concerning add-on charges was expressed because of the lack of a way to handle the nonmembers. Some managers thought an add-on policy would encourage handlers to seek more supplies from nonmembers. One of the major problems appeared to be the fact that the "bundle" of services provided handlers varies so much among GLSM cooperatives that an add-on policy would be difficult to establish.

Analysis of the questions concerning the handling of service charges is a reflection of the differences in opinions based on existing marketing conditions and established relationships with handlers. The question becomes one of how do the cooperatives move from the present rather diversified method of handling service charges to one of a uniform acceptable policy, or, more basically, should the policy be uniform.<sup>1/</sup>

One possible way would be to measure the value of market services that benefit all producers and to incorporate these services and risks in such a way that all producers and all handlers share equally. The technique would

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<sup>1/</sup> A Report to the Board of Directors, Great Lakes-Southern Milk, Inc., op.cit., pp. 17-18.

require equalization of benefits as well as payments or reimbursements on the basis of services rendered. The mechanics would be to identify specific services to conform to market areas. The precedent has been set as has been noted in various sections of this report.

## SUMMARY APPRAISAL

This paper summarizes the basic statutory authority for market controls in the development of marketing agreements and orders. It deals with the economics and rationale for "market service deductions" and for "cooperative payments" under federal orders and with a survey and condensed analysis of market services prevailing among milk marketing cooperatives in the central and southeastern regions of the United States.

Analysis of various statutes and federal order programs shows deductions from marketwide pool funds and payments for specified market services have been made for many years. From its legislative and economic justifications, and from evidence cited there remains little doubt that the Secretary of Agriculture, under powers granted by Congress and tested in the courts, has the authority to establish and enforce compliance with payments for services that benefit all producers alike. The precedent set by "market service deductions" in most federal orders and by "cooperative payments" under the New York-New Jersey order are cost oriented. An implied presumption is that equitable sharing of the cost of providing specified services also results in equitable distribution of the resulting economic benefits. This is not necessarily the case.

Cooperative organizations, who represent the producer majorities necessary to maintain federal orders, contend that their actions in establishing price structures, servicing diversified needs of handlers, moving milk from low value to high value uses, and removing unwanted surpluses to maintain the

integrity of prices is a marketwide service in which all milk producers are the beneficiaries. They further contend that the "market service deductions" made in most federal orders and the "cooperative payments" allowed under the New York-New Jersey orders are too limiting. In fact, economic benefits are not measured by, or proportionate to shares of payroll or operational costs.

An examination of federal order hearing records show that marketwide service allowances are based on estimates of absolute pay for time for persons in economic analyses and the cost of field services or plant costs. These costs are minimal and may be insignificant when compared to producer benefits. A fraction of a cent paid in securing markets, balancing supply, minimizing hauling costs or in negotiating prices may return all producers many cents in terms of net blend prices. Neither the cost of management, nor the blend price computed under an order, indicates the economic consequences of the alternative, i.e., the consequences of not having the order system at all.

Without question the majority of dairymen through their cooperative organizations have supported marketing agreements and orders because they believed the order regulations were the best approach to stabilizing markets and improving the economic welfare of dairy farmers. But, more and more of the marketing services that once rested with processor-buyers and distributors have been transferred to producers and especially to cooperatives who have assumed leadership. Buyers no longer are obligated to receive milk from all shippers on a continuous basis. Instead, they buy their supply on an f.o.b. plant delivery basis and receive milk as needed to meet day by day and weekly sales. Matching the supply with fluctuating sales rests primarily with the major producer cooperatives. Universally, nonmembers are also beneficiaries without sharing total market responsibilities. In this connection the



cooperative organization provides the leadership for developing, proposing, sustaining and implementing programs under the Marketing Agreements and Agricultural Adjustment Acts.

