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Early Development of Milk Marketing Plans

in the KANSAS CITY, MISSOURI, AREA

MAY 1952



Marketing Research Report No. 14

United States Department of Agriculture
Production and Marketing Administration
Dairy Branch

Washington, D. C.

P R E F A C E

This report is based on one of a series of studies of the operation of Federal milk marketing programs in different fluid milk markets of the country. These studies have been made by the Research Division of the Dairy Branch, Production and Marketing Administration, U. S. Department of Agriculture.

The author had the cooperation of Max M. Morehouse, Federal Milk Market Administrator in the Kansas City marketing area, in making the study of this market. Other persons who were connected with the Kansas City market during the period under study, either as representatives of the U. S. Department of Agriculture or of the Pure Milk Producers Association, contributed information and suggestions on various aspects of the report.

Previous reports in the series dealt with milk marketing in Philadelphia, St. Louis, Duluth-Superior, and Minneapolis-St. Paul. Each report has emphasized some aspect of milk marketing that is characteristic of the respective market. The present report on the Kansas City, Mo., milk market covers the period from early 1930 to 1936. During those years the milk industry of Kansas City and the Federal Government, independently or together, were attempting to stabilize the milk-marketing process. The period comprised the formative years for Federal regulation of milk marketing.

The record of events in Kansas City throws a spotlight on major milk-marketing problems which led to the Agricultural Marketing Agreement Act. Some of these problems were answered by decisions made during this period with respect to the role of local industry; freedom of entry for new producers; fixing of resale prices; and treatment of producer-distributors, but the answers are not irrevocable and questions on these matters are revived from time to time. For this reason it appeared worth while to make this case study of a city milk market for the period when the problems were first dealt with under Federal regulation.

The marketing plans which were tried in Kansas City during the 1930 to 1936 period used various combinations of use classification, auditing, pooling, base-rating, and other fundamental and accessory devices employed in today's markets. A study of the experience in this market contributes to a better understanding of milk marketing devices and practices.

The study on which this report is based was conducted under authority of the Research and Marketing Act of 1946.

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Adverse economic conditions during the early 1930's led to efforts by the dairy industry of Kansas City, Mo., and by the Federal Government to devise plans looking toward the stabilization of milk prices and the promotion of more orderly marketing of milk in the area. These efforts included: (1) An industry marketing agreement, developed by Dr. Clyde L. King as an outgrowth of an arbitration award, effective in January 1931; (2) a Federal license which regulated the market beginning in April 1934; (3) various industry agreements which supplemented the license program; and (4) a marketing plan under an industry agreement which superseded the license after March 1, 1936.

The King Agreement suffered from several weaknesses, the most serious being: (1) Failure to provide some form of equalization of payments for distributors in conjunction with a classified price plan of payment; (2) failure to provide an effective means of administration; and (3) lack of adequate safeguards from a public interest standpoint. Worsening economic conditions in 1933 led to a breakdown of the marketing plan under the King Agreement and a request for Federal regulation under the Agricultural Adjustment Act.

License No. 40 was issued by the Secretary of Agriculture and regulated the marketing of milk in the Kansas City, Mo., area beginning April 1, 1934. The operation of the license was handicapped by legal difficulties and by the magnitude of the emergency situation in milk markets throughout the country with which the Department was called upon to deal. A number of industry agreements were made which modified the pricing and other provisions of the license. In March 1936 a complete marketing agreement was developed out of negotiations between the producers' association and distributors in the market with the assistance of the Department's field representative.

Among the benefits under License No. 40 were: (1) It provided the first effective milk-marketing plan in the Kansas City area; (2) it provided a means of impartial administration with adequate audits of distributor reports; (3) the marketing plan materially improved the returns of producers; (4) the license provided protection to producers by checking weights and tests of milk; (5) it put all distributors on a clearly understood competitive basis in the purchase of milk; and (6) the license operation provided the industry and the Department with data which later proved valuable in the operation of Federal milk-marketing orders.

The most serious shortcomings of the license operation were: (1) The principle of equality of payment to producers was not achieved because of the type of base-rating plan; (2) the license was not sufficiently flexible as an instrument for assuring an adequate and well-distributed supply of

milk in the market; (3) failure to develop a public hearing procedure; (4) failure to base departmental decisions on sufficient economic analyses; and (5) weakness of enforcement authority which led to an over dependence on voluntary cooperation.

Some of the policy decisions made by the Department of Agriculture during the license period which affected later regulatory operations were: (1) The abandonment of resale price fixing; (2) opening the market to new producers; (3) exemption of producer-distributors from regulation; and (4) acceptance temporarily of industry agreements.

The industry agreements in the Kansas City milk market helped to bridge the gap in Federal milk marketing regulation during the period when enforcement of Government programs was not yet confirmed by the courts. Operation of these agreements involved several features which were questionable from a public interest standpoint, among them being: (1) Provisions limiting the entry of new producers; (2) special pricing of milk as a means of eliminating a particular type of competition; and (3) efforts to adjust resale prices simultaneously with bargaining agreements on producer prices.

An experimental policy whereby the Department, through its field representative, encouraged the industry in Kansas City to reach agreement on major issues prior to a public hearing had certain advantages during the period of legal uncertainty with respect to Federal regulation. It tended, however, to restrict the factual testimony at public hearings and, if continued, it would have relegated the Secretary of Agriculture to a passive role in the issuance of regulations.

EARLY DEVELOPMENT OF MILK MARKETING PLANS IN THE KANSAS CITY, MO., AREA

By Edmond S. Harris

I. THE KANSAS CITY MILK MARKET PRIOR TO FEDERAL REGULATION

The Marketing Area

The Kansas City, Mo., marketing area, as defined in the amended milk-marketing license (July 1, 1935), consisted of the territory within the corporate limits of Kansas City, Mo. The earlier forms of the license had included not only Kansas City, Kans., but also North Kansas City and Independence, Mo., as well as numerous outlying townships in the surrounding area in both Kansas and Missouri. Partly because of marked differences in health regulations and partly because of competitive factors which existed at the time, it was not feasible to combine the two Kansas Cities under a single marketing plan. The only effective regulation with any degree of continuity during the period under study operated within the corporate limits of Kansas City, Mo.

Kansas City, Mo., is situated on the Missouri River at the mouth of the Kansas River. Its population at the time of the license was probably a little less than 400,000. The official United States Census figure for 1930 was 399,746, and for 1940 the figure was 399,178.

Kansas City, Mo., serves one of the important agricultural areas of the country. It is a leading market for livestock, wheat, and other agricultural products of the Southwest. Meat packing, flour milling, and other food processing operations as well as lumber manufacturing are among the important industries in the city. Farm machinery and equipment and other metal products are also manufactured. In addition, Kansas City is a railway center which is served by numerous trunk lines connecting it with other parts of the country.

In 1934, the Kansas City milk market was served by 14 distributors of pasteurized milk who received milk from about 1,300 producers in the surrounding area. The milk sold by these distributors accounted for about one-half of the milk consumed in the market. The other half was supplied by about 335 producers who distributed their own milk, unpasteurized, either directly to consumers or to retail stores and restaurants in the market.

The Pure Milk Producers Association was, and is, the major organization of producers in the market. After the license was adopted, another organization known as the Bates County Producers' Association was incorporated under the Missouri Cooperative Law. This was an outgrowth of an association which had existed prior to the license under the name of the Bates County Dairy Improvement Association. The two producer organizations were of the bargaining type, neither of them owning

facilities for the manufacture of milk products or for the distribution of milk and cream in fluid form. Together the members of these organizations supplied about 91 percent of the milk sold to distributors of pasteurized milk in the market.

The distributors of pasteurized milk, with one or two exceptions, belonged to an organization called the Milk Service Association. This association, among its other functions, acted as a representative of distributors in collective bargaining with the producers' organizations. An organization called Independent Dairies represented the interests of the producer-distributors operating in the Kansas City market. Another organization which played an important part in the market prior to the license was the Consumers' League. This organization was made up of civic minded individuals who worked for many years to improve the quality of milk in the market. The semi-official status of the league had been recognized by the Health Department and by the industry but its importance was on the wane during the early 1930's and it disbanded soon after the license was issued.

The sanitary regulations with respect to milk were carried on under a city official, the Director of Public Health. Each of the larger distributors was required to employ at least one fieldman who had the status of a deputy inspector. The smaller distributors were permitted to join together for the employment of such fieldmen. These men inspected dairy farms about four times a year to check on basic equipment and to advise on improvement of milk quality. Frequent platform inspection was made of each producer's milk on arrival at the plants. The determination of bacteria counts at such times largely determined whether special farm inspections would be made by employees of the Director of Public Health. All cattle were required to be tested for tuberculosis. Pasteurization was not a requirement for milk distributed in the market.

The Supply Area

The supply area for the Kansas City, Mo., milk market extends largely to the south and east of the city. Considerable numbers of producers, however, are located to the west of Kansas City in the State of Kansas as shown in figure 1. About three-fourths of the producers were located in Jackson, Cass, and Bates Counties in Missouri and in Johnson County, Kansas. A percentage breakdown of milk production for 1936, by counties, was as follows: 1/

1/ Data supplied by Market Administrator.

<u>Missouri</u>	<u>Percent</u>	<u>Kansas</u>	<u>Percent</u>
County:		County:	
Jackson	32.5	Johnson	13.5
Cass	21.0	Douglas	3.9
Bates	12.4	Miami	2.5
Johnson	6.5	Wyandotte . . .	1.6
Clay	3.0	Franklin	0.3
St. Clair	0.9		
Ray	0.9		
Platte	0.6		
Henry	0.3		
Lafayette	0.1		
Total	78.2		21.8

Some of the largest dairy farms were located within 10 miles of the city limits especially to the south and west of the city and approximately half the city's total milk supply came from that area. About 90 percent of the producer-distributors who were operating at the time of the license were located there.

The entire supply area for the Kansas City, Mo., market lies in an agricultural region which the U. S. Department of Agriculture has designated as the Feed-Grains and Livestock Region. This is the well known Corn Belt of the United States where the deep fertile soils, sufficient rainfall, and the hot days and warm nights during the growing season combine to create conditions ideal for the growing of corn.

The counties in the supply area are in two rather distinct subregions. The 5 Kansas counties, as well as Cass, Bates, and Johnson counties in Missouri, are all in a subregion where livestock, cash grain, and dairy farming are the major agricultural pursuits. The northern tier of counties in the Missouri part of the supply area is in the central Missouri River Valley subregion, where cattle feeding and the raising of hogs are the predominant agricultural interests.

The cattle-feeding and hog subregion coincides closely with the loessal or wind-blown soil areas bordering the Missouri and Mississippi rivers. Most of the land is characteristically rolling so that much of it can be used only for permanent pasture. Cropland is good enough to produce good yields of corn and soybeans but requires careful soil management because of the slope of the land and its susceptibility to erosion. Hogs have first call on the corn crop because of the physical efficiency with which they convert concentrated feeds into meat. There is, however, a considerable surplus of corn produced which can be utilized in conjunction with normally abundant supplies of hay and good pasture for cattle feeding. Under normal conditions, beef cattle are usually preferred to dairy cattle because the former are able to make use of more grain in proportion to roughage.