But the role and authority of cooperatives to conduct business for dairymen has been challenged step by step. Litigation with respect to establishing the rights of cooperatives with respect to marketing fluid milk have been numerous and subject to almost continuous adjudication. Nevertheless, court tests have settled a number of important issues such as: (1) cooperative right of contract with its members; (2) the question of authority of cooperatives in block voting and on various referendum procedures; (3) the rights of cooperatives in marketing members' milk and in the distribution and reblending proceeds from sales. Also, the Supreme Court in a decision in April of 1956 affirmed the right of cooperatives to receive payments for services rendered and to assess nonmembers as well as members to cover those which were shown in the interest of all producers. But the responsibilities of nonmembers or cooperative minorities, who do not choose to support the efforts of majorities to improve on price and marketing efficiencies as outlined in the various acts previously noted, are not clear-cut.

Among some critical questions yet to be answered are: (1) What rights do cooperatives have with respect to self-help and in contracts setting forth the terms and conditions of sales? (2) Once favorable prices and market conditions have been established by major cooperatives, do non-participating individuals and/or organized minorities have different rights, i.e., are they free to undercut and destroy the efforts of the majority? (3) Where qualified cooperatives assume major responsibilities for services that are in the interest of all producers in a market, what rights do they

have with respect to payments for the benefit accrued to all? For example, the management of the supply and the disposal of surplus from a common market benefits nonmembers and minorities as much or more than it benefits those providing aggressive leadership.

If the intent of Congress is one to encourage cooperatives to initiate self-help, to work toward increased efficiency in marketing, engage in product development, demand creation and cost reductions, these efforts must not be thwarted by undue administrative restraints or by contradictions through surveillance under antitrust and federal trade commission authorities. The litigations and controversies as applied to milk regulations stem from enabling acts and legal remedies provided by Congress and state legislative bodies. Nevertheless, there are numerous administrative agencies responsible for rule-making, adjudication and enforcement. Differences in philosophy and the economic and political climate of the times can have an important bearing on both statutory and administrative remedies. Among the foremost contemporary problems are questions of producer equities and the status of cooperative payments as originally conceived. With the emergence of new market structures, the growth of large dairy corporations, and better coordination and stronger bargaining posture of consolidated and merged cooperatives have resulted in negotiated class I milk prices higher than the minimum of federal orders. Cooperatives that have taken the initiative in establishing the higher prices are constantly facing defeat by handlers and producer groups who are uncooperative and/or operate outside order provisions. Especially disturbing is the inability of major cooperatives to equalize the costs involved. Not the least of these is the

cost of servicing specialized milk plants and the cost of managing supplies and diverting surpluses that otherwise would depress the price of all producers. The question has been raised as to whether or not the initiation of "cooperative payments" could be extended and used under federal orders.

Conceivably, the majority of producers who voted federal orders into effect could vote them out. Under present economic and competitive structures this would be a questionable solution. Other alternatives would include: (1) to change basic legislation, (2) liberalize the interpretation of federal orders by redefining marketing functions and concepts, (3) engage in and strengthen marketing programs through strong collective bargaining, and (4) work within the present economic and legal framework and use each alternative in such a way as to achieve the equity and stability desired by all and authorized by Congress.

In this connection numerous statutes and court records show the congressional intent to maintain viable cooperatives as a part of the competitive system. Certainly there was no intent to place them at a disadvantage. Moreover, the Secretary of Agriculture, in the News for Farmer Cooperatives in December of 1972, noting a number of specific responsibilities of his office to cooperatives under laws stated, "The Department shall maintain its policy of carrying out both the spirit and intent of these laws and offer maximum encouragement to cooperatives as a means of improving farmers' income and developing rural America." Among the responsibilities referred to were those of the marketing agreements and order programs. Within this, of public policy and from the evidence cited in this study there remains little doubt that the Secretary of Agriculture, under powers granted by Congress and

tested in the courts, has the authority to establish and enforce compliance with payments for marketwide services. The problem is to find a workable and acceptable technique for equitably allocating benefits between those who do and those who do not share equally in the responsibility for operating comprehensive marketing and service programs.