The counties in the livestock, cash grain, and dairy subregion have somewhat less favorable conditions for the growing of corn. The farmers

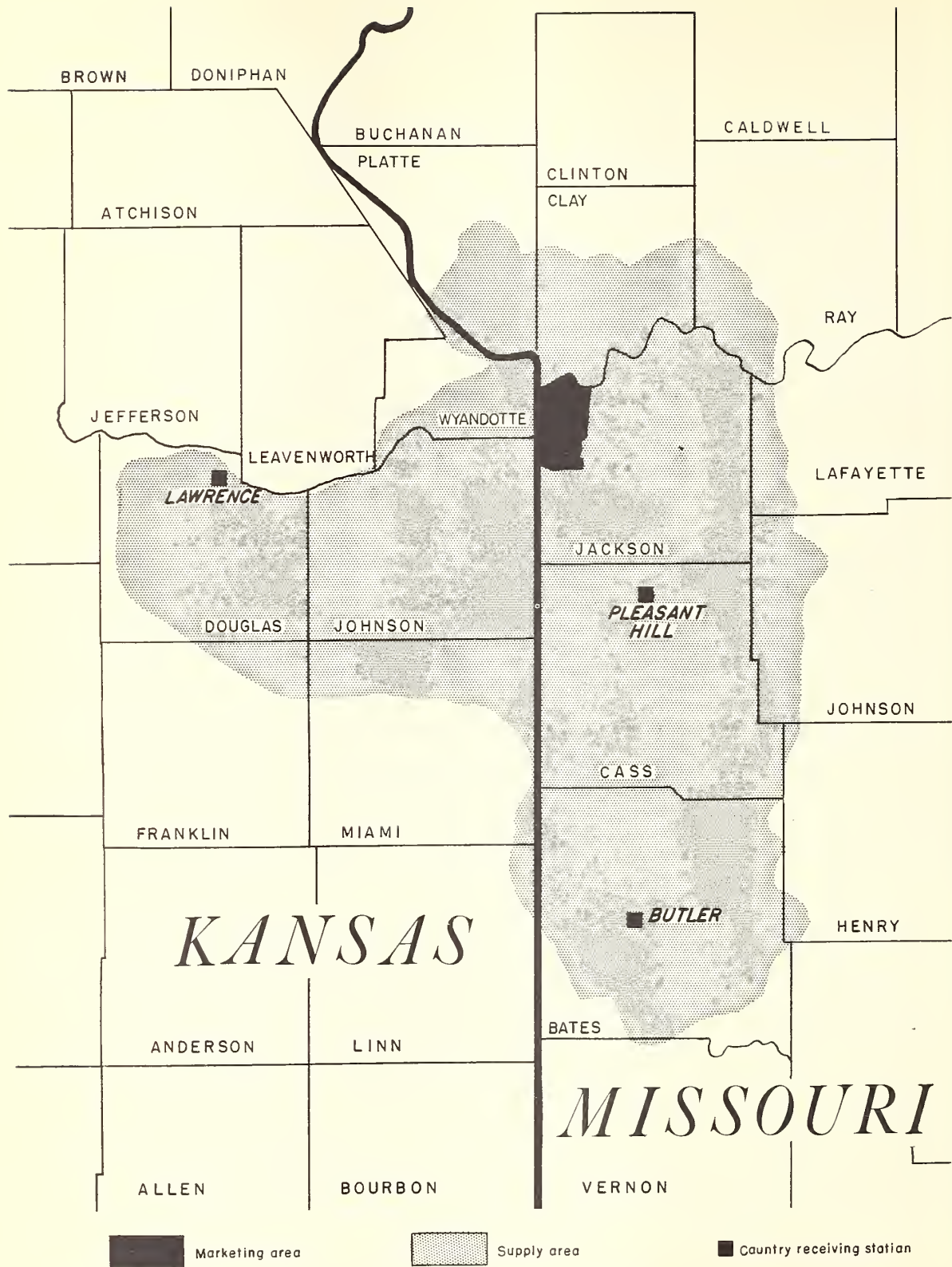


Figure 1--Kansas City, Mo., Milk Marketing Area and Supply Area, 1935.

in these counties usually produce larger crops of hay in comparison with corn, grain sorghums, and wheat. The somewhat poorer soils in this sub-region are a factor in the greater emphasis on livestock and dairy farming. These enterprises are necessary to maintain and improve the soil as well as to utilize the hay and pasture. 2/

Throughout the supply area and adjacent areas, a considerable surplus of milk over the requirements for local consumption is normally produced. Except for the area very close to the city limits, however, relatively few specialized dairy farms are found. This was the case especially during the license period. The majority of producers, supplying the distributors of pasteurized milk, carried on milk production as a farm operation of importance secondary to the feeding of hogs or cattle. 3/

A number of plants with facilities for the manufacture of ice cream, cheese, butter, and evaporated milk are within or close to the supply area. These plants provide an outlet for milk produced for the Kansas City market, but which cannot be sold in fluid form, and an alternative market to which local producers may shift, if the price relationship should become sufficiently attractive. The producers supplying these plants are also a potential source of supply for the Kansas City fluid milk market. If the difference in prices for fluid and manufactured milk should become sufficiently great, some of these producers would be induced to equip their farms to meet the quality standards set up by the Kansas City health authorities.

According to the Market Administrator, the two plants which exercised the greatest influence in establishing the price for manufactured milk in the Kansas City market were those at Tonganoxie, Kans., and at Kansas City, Kans. The first of these, owned by the Franklin Ice Cream Company, was engaged mainly in the manufacture of ice cream mix and condensed milk for use in ice cream making. It was located about 25 miles west of Kansas City, Mo. The Kansas City, Kans., plant was a cooperative known as the Milk Producers Marketing Company. It was a cheese factory which also supplied cream to ice cream manufacturers and to distributors in Kansas City, Kans. It also had contracts for the disposal of skim milk to packing houses. 4/

Three country receiving stations were operating in the supply area during the license period. One of these was at Pleasant Hill, Mo., about 35 miles southeast of Kansas City, and the other was at Butler, Mo., 65 miles south of Kansas City. The plant at Pleasant Hill also had facilities for the condensing of surplus milk. A third plant, at Lawrence, Kans.,

2/ Generalized Types of Farming in the United States. U. S. Dept. of Agr., February 1950. p. 6.

3/ Economic Brief with Respect to the Proposed Milk Marketing Agreement and Proposed Order for the Kansas City, Mo., Marketing Area. By P. M. Miller and H. L. Forest, U. S. Dept. of Agr., April 1936. p. 47.

4/ Reports of the Market Administrator for the period July 1935 to June 1936, and for the period July 1936 to June 1937.

ceased operations in the fall of 1934 as a receiving plant for producers supplying the Kansas City market.

All the milk produced for the Kansas City, Mo., market was transported to the market by truck. According to the annual report of the Market Administrator, 58 routes were in operation between July 1935 and June 1936. Of these, 27 were operated to bring milk from the farms to the country receiving stations and 31 trucking routes carried milk from farms or country stations to the city plants of the distributors.

The Agricultural Adjustment Act

On July 18, 1933, a public hearing was held in Washington to consider a marketing agreement program to regulate the marketing of milk in the Kansas City, Mo., area. This hearing was called by the Secretary of Agriculture at the request of milk producers and milk distributors in the Kansas City market. The Secretary's authority for calling this hearing was provided by Congress in the Agricultural Adjustment Act which had as a primary objective the relief of "the existing national economic emergency by increasing agricultural purchasing power." Section 8, subsection (2) of the act provided that the Secretary of Agriculture, in his efforts to carry out this objective, shall have power: "To enter into marketing agreements with processors, associations of producers, and others engaged in the handling, in the current of interstate or foreign commerce of any agricultural commodity or product thereof, after due notice and opportunity for hearing to interested parties." It was further provided that such agreements would not be held in violation of antitrust laws.

In addition to the provision for marketing agreements, dairy products could be made subject to two other provisions for control under section 8 of the Agricultural Adjustment Act. One of these provisions authorized reductions in production through the use of voluntary arrangements with producers and by means of benefit payments to them. The other provision gave the Secretary of Agriculture the power to issue licenses to eliminate unfair marketing practices or charges. A license granted to a handler of a commodity could be suspended or revoked by the Secretary, after a hearing, because of violations of terms and conditions of the license. The use of his power to enter into agreements, to issue licenses, or to enter into arrangements for control of production was left to the discretion of the Secretary. He could, if he considered it would help to carry out the purposes of the act, resort to any combination of these powers to control the marketing of a commodity.

Transition from Free to Regulated Competition

The hearing held in July 1933 was a landmark in the history of milk marketing in the Kansas City area. For the first time the majority of milk producers and distributors were requesting Government action to protect their interests and were ready to acquiesce to some form of regulation of milk marketing.

The transition from characteristically "free" competition in the Kansas City milk market to regulated competition was not however a sudden one. Many changes had taken place over the years to modify competition in milk marketing. By 1933, neither the individual producer nor the individual dealer was in a position to compete freely with others in the sale or purchase of milk. The request for Federal regulation was preceded by a long history of attempts by organized dealers and organized producers to attain some measure of control over milk prices in the Kansas City market. During the years immediately before the hearing, producers and dealers tried to arrive at agreements to withstand the disorganizing effects of the economic depression upon the Kansas City milk market. The prior organization of producers and distributors into associations was an important step in modifying the earlier competitive processes.

Producers supplying milk for the Kansas City market were represented at the hearing in July 1933 by the Pure Milk Producers Association. This cooperative association, organized in 1929, had as its primary purpose the representation of its members in selling milk to Kansas City dealers. At the time of the hearing, the Pure Milk Producers Association claimed to represent about 1,200 of the 1,300 producers supplying proprietary distributors of milk in the Kansas City market.

Producer-distributors in the Kansas City market were represented by an association known as Independent Dairies. This association was reorganized in May 1932. It had, for about 20 years previously, operated under the name of the Kansas City Milk Producers' Association. At the time of the hearing, Independent Dairies represented about 150 producer-distributors on the Kansas City market. 5/

At the first hearing on Federal regulation all the pasteurizing distributors with two exceptions were represented by the Milk Service Association. One of the nonmembers was a small distributor in the market. The other was the Protected Milk Products Company which entered the Kansas City market on June 22, 1933, less than 30 days before the hearing.

The King Agreement

In 1930, producers and dealers in the Kansas City milk market called on Dr. Clyde L. King to "arbitrate" differences between them. Dr. King was, at that time, a professor at the University of Pennsylvania who had made a notable reputation as an arbitrator of milk disputes in many cities. Actually Dr. King was more than an arbitrator. He was an architect of industry agreements that went well beyond the immediate points in dispute. 6/

5/ Record of Public Hearing, July 18-19, 1933. Pages 54-55.

6/ It was undoubtedly due to this phase of his work that Dr. King was repeatedly sought out by producers and dealers. Following the passage of the Agricultural Adjustment Act, Dr. King was called to Washington as a consultant on milk marketing work and later was appointed Chief of the Dairy Section of the Agricultural Adjustment Administration.

Out of Dr. King's arbitration in Kansas City came an attempt at a kind of self-regulation on the part of the industry. An agreement was drawn up by Dr. King and accepted by the Pure Milk Producers Association and the distributors of Greater Kansas City. The basic agreement was accepted September 6, 1930. A buying plan and a schedule of prices to be paid to producers were later adopted to go into effect on January 1, 1931.

The King Agreement was to be administered in part by a service organization established by the dairy farmers and in part by a marketing committee composed of dealers and farmers. The functions of the farmers' service organization were carried out by the Pure Milk Producers Association. Agents of the association were to have free access to the plants of dealers for checking weights and tests of milk. The association was also to assist producers and dealers in maintaining and improving the city's milk supply.

The King Agreement provided for a marketing committee composed of three dealers and three farmers. This committee, which was to meet at least once every 2 weeks, was given broad although not very clearly defined authority for study and recommendation in connection with the agreement. Its duties were:

1. To recommend to individual dealers and to farmers such steps as will improve the market situation and stabilize market conditions
2. To make rules and regulations under which new shippers shall be admitted to the market
3. To outline a territory neither too large nor too small to supply this market permanently with a high quality of milk
4. To study trucking and receiving station costs and problems and to make recommendations thereon
5. To recommend the conditions, rules, and regulations under which producers must ship all or part of their surplus.

The philosophy of supply limitation is indicated under the second and third of the duties assigned to the marketing committee. This limitation was later to become one of the important points of dispute in the early period of Federal regulation.

The King Agreement provided a classified-price plan and a base-surplus plan of payment to producers. Each producer was allowed to make his own base for the calendar year 1931. This base was the average per day of his production for October through December, 1930 multiplied by the number of days in the current delivery period. The total of all bases was referred to in the agreement as the "basic" milk available for the market.

The classified price plan of payment adopted in the King Agreement provided for four classes of milk, as follows:

- Class I - fluid milk
- Class II - fluid cream
- Class III - manufactured milk equal to the remainder of the basic milk
- Class IV - all milk over basic milk

The classified price plan was not used (as it was later, under the Federal licenses and orders) to determine the cost of milk to the individual distributor. It was simply a device for arriving at uniform base and excess prices payable to all producers in the market. As no system of market-wide pooling or equalization among distributors was provided, the cost of milk to the individual distributor reflected the proportions of his producers' base deliveries to their deliveries of excess milk.

The class prices paid by handlers, for milk of 4-percent butterfat content, were as follows:

- Class I - \$2.78
- Class II - \$2.12
- Class III - 4 times 92-score Chicago butter (f.o.b. the farmer's gate)
- Class IV - 4 times 92-score Chicago butter (less hauling charges)

The butterfat differential, up or down from 4 percent, was to be submitted to Dr. King for further arbitration. Deductions for hauling were to be the actual contract price to the trucker. In the case of milk delivered to a country receiving station, the farmer would receive the Kansas City price less 35 cents per hundredweight at the plant. The uniform price of base milk was computed substantially as follows:

1. Class I and II prices were multiplied by the total number of hundredweight of milk sold as fluid milk and fluid cream, respectively, by all distributors in the market
2. The Class III price was multiplied by the remaining quantity of base milk delivered by producers during the period
3. The amounts of money computed in steps (1) and (2) above were added and divided by the total quantity of base milk delivered by producers.

The reader is referred to Appendix A for an illustration, in somewhat simplified form of the mechanics of computing prices under the marketing plan and the effect of different ratios of base deliveries upon distributors' costs.

The entire supply of basic milk was to be adjusted by the transfer of farmers among individual distributors, so that the proportion of each farmer's base which was sold as fluid milk would be approximately the same. This provision was an attempt to create an equitable situation among distributors much as the later license and order attempted to do through market-wide equalization. The failure to carry out this provision of the King Agreement had serious consequences (pages 13 and 82).

A check-off of 3 cents per hundredweight was to be paid by dealers to the association for milk supplied by its members. The King Agreement provided that 3 cents per hundredweight would be deducted from payments to nonmember producers. This money was to be used for educational work. The apparent purpose of the deduction from nonmembers was to equalize their payments with those of producers who were members of the association. 7/

The marketing plan set up under the King Agreement included a code of fair practices to govern the conduct of distributors. Concern with resale prices is indicated by point 10 of the Agreement:

There is to be no change in the retail price to consumers at present, but wholesale prices will be readjusted to be effective not later than October 1.

The King Agreement was amended several times during its operation for the 30 months prior to the hearing on a Federal program of regulation. These amendments reduced the prices paid by dealers from \$2.78 for Class I milk and \$2.12 for Class II milk to \$1.88 for both Class I and Class II milk. During this period there occurred a substantial reduction in the proportion of so-called basic milk production which was paid for as Class I and Class II milk. As a result of the decline in class prices and the lower proportion of milk paid for as Class I and Class II milk, the gross income of producers was reduced by about 50 percent between January 1931 and July 1933. 8/

7/ The wording of the provision was as follows: "There is to be no discrimination as between nonmembers and members. To make certain of this, a net price will be announced to be paid all farmers. From all nonmembers 3 cents per cwt. will be checked off to go into educational work, preferably dairy council work."

8/ Record of Public Hearing, July 18-19, 1933. Page 182. The decline in the proportions of milk paid for at Class I and Class II prices under the King Agreement compared with the proportions of milk actually used in these higher priced classes is discussed in part VI of this report (page 82).

Conditions Leading to Regulation

Disturbing marketing practices and declining prices continued to plague producers and dealers in spite of the King Agreement. Other measures were resorted to in an effort to prevent a collapse in the price structure. E. P. Mulligan, representing the Pure Milk Producers Association at the July hearing, mentioned several of these measures: 9/

1. Stricter public health standards
2. The adoption of a code of ethics and fair practices among dealers
3. Regulations and agreements between raw milk and pasteurized milk dealers, "to stabilize the market through enforcement of State laws controlling the use of bottles and other milk containers."
4. Court proceedings and obtaining of a Federal injunction to help regulate the use of bottles
5. An agreement among pasteurized and raw milk distributors for a temporary suspension of price competition on sales to stores and restaurants. Under this agreement no dealer would serve a grocery store or other wholesale stop which was being served by some other dealer. 10/

Shortly before the hearing in July 1933 a tentative agreement was signed in Washington by representatives of pasteurized and raw milk distributors. This agreement was for the purpose of maintaining the retail price structure in the market pending the issuance of a Federal milk-marketing agreement. Neither the Milk Service Association (pasteurizing distributors) nor Independent Dairies (raw milk distributors) were able to get even temporary compliance with this agreement from all their members. 11/

Representatives of producers and dealers regarded the disorganization of the Kansas City milk market which led to the July hearing as an emergency situation. At the hearing, there was no discussion of whether government regulation of milk marketing was desirable on a long-run basis. All the representatives of the industry were agreed that the exercise of some government authority was essential to prevent a complete collapse of milk prices in the Kansas City area. They also considered producer and resale prices as interdependent during the emergency and looked to the Secretary of Agriculture to help maintain both.

9/ Record of Public Hearing, July 15-19, 1933. Pages 7-8.

10/ This agreement was maintained for 75 days. It broke down about 30 days prior to the July hearing, when a new distributor, who was not a party to the agreement, entered the market.

11/ Record of Public Hearing, July 18-19, 1933. Page 24.

The general economic depression had reduced consumer purchasing power. Producers and dealers had tried through agreements and other devices, mentioned above, to carry out what they considered an orderly price retreat consistent with the profitability of their operations. This, they were unanimous in asserting, had not been possible.

The president of the Pure Milk Producers Association stated the need for regulation as follows:

Kansas City, Missouri, is surrounded with such an area of land, easily convertible to the production of milk that it is impossible to regulate surplus and prevent it from lowering the price to the producer. Due to the availability of land, dairy cattle, and equipment, it is impossible to keep new producer-distributors not parties to the agreements . . . from coming in and tearing down the market. 12/

J. V. Quigley representing the Milk Service Association traced the history of resale prices during the period prior to the hearing. Prices reached their lowest level early in 1932 when many stores sold milk for 4 cents a quart. A Federal injunction on the use of bottles enabled the Milk Service Association and Independent Dairies "to discipline their members in conformity with their agreement." The resale price structure was further strengthened by an agreement under which no dealer would serve a wholesale stop already served by another dealer. Mr. Quigley testified that these efforts were nullified by the entrance on the market of a new dealer not a party to these agreements. This, according to Mr. Quigley, created an emergency and the dealers fear that, unless the Government acted quickly, milk prices would return to their former chaotic state. Pictures of store fronts, as entered in the hearing record, showed that stores just prior to the hearing were selling milk for 7 or 8 cents a quart. 13/

The position of the Protected Milk Products Company, (the new distributor on the Kansas City market), was in accord with the Milk Service Association on the need for Federal regulation although this company differed on specific provisions. Cline W. Johnson, attorney for the company, stated its position as follows:

Due to substantial surplus in the milkshed surrounding the Metropolitan area a milk war has become imminent which can only be averted in the opinion of Protected Milk by government control and agreement between the various producers and distributors. Due to the unsettled condition in the dairy industry in the Kansas City Metropolitan Area, it will be impossible for either distributors or producers to operate on a profitable basis until uniformity in price structure is obtained . . . A marketing agreement enforced under governmental control and supervision is the only way in the opinion of Protected Milk that the production and distribution of milk and other dairy products can be properly controlled. 14/

12/ Record of Public Hearing, July 18-19, 1933. Page 6.

13/ Record of Public Hearing, July 18-19, 1933. Page 25-26.

14/ Record of Public Hearing, July 18-19, 1933. Page 14.

None of the industry representatives who testified on the need for regulation appeared to recognize the direct relationship between the payment plan which was then in effect and unstable resale prices. Soon after the license was established, the Market Administrator analyzed the method by which distributors paid for their milk under the King Agreement and found that the proportions of their total supply paid for in each of the several price classes bore practically no relation to the proportions of milk actually used in these classes by the individual distributors (page 82). This meant, for example, that a distributor who sold almost all his milk as fluid milk and fluid cream obtained his supply for this purpose at a substantially lower price than his competitor who handled milk for manufacturing uses. Such a distributor could afford to cut his price to stores and consumers below the prevailing level without necessarily taking a loss. The base-rating plan further intensified this inequality of payment among distributors because those whose producers had been assigned low bases in relation to their total current deliveries of milk were required to pay out less money than those who received milk from producers whose current deliveries were largely within their bases. These discrepancies in payments were not intended to occur under the King Agreement. They were, however, an inevitable result of the failure of distributors to report their use of milk by classes and to submit their reports to impartial audits.

II. ADOPTION OF A FEDERAL LICENSE PROGRAM

The Proposed Marketing Agreement

The Secretary of Agriculture called the July 1933 hearing on a marketing agreement proposed by the Pure Milk Producers Association, the Milk Service Association, and Independent Dairies. The proponents contemplated that the Secretary would enter into a marketing agreement and would then use his licensing power to bring nonsigning handlers into line. Because of a change in policy which took place in the Department early in 1934, the July hearing did not lead to an agreement (page 23). This hearing was, however, the only one held in this market prior to its regulation by a license program in April 1934. Among the major provisions of the proposed agreement, as modified by the proponents at the time of the hearing, were the following:

Parties to agreement. The agreement was to be among contracting producers, distributors, producer-distributors, and the Secretary of Agriculture. The Secretary was asked to implement the agreement by issuing licenses, under Section 8 (3) of the Agricultural Adjustment Act, whereby only those distributors who complied with the terms of the agreement would be allowed to continue in business.

Marketing area. The marketing area was to include the corporate limits of Kansas City, Independence and North Kansas City in the State of Missouri, and all territory within 10 miles, airline distance, of the corporate limits of Kansas City, with the exception of Wyandotte County in Kansas. The exception of Wyandotte County eliminated Kansas City, Kans., from the marketing area.

Classification of milk. Four classes of milk were provided. Class I comprised fluid milk sales, Class II comprised fluid cream sales, Class III was manufactured milk up to the remainder of a dealer's base, and Class IV was any additional milk purchased. The proposed plan was a continuation of the classification system in the King agreement.

Class prices. The agreement provided for the following Class prices per hundredweight of milk of 4-percent butterfat content:

Class I	- \$1.85 (f.o.b. city plant)
Class II	- \$1.85 (f.o.b. city plant)
Class III	- Wholesale price of 92-score butter at Chicago, times 4 (f.o.b. farmer's gate)
Class IV	- Wholesale price of 92-score butter at Chicago, times 4 (f.o.b. city plant)

The butterfat differential was 4 cents for each one-tenth of 1 percent variation from 4 percent. Country station charges and hauling rates were to be the same as those in the King agreement. A deduction of 35 cents per hundredweight was to be made on payments to producers for milk delivered

to a country plant. Hauling charges on direct shipped milk would be the actual contract rate paid to the trucker. A copy of the King Agreement was attached to the proposal.

Base-rating plan. A continuation of the base-rating plan, started under the King Agreement, was provided. Members of the Pure Milk Association were to receive a base equal to that already recorded in the files of the Association. ^{15/} Producers who were not members of the Association were to be allotted bases by the local representative of the Secretary "upon a basis which will be equitable as compared with the established 'bases' of all other producers delivering to the same assembly point. . . ." New producers were to receive a base equal to 60 percent of their production for the first 90 days on the market.

Pooling plan. The marketing agreement provided for a continuation of the individual-handler pooling arrangements, whereby each dealer would distribute among his own producers the full value of their milk at the class prices in accordance with the base-rating plan. Provision was made for transferring producers among dealers so as to maintain insofar as possible the same ratio of fluid milk sales to total basic production for each.

Resale prices. A schedule of prices to be charged by distributors for milk and fluid milk products was provided. Milk was to be sold at the same price whether delivered to houses or sold by stores. Premium prices were provided for milk of high (over 4 percent) butterfat content and for milk which was sold in bottles covered with double caps (covering the lips of the bottles).

Marketing service deductions. The proposed agreement followed the pattern of the King Agreement in providing for the same net returns to members and to nonmembers of a cooperative association. Dealers were required to make check-offs from payments to nonmembers at the same rate as they were authorized to make for members of the Pure Milk Producers Association. The amounts deducted from the checks of nonmembers were to be turned over to the Milk Service Association to be used "for the purpose of securing to said producers . . . advertising, educational, and other benefits similar to those which are secured by the members of the Pure Milk Producers Association . . ."

Other provisions. A Milk Advertising Committee was to be set up supported by a check-off of 1 cent per hundredweight, made by distributors from producers' checks, an equal amount to be paid by distributors out of their own funds, and a payment of one-twentieth of a cent for each quart of milk sold by producer-distributors.

Farmers meeting health requirements for the market "shall, as heretofore, be permitted, as far as marketing conditions may allow, to become members of the Pure Milk Association on an equal basis with existing members . . ."

^{15/} Members of the Association had established their bases on their average production during October, November, and December, 1930.

The contracting parties to the agreement were to be required to maintain systems of accounting satisfactory to the Secretary. Books and records were to be subject to examination during the usual hours of business. Reports were to be furnished the Secretary as required by him.

The agreement sought to enhance the authority of the Kansas City health ordinance and the Kansas City Exchange Company (a corporate body empowered to exchange bottles for members of the Milk Service Association). It provided that the standards established by the health ordinance of Kansas City should apply throughout the market area as defined in the proposal. It also provided that the regulations governing the use and interchange of milk bottles shall be those prescribed by laws of the State of Missouri and the regulations on exchange that are agreed upon between the Kansas City Exchange Company and Independent Dairies, subject to confirmation by the Secretary.

Major Issues at Hearing

The hearing, on July 18, 1933, to consider the proposed marketing agreement for the Kansas City area, was attended by several members of the Department including representatives of the Dairy Division and of the Consumer's Counsel of the Agricultural Adjustment Administration. A presiding officer, Francis Goertner, was designated by the Secretary.

As noted above, there was complete agreement on the need for a Federal agreement, enforced through the Secretary's exercise of his licensing power under the Agricultural Adjustment Act. The particular proposal advanced by the organizations of producers, distributors, and producer-distributors was, however, the subject of some discussion and controversy. ^{16/} Some of this discussion brought out differences among the proponents themselves on particular provisions. The sharpest controversy, however, developed between the Protected Milk Products Company and the proponents over parts of the proposed agreement affecting the retail prices and marketing practices.

The Protected Milk Products Company had entered the distribution business in Kansas City about 30 days prior to the hearing. It had engaged in very extensive advertising and was selling its milk through stores in bottles the caps of which were covered with cellophane paper. At the time, Kansas City distributors, with the support of producers, were trying by almost every means to prop up a sagging price structure. The new company came on the market while the agreement on store competition was in effect. This suspension of competition was agreed to by producers of both pasteurized and raw milk. Under the circumstances, a new, aggressive competitor on the Kansas City market was most unwelcome to the industry.

The following objections were made to the proposed agreement by Mr. Johnson, attorney for Protected Milk:

^{16/} The proponents of the agreement were: (1) The Pure Milk Producers Association representing dairy farmers; (2) The Milk Service Association representing proprietary distributors; and (3) Independent Dairies representing producer-distributors.

1. The proposal failed to allow for a differential in the price of milk sold from stores and milk delivered to homes. Mr. Johnson contended that the difference in cost of distribution, including a fair margin for the store, was from 1 to 3 cents. 17/
2. The price schedule required that milk sold in bottles with double caps should be priced 2 cents higher than that in single cap bottles. This provision, Mr. Johnson contended, was designed to discriminate against Protected Milk which recently came on the market with a cellophane cover over the bottle. It prevents the consumer from getting the benefit of this extra protection. The cost of putting on the cellophane cap, according to Mr. Johnson, was only about a fifth of a cent per quart. 18/
3. The agreement failed to provide a uniform bottle charge.
4. The code of fair practices provided for in the agreement would prevent legitimate promotional methods. It would, Mr. Johnson contended, tend to restrict advertising to newspapers and would even compel a distributor to get permission of the Milk Service Association before he could contribute to local charities or benefits. It could also restrict a distributor in the use of any type of special container or in selling any new kind of milk drink. 19/

Store-Home Differential

The retail price schedule became the main issue at the hearing. The Milk Service Association and Independent Dairies defended the relationship of home and store prices in the proposal as necessary because of the recent competitive history of the market. The premium price of 2 cents on double cap milk was also defended as conforming to a past practice by which all double cap milk had come to be looked upon as special-quality milk.

Testimony at the hearing indicated that distributors in the Kansas City market looked upon store sales as the most competitive and most vulnerable part of their businesses from the standpoint of maintaining what they considered to be a desirable price structure. Stores offered the outlet for surplus milk most attractive to producer-distributors or pasteurizing distributors operating on a small scale. Prices on home delivered milk were less subject to direct price cutting by small distributors with a temporary surplus because the investment needed for delivery equipment and for the promotion of this type of business was considerable. The distributors of home-delivered milk considered a wide store differential as a great threat to their investment in this channel of distribution. They looked

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- 17/ Record of Public Hearing Page 85
18/ Record of Public Hearing Page 92
19/ Record of Public Hearing Page 104

upon the reduction or elimination of the store-home differential as one of the most important points of their proposal from the standpoint of stabilizing the entire price structure.

The effect of store competition on the milk price structure is indicated by the testimony of Mr. Quigley of the Milk Service Association. Mr. Quigley told how the pasteurizing distributors resorted to the use of so-called "fighting" brand names which they would use to meet price competition. The distributor's name was not put on the bottle caps of these brand names. How these brands were used was described by Mr. Quigley as follows:

Now, there has been developed on our market also, by some of our better wholesale men, . . . a second brand of wholesale milk which they just let fall down to the bottom as far as they want it to go with the surplus milk of the producer-distributors or the other wholesale plants. It differs primarily in name . . . Another brand handled by the retail dealers up until some three months ago is a brand of raw milk which we sell 2 cents under our pasteurized brand. That bottle has been on our market twice. At the beginning of 1932 when the market broke down below us . . . We introduced that bottle to grab onto the volume of the distributors' market . . . The bottle was again on the market in December 1932, and was maintained on the market for some three months, until through cooperation, and very pleasant cooperation, with the Producers Association in a moratorium, it was possible . . . (to act) . . . through the disciplinary power of a Federal injunction . . . against 14 distributors in the market. 20/

The position of the Milk Service Association on the relationship of store and home delivered prices was complicated somewhat by the fact that 4 or 5 distributors who were members of the Association were engaged solely in sales of milk to stores and other wholesale outlets. The elimination of a store differential would be detrimental to this type of business. The opposition to this part of the proposed agreement by these members combined with the arguments of Protected Milk led to its modification during the course of the hearing. The case for allowing a 1-cent store differential was stated by a member of the Milk Service Association:

The market in Kansas City has for many years operated upon a differential of at least 1 cent per quart between resale prices in grocery stores and the price off the retail wagons . . . Upon this set-up exclusive wholesale dealers have developed and of these I happen to be one. These dealers have built up large investments in equipment and good will . . . Some of us have been in the market for 20 years or more. We are just as legitimate a part of the market as any other dealer and are entitled, we do believe, to protection in this market setup, just as much as any other dealer, be he large or small. 21/

20/ Record of Public Hearing Page 74.

21/ Record of Public Hearing Page 176.

In retreating from their original position against a lower price on milk sold out of stores, the proponents sought to maintain certain safeguards against what they considered destructive competition in the Kansas City market. Under their modified proposal, no brand of milk which was delivered to homes would be permitted to be sold from stores at a lower price. Also, the store differential would not apply to milk sold in double-cap bottles. A 2-cent premium would apply to such milk regardless of the quality of the milk itself.

Double-Cap Milk

The limited concessions made by the proponents of the marketing agreement regarding a store differential served to emphasize the issue of pricing milk in double-cap bottles. A larger part of the hearing was devoted to this matter than to any other subject. The significance of this issue grew out of the current competitive situation in which Protected Milk played a major part.

The argument for a 2-cent premium on milk sold in bottles with any sort of cover over the lip of the bottle was based on the allegation that this was the custom in the market and that this custom would have to be recognized in the agreement to protect consumers and to protect the investments of handlers of double-cap milk.

The case for the 2-cent premium was stated by L. H. Haas, on behalf of Independent Dairies, the organization of producer-distributors:

Now, with reference to the marketing of special or premium milk, which is noted in the contract as 'double-cap' milk. We believe there should be a 2-cent differential in the price . . . This 2-cent differential is not alone based on the butterfat content, nor on the overcap of the milk. It has been produced by a series of educational movements, and the consumer has always expected that when they leave a bottle of overcapped milk produced under the conditions required for this special milk, they are expected to believe that it contains in the bottle the things that they are paying the extra price for . . . 22/

The custom of selling double-cap milk at a premium price was largely tied in with an educational campaign carried out by an organization known as the Consumers' League. The League, organized about 1912, had concerned itself largely with improving the quality of milk in Kansas City. It had carried out an educational campaign for milk of a low bacterial count largely in connection with raw milk sold by producer-distributors. Directed by unpaid workers, this league was normally financed by a Community Chest appropriation of about \$14,000 a year to maintain its own laboratory and inspection force. In reply to allegations made at the hearing, the president of the league stated, in a letter dated July 25, 1933, which was made part of the

hearing record, that some financial help was currently being received from distributors selling double-cap milk:

This year the demand for funds for relief was so great that the Charities Committee was obliged to reduce the allotment of the Consumers' League from \$13,600 to \$8,000, and in consequence, to enable the League to retain its second field worker, some members of the white list voluntarily increased their subscription to the Charities Fund with the understanding that the money was to go to the Consumer's League for the purpose of paying that salary.

A major undertaking of the league was the maintenance of a "white list" of dairymen selling milk of low bacteria count. "White list" distributors selling raw milk were required to keep their counts down to 10,000, compared with a city ordinance requirement of 30,000. Pasteurized milk sold by "white list" distributors was required to have a count of less than 30,000 before and 10,000 after pasteurization.

The Consumers' League supported the requirement of a 2-cent premium for double-cap milk. In a letter written to the Department of Agriculture prior to the hearing and made a part of the record, the Chairman of the league's milk committee stated that Kansas City consumers considered the 2-cent differential between single-cap and double-cap milk as the only practical device to enable dairymen, who wish to sell a high quality milk, to do so.

In the same letter, it was noted that it would be better if milk prices could be based directly on the quality of the milk "rather than on the artificial and worthless distinction of the special double cap." It was also noted in his letter that some dealers were selling ordinary milk in double-cap bottles and getting premium prices for it. They could do this without violating the Kansas City milk ordinance which allowed all milk conforming to the ordinance to be labeled "grade A". The league position was that these violations of the custom of putting special quality milk in double-cap bottles was less of a threat to a high-quality supply than was a price war. Such a price war, according to the league statement was "made inevitable when a milk company is permitted to enter our market, dress up an inferior quality with a fancy package and a double-cap, and sell at a price so low as to force the other companies, who want to put out a good quality, down to a price which necessarily prevents them from doing so."

From the testimony in the hearing record, it is clear that the opposition to Protected Milk was not based on the fact that it sold ordinary milk in double-cap bottles. Other dealers had done the same thing and the proposed agreement was not drawn up to stop the practice. The opposition appeared to be based on the fact that Protected Milk did not charge the customary premium and had carried out an aggressive campaign to convince consumers that it was selling milk of good quality which was safe to drink.

At the time Protected Milk entered the Kansas City market, it was not a party to the agreement among dealers for a suspension of price competition for store sales. The entrance of Protected Milk had broken up the agreement and in this sense was a factor in the renewal of a price war

which had been going on intermittently for several years.

The milk sold by Protected Milk in double-cap bottles was part of the regular supply produced by members of the Pure Milk Producers Association. It conformed to the Kansas City ordinance requirements and was eligible to be labeled "grade A." Most of the "white list" milk of lower bacterial content was unpasteurized and, in this respect, the pasteurized milk sold by Protected Milk would probably have been considered a safer product by milk sanitarians. 23/

The "white list" was put out by the Consumers' League in an effort to enable consumers to know which distributors sold milk of high quality from the standpoint of low bacteria count. This was especially important in enabling consumers to distinguish among the producer-distributors so as to obtain unpasteurized milk which was relatively safe. At the time of the first hearing, about half the Kansas City supply was put out by producer-distributors in unpasteurized form. The June 1933 "white list" contained the names of 22 producer-distributors. One pasteurizing distributor had its entire supply "white listed" and two others had part of their supplies so listed. The list was prefaced with the following words of caution which indicated that the double-cap was no infallible guide to quality:

The Consumers' League cautions milk consumers to compare the caps on their bottles of milk with the following list of labels to assure themselves that they are getting approved "white list" milk.

Other Subjects Discussed

There was very little testimony at the hearing on such matters as the classification of milk, prices to be paid to producers, the pooling plan, or the base-rating plan. In drafting their proposal, the proponents had followed the pattern laid out in the King Agreement and they were in accord as to the level of producer prices with which they wanted to start.

23/ "The importance of pasteurization in safeguarding milk supplies has been demonstrated conclusively over a long period of years. That raw milk can and does transmit disease and that pasteurization prevents such transmission has been proved to the satisfaction of health authorities by laboratory and commercial scale experimental work, by epidemiologic methods, by statistical methods, and by animal experimentation . . . Pasteurization is the most important protective measure which can be applied to milk," according to Andrews, John, and Fuchs, A. W., in a paper entitled "Pasteurization and its Relation to Health," prepared at the request of the Council on Foods and Nutrition of the American Medical Association and printed in its Journal of September 11, 1948. Mr. Andrews was a former Sanitary Engineer and Mr. Fuchs was Sanitary Engineer Director, Milk and Food Section, U. S. Public Health Service.

Quality premiums. An element of disagreement between producers and dealers was brought out with respect to prices paid producers for special quality milk. The Producers' Association requested that producers should be paid premiums of 20 cents per hundredweight (slightly less than 0.5 cents per quart) for milk sold to consumers as "white list" or "special" milk at premium prices of 2 cents a quart. The Association proposed an amendment to cover this. The Milk Service Association took a position that a 20-cent premium to producers on such milk was too large "in view of the economic condition of the milk industry . . . Our suggestion would be that it be made 10 cents on the sales, purely in the spirit of compromise . . ." 24/

Marketing area. Mr. Mulligan of the Producers' Association stated the reasons for not including Kansas City, Kans., as part of the marketing area to be covered by the agreement:

The Kansas City, Kansas, market which is supplied entirely by producers in Kansas has always been recognized as a separate market. The resale market as a general thing is a different market in regard especially to price, but also in respect to the quality of milk . . . Their method of buying is different. They have been buying strictly on a butterfat basis, without any regard such as we have to the different classes of milk. 25/

Hauling and station charges. Mr. Pritchett, manager of the Pure Milk Producers Association, testified that producers were dissatisfied with hauling and station charges. Hauling charges on many milk routes had not come down during the past few years in spite of the general deflation. Some of these routes were operated by dealers. With respect to station charges, Mr. Pritchett proposed that the Secretary of Agriculture should direct an investigation along the following lines:

We not only want the cost studied, but we beg of you to make an economic study of these cooling stations. We believe that there is no place for these cooling stations on our market. They are responsible for an additional 35 cents a hundred on Class I and Class II milk being charged against the farmer . . . We have milk coming in directly from further distances in some cases . . . 26/

Production control. Some interest was expressed in possible ways of limiting the volume of milk coming to the Kansas City market. Mr. Goertner, who presided at the hearing, showed his interest in this matter when questioning a witness regarding the distance a health department inspector would go to approve a farm: "I wanted to get some explanation on the record as to the inspection practices of the health authorities there, and whether the inspection had not been so widespread as to create a considerable oversupply of milk." 27/

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- 24/ Record of Public Hearing Pages 191 and 213.
25/ Record of Public Hearing Page 11.
26/ Record of Public Hearing Page 204.
27/ Record of Public Hearing Page 33.

Mr. Mulligan stated that chronic difficulties in the market had been due partly to:

The absence of restriction upon, or control over, the area or limits of the milkshed from which the production of fluid milk consumed in the Kansas City metropolitan area originates. We feel that this area should be a controlled area . . . 28/

Later in the hearing, Mr. Mulligan proposed that the counties of the supply area should be named in the agreement as issued.

That restriction on the admission of new producers was practiced is indicated by Mr. Quigley's reply to the question of how bases were allocated to new producers:

The market was so oversupplied with milk that no new producers have been taken into the market since the time that the marketing plan was set up by Dr. Clyde L. King in 1930, except where it was agreeable to the shippers who were immediate neighbors to the man taken in, and to the various parties operating in the market. 29/

Audit of books and records. Mr. Mulligan attributed some of the failure of voluntary agreements to:

The failure of certain distributors to submit to the Association at periodic intervals, as required by said voluntary agreements, reports of sales and purchases of milk and to permit the Association to make such audits and other investigations as are necessary to properly verify such reports and to enter the plants of dealers for such purposes. 30/

To remedy this defect, Mr. Mulligan suggested, on behalf of his association, that the proposed agreement be amended "to provide for access to books and records of the distributors by an employee of our Association accompanied by a certified public accountant for the purpose of checking reports of sales and purchases . . ." The Milk Service Association, on behalf of the dealers, expressed its willingness to allow a certified public accountant to examine sales records and to verify the accuracy of reports. It would not agree to permitting such an accountant to be accompanied by a representative of the Pure Milk Producers Association. 31/

Change In Government Policy, January 1934

A considerable time elapsed while the Department of Agriculture

<u>28/</u>	Record of Public Hearing	Page 184.
<u>29/</u>	Record of Public Hearing	Page 37.
<u>30/</u>	Record of Public Hearing	Page 188.
<u>31/</u>	Record of Public Hearing	Pages 192, 216

considered the issues raised at the July 1933 hearing and prepared an agreement for the Kansas City market. Most of the discussion within the Department concerned the schedule of resale prices to be made a part of the agreement and the best way of dealing with producer-distributors. The consideration of resale prices involved the issues raised by Protected Milk, such as the question of store-home differentials and the pricing of double-cap milk, and also an appraisal of handlers' margins as a whole.

On December 6, 1933, the Administrator of the Agricultural Adjustment Administration transmitted to the Secretary of Agriculture a draft of a milk marketing agreement with a recommendation that he approve it. This proposed agreement was not approved because of a broad change in dairy policy which was then under consideration by the Department. This change involved the abandonment of resale price fixing and incidentally a discontinuance of the policy whereby the Secretary entered into marketing agreements with distributors and organized producers.

The new policy was announced on January 8, 1934, and became effective on February 1 of that year. The considerations which prompted the new policy, are described by the Agricultural Adjustment Administration as follows: 32/

During the period in which resale price fixing was in effect, many difficulties were encountered. In some instances the establishment of resale prices appeared to 'freeze' margins of distributors at questionable levels. In other cases, distributors demanded higher margins on the grounds that their operating costs had risen because of recovery measures. Another problem was the difficulty of establishing an acceptable differential between store and delivered prices to milk consumers. A major problem was that of enforcing resale prices.

Since the primary purpose of the Agricultural Adjustment Act is to increase returns to producers of farm products, the modified milk policy concerned itself entirely with the establishment of producer prices, and left resale prices to the forces of competition.

Even under the new policy, the Department continued to be concerned with resale prices in several ways. In some markets, schedules of minimum resale prices were established as a protection to the producer prices. These minimum prices were set at a level which the Department considered low enough to allow the forces of competition to operate among dealers in the market. The previous concept of setting resale prices at a level to guarantee dealers a so-called "fair margin" was abandoned.

In collaboration with some State enforcement agencies, the Department at times became a party to regulations under which producer and resale prices were established with due regard to each other. In such cases, however, the enforcement of resale prices was entirely a State responsibility.

In some markets under Federal regulation, producers and dealers made their own arrangements for maintaining a schedule of resale prices. This, as is indicated in later sections of this report, occurred in Kansas City. In the opinion of John D. Black, who made a study of the early history of the regulatory programs, this came close to the Department's acceptance in practice of maintaining resale prices: 33/

It must be evident that giving general administrative sanction, by virtue of maintaining in the market a license and a local administration, to producer-distributor arrangements under which they establish and maintain resale prices, approaches accepting the resale price principle.

Adoption of License Program, April 1934

Kansas City, Mo., came under a milk license on April 1, 1934. This was accomplished through an amendment to a license for Kansas City, Kans., which the Secretary had issued 2 weeks earlier. The amended license applied to an area designated as the Greater Kansas City Sales Area. Max M. Morehouse was appointed by the Secretary of Agriculture as Market Administrator. Previous to his appointment, Mr. Morehouse had been manager of the Wichita Milk Producers' Association.

The Agricultural Adjustment Act required a hearing prior to an agreement but required no hearing in connection with the issuance of a license. A public hearing had been held in Kansas City, Kans., in December 1933, on a proposed agreement for that market. Information received at this hearing and the hearing in July 1933 on an agreement for Kansas City, Mo., was largely relied on in drawing up the license for the Greater Kansas City Sales Area.

The need for a public hearing to develop the essential facts on which a license could be issued was indicated in a formal opinion of the General Counsel of the Agricultural Adjustment Administration, dated March 6, 1934. He noted that section 8(3) of the act did not require a hearing prior to the issuance of a license but he felt that the absence of such a requirement might render this section unconstitutional. In such an event, he stated, "the mere fact that a hearing, although not required by the act, has in fact been held will not validate a license."

The general patterns of the agreements that had been proposed for the two areas were similar. The parties to both agreements were to be the same associations of producers and distributors of pasteurized milk. Different groups of producer-distributors were, however, operating in the two markets. Also, there was evidence in both hearing records showing marked differences in the health regulations, prices, and marketing practices in the two markets which would have seemed sufficient to cast considerable doubt as to the advisability of combining the two areas under

33/ The Dairy Industry and the AAA, by John D. Black. The Brookings Institution. Page 126.

one license (page 22).

The decision to combine the two areas under one license was made after an exchange of wires between the Dairy Section of the Agricultural Adjustment Administration and the Pure Milk Producers Association indicated the move would have producer approval. In acknowledging receipt of a protest from the Milk Service Association that the license conditions were "drastic and out of line with this market" the Chief of the Dairy Section stated: ". . . Inasmuch as the license covers mainly producer prices and equalization of opportunities among producers, and inasmuch as we believe the license does not discriminate or cause any unfair competitive position among distributors, we have seen fit to approve such license."

The essential features of the first milk license for Kansas City, Mo., were as follows:

Marketing area. The "Greater Kansas City Sales Area" was defined in the license to include Kansas City, Kans.; Kansas City, Independence, and North Kansas City, Mo.; and specified townships or parts of townships in Wyandotte and Johnson Counties, Kansas, and in Jackson and Clay Counties, Missouri.

Classification of milk. The first license divided milk into three use classes as a basis for establishing minimum prices to be paid by dealers. Class I milk was all milk sold for consumption in fluid form, Class II milk was all milk sold for consumption as fluid cream, and Class III milk was milk sold for all other uses.

Class prices. The license established the following minimum prices per hundredweight of milk testing 3.5-percent butterfat:

Class I - \$1.75.

Class II - Price per pound of Chicago 92-score butter, times 3.5, times 1.25, plus 25 cents.

Class III - Price per pound of Chicago 92-score butter, times 3.5, plus 20 cents.

A butterfat differential was provided in connection with dealer payments. This amounted to 4 cents per hundredweight for each one-tenth of 1 percent variation in the test of milk from 3.5 percent butterfat.

A location differential was allowed for milk received at country plants, to the extent such receipts were needed to supply a dealer's Class I sales. The differential amounted to 10 cents per hundredweight for plants in the 30- to 45-mile zone, plus 1 cent for each additional 15 miles. Class I sales of any dealer were presumed to come from milk delivered "in or nearest to" the sales area.

Pooling plan. The license set up a market-wide plan of pooling the proceeds of sales to dealers and distributing them among producers. A base-rating plan was operated in conjunction with this pool plan. Members of the Pure Milk Association were to be given the same bases which they had previously established as shown by the files of the Association. Bases for nonmembers (including new producers) were to be set by the Market Administrator in a manner equitable with the bases established for Association producers.

The Market Administrator was directed to compute a blend price for all "delivered base" milk in the market. ^{34/} Each producer received this price, subject to butterfat and location adjustments, for all milk delivered by him up to the amount of his "delivered base." For deliveries in excess of his "delivered base," he received the Class III price. The butterfat differential received by producers was 4 cents for each one-tenth of 1 percent variation in the test of milk from 3.5 percent butterfat. The location adjustment, in connection with payments to producers, was 10 cents for milk delivered to plants in the 30- to 45-mile zone, plus 1 cent for each additional 15 miles. This differential applied to all the milk delivered by a producer, in any of these zones. As noted above, the differential allowed to a dealer applied only to that part of his milk which was presumed to be needed for his Class I sales.

Producer-distributors. The license exempted producer-distributors from its pricing and pooling provisions, unless their daily sales of milk, cream or products thereof, during any delivery period, exceeded the equivalent of 250 pounds of milk. All other producer-distributors were required to make regular production and sales reports to the Market Administrator, to accept a base quota and to share in the system of pooling proceeds of sales of milk among producers in the market on the basis of the minimum class prices.

New producers. New producers were not allowed to ship milk to the market unless they received a written permit from the Market Administrator. In deciding whether to issue such a permit, the Market Administrator was directed to "ascertain whether its issuance will tend to prevent the effectuation of the policy of the act or of the purpose of this license." The right of appeal from the Market Administrator's decision to the Secretary of Agriculture was provided.

Deductions for marketing services. A deduction of 3 cents per hundredweight was required to be made from the checks of producers and turned over to the Market Administrator. The Market Administrator paid

^{34/} The license defined "delivered base" milk for each producer as "that quantity of milk delivered by such producer to distributors which is not in excess of 90 percent of the established base of such producer." The market administrator was authorized to adjust the percentage between 80 to 100 percent of the established base to maintain the total of "delivered bases" in close approximation to total Class I and Class II sales in the market.

these deductions to the Pure Milk Association, with respect to its members milk, to enable the Association to perform market services, such as check weighing and testing of its members' milk. The Market Administrator retained the 3 cents from the milk delivered by nonmembers, in a separate fund, to render to such nonmembers similar market services.

Expense of administration. The expense of administering the license was met by deductions of 1 cent per hundredweight from payments to producers. Producer-distributors were also required to pay 1 cent per hundredweight on their own production for this purpose.

Resale prices. A schedule of minimum resale prices was provided by the license. In line with the new policy of the Department of Agriculture, these minimum prices were lower than distributors considered necessary to give them a proper margin. Also, the schedule did not deal with the home-store differential, or with prices of double-cap milk--problems which had taken up a good part of the July 1933 hearing.

The minimum resale price schedule set up retail and wholesale prices for milk of 4 percent or less butterfat and for milk of more than 4 percent butterfat. These prices were 8 cents and 9 cents per quart, respectively. The minimum wholesale price per quart of milk was 1 cent less than the retail price. No differential was established in the minimum price of milk sold out of stores and of milk delivered to homes. However, since it was anticipated that the prevailing resale prices would usually be above the minimum, there was a possibility that a home-store differential could be established by competition.

III. OPERATION OF LICENSE NO. 40

Economic Conditions During License Period

The period of license operation, from the spring of 1934 to the fall of 1936, was marked by a general economic recovery for the country as a whole. Indexes of employment, payrolls, and business activity were rising and the Federal Government's relief spending was a further factor in raising the purchasing power of consumers. Dairy farmers in the Kansas City area did not share fully, however, in this general improvement in the economic situation. Severe drought conditions prevailed in the milk supply area, especially during summers of 1934 and 1936. Pasture conditions during the spring and fall months of these years and during the greater part of 1935 were poor in most parts of the area. 35/

The droughts created seriously adverse production conditions for dairy farmers in the Kansas City area during 1934 and 1936. Because of the lack of normal pasture and the failure of local feed crops, milk producers had to buy unusual amounts of supplementary feed which added considerably to costs of production. The drought conditions also retarded the economic recovery of the Kansas City metropolitan area with consequent effects on consumer purchasing power. Kansas City is primarily a food processing and agricultural distributing center and the decline in crop and livestock production in the surrounding area prevented as rapid a recovery of industrial and business activity in Kansas City as was taking place in the rest of the country.

Amendments to the License

License No. 40 was first made effective on March 17, 1934, for the Kansas City, Kans., sales area. It was amended 2 weeks later to include Kansas City, Mo. After that date four additional amendments were issued by the Secretary of Agriculture. One of these amendments eliminated the Kansas City, Kans., part of the sales area. Thus, the license which was originally issued to cover one sales area became an instrument for regulating an entirely different sales area. The amendments are discussed in detail in relation to the various problems which developed during the period of the license operation. A summary of the important points of each amendment is contained in table 1.

Problems of Enforcement

There was difficulty in enforcing the provisions of License No. 40 which in time became a contributing factor to the setting up of industry

35/ Reports of the U. S. Department of Agriculture on pasture conditions for months of April through September, 1934, 1935, and 1936.

Table 1.---Provisions of amendments affecting License No. 40

		Effective date of amendment			
Provision affected 1/	April 1, 1934	May 16, 1934	July 17, 1934	July 1, 1935	August 1, 1935
Sales area	Kansas City, Mo., Independence, North Kansas City, and certain townships in Missouri added.			Sales area reduced to corporate limits of Kansas City, Mo.	
Producer-distributors		Pool exemption raised to 500 pounds per day.	Each producer-distributor's established base exempted from pool.	Producer-distributor's exempted from pricing and pooling provisions.	
New producers		Permit system replaced by new producer clause under which new producers were to receive Class III price for all milk for a 3-month trial period.			

Table 1.--Provisions of amendments affecting License No. 40--Continued

Provision affected 1/	Effective date of amendment			August 1, 1935
	April 1, 1934	May 16, 1934	July 17, 1934	
Classification			<p>The following products were changed from Cl. III to Cl. II: Chocolate milk, chocolate drinks, flavored milk, creamed milk, cheese, and creamed butter-milk.</p>	
Minimum class prices		<p>Out-of-area pricing provision adopted.</p>	<p>Class II pricing formula revised to increase Cl. II price. All class prices based on 3.8% instead of 3.5% butterfat.</p>	
Transportation allowances		<p>Each producer given right to select means of transporting milk. Distributors required to report charges at request of Market Administrator</p>	<p>Country station charges and transportation allowances increased.</p>	

Table 1.--Provisions of amendments affecting License No. 40--Continued

		Effective date of amendment			
Provision affected ^{1/}	April 1, 1934	May 16, 1934	July 17, 1934	July 1, 1935	August 1, 1935
Base-rating					Base-rating plan eliminated from license
Other changes		<p>Co-ops prohibited from making unauthorized deductions from producers. Distributors permitted to make cash deposits, in lieu of bonds, to guarantee payments. An "anti-dumping" provision was adopted with respect to cream sales.</p> <p>Minimum resale price of cream sold in gallon lots was increased.</p> <p>Schedule of minimum resale prices was eliminated.</p>			

^{1/} See pages 26-28 for a summary of these and other important provisions in the license as originally issued.

agreements. There was discontent among some distributors because they considered that the schedule of resale prices did not provide sufficient operating margins. Some distributors were opposed to the market-wide equalization plan. These included almost all producer-distributors who, because of their large number and small scale of operation, posed especially difficult problems of enforcement. Satisfactory enforcement was further hampered because the license covered an area which was not at that time a homogenous milk market. During the period of its operation, marketing conditions on the Kansas and Missouri sides of the sales area were sufficiently different to have warranted separate licenses. All these factors were added to the legal problems which beset all Federal licenses and made the Kansas City license very difficult to administer.

Most of the day-to-day work of obtaining compliance with the license was carried out by the Market Administrator through talks with violators, letters and telephone calls to distributors whose reports or payments were not received on time, and by various means of helping distributors understand the meaning of the terms of the license and how they could best bring their operations into compliance. Some assistance was given to the Market Administrator on more serious cases of violation by compliance officers of the Department of Agriculture who interviewed the parties concerned to discuss the possible legal consequences of continued violation.

Dissatisfaction with Resale Prices

One of the main points of criticism of the license was its resale price schedule. The hearing had shown that this was looked upon by distributors and the producers' association as an important aspect of regulation. They looked upon "price wars" among distributors as the immediate cause of a disorganized market and the prime factor in lowering prices to producers. When organized producers, distributors, and producer-distributors had prepared their agreement they were careful to include a resale price schedule which would guarantee what they considered satisfactory margins and, at the same time, afford some protection to established distributors from new competitors (pages 16-21). The resale price schedule which was made a part of the license was unsatisfactory to distributors from both standpoints. The minimum resale prices were below the level at which some milk was being sold when the license went into effect. No provision was made for special pricing of double-cap milk. This had been relied on as an important device for checking new competition in the distribution of milk.

On March 24, 1934, a week before Kansas City, Mo., was brought under the license, the president of Independent Dairies, in a wire to the Department, expressed his fear that the minimum resale prices would become the actual prices in the market:

One reason why the producer-distributor cannot exist under the proposed license is that the minimum resale price is considerably lower than the present price. We feel that we are justified in asking a price at least equal to the one now in effect.

Producers and distributors continued their efforts to get the Department of Agriculture to enforce a higher schedule of resale prices. On September 26, 1934 officers of the Pure Milk Producers Association supported the Milk Service Association's request for raising the minimum resale prices by 1 cent a quart. In acknowledging their request, the Chief of the Dairy Section stated that "It is the policy of the Administration to regulate as little as possible the prices and practices in the distribution of milk and yet effectuate the purposes of the Agricultural Adjustment Act . . ."

The license schedule of resale prices probably had little influence on the actual prices which prevailed in the market during this period. This does not mean that the prevailing prices were established on a competitive basis. The testimony at the hearing in 1933 and the industry agreements, which were made while the license was in operation, indicate that organized producers and distributors did their best to "stabilize" resale prices by agreement.

The minimum resale price of cream sold in gallon lots was increased by the amendment of July 17, 1934. This action was taken because the price of such cream was below the price which the license set for the milk from which the cream was produced. No other change of any significance was made in the resale price schedule while it remained a part of the license. The amendment of July 1, 1935, dropped the entire schedule of resale prices from the license.

Opposition to Market-wide Equalization

The market-wide pooling provision of the license was an entirely new feature for producers and distributors in Kansas City. Among producers, this provision was generally welcomed as a forward step in milk marketing. It served to equalize the returns of all producers supplying the market, regardless of how their milk was used by individual distributors. This carried out an objective which organized producers had long sought to achieve, and no serious objection was raised by unorganized producers.

To distributors, however, market-wide equalization was almost a revolutionary step in the marketing of milk. It meant that those with a relatively high proportion of Class I milk sales had to make payments to an "equalization fund" to be drawn out by distributors with relatively low Class I milk sales so that all producers could be paid a uniform price for base and excess milk. Some of the distributors who had to pay into the fund were opposed to this provision. They included the great majority of producer-distributors. The attitude of the distributors who would have to pay into the equalization fund is summed up by one distributor in a letter to the Department:

. . . Operation figures of milk dealers in large volume classes with those of small volume classes have shown that the small dealer was able to compete with the large dealer only because of lower overhead and lower weighted cost of his milk obtained

through the carrying of less percentage of surpluses . . . Could you or some other economist explain to me how the medium size or small dealer is going to compete when the dealers' pool idea has been incorporated into all the new licenses. It seems that because in the majority of cases, the small dealer has appeared as a price cutter, the AAA officials are assuming that all the business should be given to the largest dealers. 36/

This attitude was supported by producer-distributors. The President of their association, Independent Dairies, wired the Agricultural Adjustment Administration on March 14, 1934, as follows:

At a mass meeting of 150 raw milk dairymen, members of Independent Dairies, Inc., representing over 50 percent of the Kansas City market, the following resolution was unanimously adopted: That, we are opposed to the equalization pool and ask that the government stay out of our market on the supposed plan as it would bankrupt the entire membership.

As indicated in later sections of this report, the opposition to equalization on the part of proprietary distributors, tended to disappear as they gained experience with its operation under the license and industry agreements. Opposition on the part of producer-distributors continued until they were exempted by amendment to the license.

The Producer-distributor Problem

Opposition to the resale price schedule and equalization presaged a difficult time for the Market Administrator in administering the terms of the license. Many distributors who were required to pay into the equalization fund were prepared to hold out until their rights and obligations were more clearly defined by court tests of the validity of the license.

Enforcing the license with respect to producer-distributors in the market presented a very serious problem. There were about 335 producer-distributors in the Greater Kansas City sales area at the beginning of the license period and they distributed about half of all the milk in the area. The market for raw milk was, to some degree, distinct from the market supplied by the pasteurizing distributors. Production requirements for milk to be sold in a raw state, were more rigid and the preference of some consumers for either raw or pasteurized milk was fairly definite. Some distributors of pasteurized milk even purchased some bottled raw milk from producer-distributors to meet the demand of their own customers. Many producer-distributors had, over a period of years, established firm bonds of personal contact with their customers.

36/ Letter, dated February 22, 1934, from a Kansas City milk distributor to the Dairy Section, AAA.

The major point of dissatisfaction with the license, on the part of producer-distributors, stemmed from their economic position in the market. Almost all of them operated dairy farms which were located close to the city. These farms were in most cases substantially larger than those owned by producers shipping to pasteurizing distributors. Most of the producer-distributors had long followed the practice of controlling their production to keep their supplies of milk in a close relationship to the needs of their customers at all times of the year. This practice was an essential factor in their ability to survive as milk distributors in competition with the large pasteurizing distributors. The producer-distributors considered that problems of seasonal production and seasonal surpluses were not their problems and they did not see why they should be compelled to pay a toll, through the equalization pool, to subsidize producers who supplied the pasteurizing distributors.

The position of producer-distributors who reported to the Market Administrator with respect to the equalization pool for the second half of May 1934 is shown in table 2. Of 223 producer-distributors who reported to the Market Administrator on their operations, 82 were exempt from payments, 26 received payments totaling about \$125, and 115 were required to pay a total of \$1,992.63. Producer-distributors, as a whole, continued to be delinquent in their equalization payments during the entire period of the license. A sizable minority refused to make reports to the Market Administrator.

During the months from April through December 1934, 330 producer-distributors made at least one report to the Market Administrator. In his report to the Chief of the Dairy Section, the Market Administrator said that this comprised all the producer-distributors with the exception of two or three of the larger ones and a number of small ones. He estimated that at least 95 percent were included, representing about 98 percent of the volume of milk. The decline in the number of reports received during this period reflects the difficulties which the Market Administrator was experiencing in merely getting producer-distributors to report :

<u>Month</u>	<u>Producer-distributors reporting</u>
April	298
May	299
June	293
July	283
August	263
September	237
October	214
November	172
December	154

Table 2.--Producer-distributor payments and receipts from market-wide price pool in Kansas City Sales Area, for period May 16-31, 1934

Range of payment or receipt (Dollars)	Payments		Receipts	
	Producer-	Total	Producer-	Total
	distributors	amount	distributors	amount
	reporting 1/		reporting 1/	
	Number	Dollars	Number	Dollars
0- 9.99	69	312.50	23	82.50
10.00-19.99	19	292.50	3	42.50
20.00-29.99	12	300.00	0	0.00
30.00-39.99	4	140.00	0	0.00
40.00-49.99	3	135.00	0	0.00
50.00 or more	8	812.63	0	0.00
Total	115	1,922.63	26	125.00

1/ 196 reports were received by the Market Administrator at the time this tabulation was made. He included 27 additional reports on the basis of information contained in reports for the previous pay period, making a combined total of 223. Of these, 82 were exempt from participation in the pool, under the terms of the amended license.

Source: Compiled from data contained in an unpublished report, dated June 21, 1934, prepared for the Chief of the Dairy Section, Agricultural Adjustment Administration.

Another serious obstacle to enforcement of the license with respect to numerous small operators was the distortion of reports to suit their interests. The Market Administrator indicated in his report that it was almost a hopeless task to get them to make proper reports:

A study of these reports clearly reflect the fact that some Producer-Distributors made their report so that it entered the equalization pool to their advantage. For instance in a number of cases you find that their first report shows little or no cream sale - all Class I. The next report or so shows a wonderful increase in Class II and as soon as the License was amended so that their milk was not pooled, there was a very sudden decrease of Class II. This office knew of this at the time and in a number of instances we endeavored to investigate. The claim was made that they sold to some stand and the stand man would affirm the statement. It would take the Army and Navy to police the matter. 37/

The Department attempted to deal with the producer-distributor problem in two ways: (1) By changing the method for exempting producer-distributor milk from the pool; and (2) by adjusting the relationship between the class prices so as to reduce the obligation of producer-distributors to the pool.

The license at first allowed producer-distributors an exemption from the pool amounting to sales of 250 pounds of milk per day. On the basis of this exemption only 19 of the producer-distributors on the Kansas City market were completely exempted from participating in the pool. The amendment of May 1934 raised the exemption to 500 pounds of milk daily. This provision was at that time becoming the standard provision in most of the licenses on the assumption that 500 pounds was roughly the equivalent of the Class I and Class II sales of the average retail milk route.

While this provision amounted to a concession to producer-distributors it did not meet their approval. The producer-distributors of Kansas City, Mo., had asked that the price of Class II milk be raised to the Class I level so as to reduce their payments into the pool. The Department was, at that time, unwilling to go this far in meeting producer-distributor criticism of the license.

In spite of the provision for more generous exemption permitted under the May 1934 amendment the producer-distributors in the Kansas City market continued to present a serious problem in administration and enforcement. The 500-pound exemption was not large enough to satisfy the larger producer-distributors. At the same time it permitted a number of smaller producer-distributors to expand their operations considerably without having to come under the pricing and pooling regula-

37/ Report of the Market Administrator on the operation of License No. 40 from March 17, 1934 through June 30, 1935.

tions of the order. The amendment of July 1934 attempted to meet this situation by allowing an exemption from the pricing and pooling provisions of the license to each producer-distributor of a quantity of milk equal to his established base. The quantity exempted was ratably deducted from the total sales of Class I, Class II, and Class III milk of each producer-distributor. This exemption replaced the flat 500 pound per day exemption allowed under the previous amendment. The amendment also attempted to provide producer-distributors with a normal outlet for their excess milk. It provided that all milk except bottled milk and cream which was sold by producer-distributor to proprietary distributors would be sold at the Class III price. If this milk was used in some other class than Class III by the purchasing distributor, the difference between the value of such class use and the Class III price must be paid into the Market Administrator's equalization account.

This method of dealing with producer-distributors had not been previously used in any other milk license. In submitting it for approval the memorandum of the Dairy Section claimed that the amendment would have the following advantages:

1. It grants a larger exemption to producer-distributors and will therefore have a greater degree of market acceptability.
2. It imposes a more immediate check on a large number of producer-distributors who were formerly totally exempt and who could have expanded their business greatly before being affected by the base-surplus plan.
3. It provides one means of recognizing the particular advantages that normally would accrue to producers located close to the market.
4. It provides a normal and acceptable market outlet for any excess milk produced by producer-distributors.

The Legal Division criticized this provision on the grounds that it was formulated on an inadequate body of economic information. Their memorandum pointed out that it would increase the volume of milk exempted from the equalization pool from about 700,000 pounds to more than 2,000,000 pounds for each semi-monthly delivery period. This it was felt might result in unfair discrimination against the pasteurizing distributors who were subject to the order. Also it might be considered unfair to the regular producers in the market because the exemption of this additional milk would result in a lower blended price. In its memorandum the Legal Division stated:

It is believed that this proposal is predicated upon the possibility that the existing license may have to be revoked for the reason that under the present exemption allowed producer-distributors the equalization pool is not working, and the license may fail because of inability to enforce its provisions. That

is not sufficient justification for the inclusion of a provision which presents a serious legal question.

The Consumers' Counsel supported the change in the producer-distributor provision, stating that "it makes the license more nearly approach the limits of enforcibility." In its memorandum the Consumers' Counsel indicated that the new provision should be accompanied by a policy of allowing greater freedom of "base" transfers among producers and producer-distributors.

During the year that elapsed following the issuance of this amendment, the difficulty of enforcing the Kansas City license became greater. In a letter to the Chief of the Dairy Section, dated December 31, 1934, Mr. Morehouse had recommended exempting producer-distributors from the license "unless some definite action can be taken by the Administrator to enforce any or all provisions of the license as applied to producer-distributors . . ." He attributed failure of enforcement to the following factors:

1. Many producer-distributors considered the first license so unfair that they wouldn't comply; the habit of non-compliance, once started, was difficult to overcome even when the license provisions were made more lenient.
2. Some producer-distributors complied for a time until they heard that their neighbors and competitors were not complying; then they refused to comply until the Market Administrator showed he could get the others to comply.
3. A growing belief that the Administration could not enforce the license against a distributor whose own operations were not in interstate commerce.
4. Personal contact brings some temporary results in compliance, but the cost of continuous personal contact is prohibitive.
5. About half the producer-distributors are living from hand-to-mouth and are heavily in debt; equalization payments required under the license impose a serious hardship on such operators.

In July 1935, the Department gave up all efforts to regulate the operations of producer-distributors. An amendment adopted at that time exempted milk produced by producer-distributors from the pricing and pooling provisions of the license. If the producer-distributor purchased part of his supplies from other producers, he was permitted to deduct his own production on a pro rata basis from his sales in each class. The producer-distributor was, however, given the option of participating in the pool by reporting and accounting for all of his sales in each class. By the terms of the amended license those farmers who bottled raw milk and sold

it to pasteurizing distributors were left in the category of original producers.

Problems of Defining the Sales Area

There were no plans for combining Kansas City, Kans., and Kansas City, Mo., in one sales area when the first agreements and licenses were contemplated. This is evidenced by the fact that separate hearings were held in the two cities, one in Kansas City, Mo., in July 1933 and the other in Kansas City, Kans., in December of the same year. Moreover, there was no evidence presented at either of these hearings to indicate that these two cities and their adjoining territory constituted a single milk market. At the hearing in Kansas City, Mo., the representative of the Pure Milk Producers Association testified specifically on this point saying that the two cities had in the past been considered separate milk markets, that their sanitary regulations were different, and that resale prices in the two cities had not been the same. He pointed out also that distributors in Kansas City, Kans., bought milk on a butterfat basis whereas those on the Missouri side bought bulk milk on the basis of its weight with a butterfat differential applied. The class price system had not been introduced in Kansas City, Kans., and all producers who supplied that city were located in the State of Kansas. (Page 22.)

The greater Kansas City sales area proved to be unworkable almost from the start. It became evident that the diversity of health regulations and of economic conditions in the sales area were making it difficult to administer the license. The pasteurizing distributors in Kansas City, Mo., were willing to go along with the license program but distributors in other parts of the sales area could see little benefit to them in compliance with the license provisions.

In September 1934, less than 6 months after the two city areas were combined under the license, the Market Administrator wrote the Chief of the Dairy Section, as follows:

It looks very much as though the Kansas City, Missouri, and Kansas City, Kansas, markets are going to separate at least as far as their relationships to the Arbitration Agreement.

The Pure Milk Producers Association has recognized the difference in the Distributor set up, and their representative and that of the Pasteurizers have a meeting scheduled with Mr. McBride in Columbus, Ohio, next Saturday and Sunday and are going to attempt to arrive at a different set up.

In a letter, written 2 days before, the Market Administrator had summed up his observations in the following paragraph:

The situation on the Kansas side of the market is bad. That market just don't seem to be able to get as much for their milk as they do on the Missouri side. The Health Ord-

nance is not in any way enforced, the Distributors, as a whole, are not as high class merchandisers and their trade had not in the past been educated to paying the price and the percentage of consumers who are financially able to buy is less.

On October 4, 1934, the Chief of the Dairy Section told the Market Administrator that its field representative had confirmed his view that the two cities should operate under separate licenses. The Market Administrator was advised not to initiate requests for an amendment but he was asked why no request for the separation of the two markets had been sent to Washington. The matter of getting requests from the industry was pressed by the Chief of the Dairy Section in several subsequent letters. 38/

The Department waited for a proposal from the industry before acting on a change. The proposal did not come to Washington and there is evidence that, at this time, officials of the producers' organizations and of distributing companies were concerned primarily with getting their side agreements operating and did not consider the wording of the license provision as a matter of great practical importance. 39/

The change in the sales area came about as a part of an amendment to the license, effective July 1, 1935. The sales area was reduced to the corporate limits of Kansas City, Mo. In recognition of the fact that distributors in Kansas City, Mo., would do a considerable amount of business beyond the city limits where they would come into competition with unregulated distributors who had access to lower priced supplies of uninspected milk, an out-of-area pricing provision was provided by the amendment. Under this provision the Market Administrator was permitted to make adjustments in the prices of Class I and Class II milk sold by distributors outside of Kansas City, Mo., by determining the prevailing prices in the outside market and permitting a reasonable allowance to the distributor for transporting milk to such market.

Legality of Licenses

Enforcement of the license was handicapped by the uncertain status of the Agricultural Adjustment Act and the rather vague wording of section 8 of the act pertaining to milk regulation. This not only made it difficult to prosecute violators successfully in the courts but also reduced

38/ Letters from the Chief, Dairy Section, AAA, to the Market Administrator, October 4, 9, 19, and 23, 1934.

39/ This was due partly to the growing unenforceability of the license and partly to the fact that the industry was learning to use the prestige of the Government and the office of the Market Administrator to get what it wanted, through these side agreements. A fuller development of these points is made in the next section.

the effectiveness of various administrative actions designed to promote compliance with the terms of the license. Such actions included warning letters, instructions for making proper reports, investigations, informal hearings, telephone check-ups, and other means of showing distributors that the provisions of the license were to be impartially and vigorously administered.

Adverse court decisions during 1934 and 1935 slowed up enforcement work on the licenses. 40/ The legal status of milk regulation was rendered uncertain by the decision of the U. S. Supreme Court in the Hoosac Mills case. This decision, rendered January 6, 1936, declared invalid those parts of the Agricultural Adjustment Act which provided for control of production by means of processing taxes and benefit payments. As these parts constituted the core of the act, the decision left serious doubt as to the status of the provisions in section 8 under which milk marketing was being regulated.

A Federal District Court declared Federal milk regulation in Boston was unconstitutional on the basis that the Supreme Court's decision in the Hoosac Mills case had invalidated the entire Agricultural Adjustment Act, including the marketing agreement provisions. This decision was reversed by the Circuit Court of Appeals, but the reversal came too late to undo the damaging effect of the lower court's decision on the Government's enforcement efforts in connection with milk marketing programs throughout the country.

40/ During 1935, there were decisions in seven suits involving milk licenses in various parts of the country. In each instance the decision was against the Government. (Report of the Agricultural Adjustment Administration: 1933 to 1935).

IV. THE ROLE OF INDUSTRY AGREEMENTS

Assumption of Responsibility by the Industry

The license had been in operation only a few months when organized producers and distributors began to take control of the situation, at least insofar as changes in the producer price structure were concerned. This assumption of responsibility by the industry was a gradual process. It started in August 1934 when C. G. McBride, a professor of dairy marketing at Ohio State University, was called in to arbitrate the question of premium payments over the minimum license prices. In calling on a private arbitrator, producers and distributors passed up the opportunity of directing to the Department of Agriculture their requests for consideration of price changes, in which case any changes would have been incorporated in the license through the amendment process.

After a succession of such arbitration awards, the industry engaged in direct negotiations on prices and in some cases arrived at decisions which were inconsistent with the provisions of the license itself. In March 1936, the industry completed the process of taking over control from the Department by drafting a full-fledged marketing agreement in which the term, Supply Committee, was substituted for the Secretary of Agriculture. The organizations of distributors and of the producers signed agreements which bound them to compliance with this industry-devised marketing agreement.

The Department at first took a rather cautious attitude toward these industry agreements. In regard to the first of the arbitration awards, the Department showed concern for any inconsistency with the license program and reminded the Market Administrator of the limits of his authority under the license:

We note that the decision of the Board involves changes in the prices and one change in the classification of milk from what is specified in the Federal milk license. We believe that everything possible should be done to bring the license more in line with the market practice or withdraw the license entirely. There is no objection to having the Board specify higher prices than those in the license, but it should be clearly understood that your activities as Market Administrator cannot be supported if they go beyond the prices and provisions established in the license itself. You might carry the additional price either as a premium or as a separate pool, but it cannot be expected that the Government will enforce those additional prices or any adjustments due as a result of such price increase. 41/

41/ Letter from the Chief of the Dairy Section to the Market Administrator, August 23, 1934.

This attitude of the Department changed under the pressure of circumstances brought about primarily by the legal difficulties which were encountered in enforcing the Federal licenses. Eventually, through its field representative, the Department gave assistance in devising industry agreements and permitted the Market Administrator to become further involved in administrative responsibilities with respect to them. At first, the Department authorized him to perform certain necessary services, such as the computation of premium payments over the minimum license prices, but did not permit him to take formal responsibility for the carrying out of such functions. By the time the industry marketing agreement of March 1936 was drawn up, however, the Market Administrator cooperated with the industry through its Supply Committee to administer this agreement.

The Arbitration Awards

Arbitration award of August 11, 1934. During the drought period of 1934, producers became dissatisfied with the minimum prices established by the license. In July, the Pure Milk Producers Association pressed for a premium price. A price of 46 cents a hundred pounds over the license price was accepted by the distributors on a tentative basis, effective August 1, 1934. Dr. McBride was called in as arbitrator of the price dispute. The majority of distributors agreed to abide by the decision of an arbitration board composed of Dr. McBride, J. V. Quigley, representing the distributors, and John Gage, representing the producers.

The arbitration board, after hearing testimony for 2 days, decided on August 11, 1934, that the price of Class I milk should be raised to \$2.45 a hundred pounds of milk containing 3.8-percent butterfat. This decision called for a 58-cent premium over the license price. The Board also decided to add 15 cents and 5 cents to the license formula prices for Class II milk and Class III milk, respectively. 42/

The Board further modified the marketing plan provided by the license by deciding that Class III milk was ". . . to consist of an amount not in excess of 10 percent of the combined usages of Classes I and II, and the remainder of any Class III usage to be paid for on the basis of the Class II price . . ." and further ". . . that in the event of any shortage in production of base milk rendering the amount delivered by producers insufficient to adequately supply the needs of distributors for Class I and Class II sales, that a price equivalent to the blended price, calculated as above, was to be paid to all individual producers for any milk delivered in excess of the base of such producer."

The increases in prices to producers granted by the Board were, according to the text of the decision, not sufficient to cover increased

42/ Report of the Market Administrator on the operation of License No. 40 from March 17, 1934, to June 30, 1935.

costs of production. A further increase was anticipated by the following paragraph included in the decision:

We believe that further price increase to consumers of milk in the Kansas City market is inevitable and the arbitrated increase in price as determined and agreed upon shall be effective pending such increase in consumer prices or change therein made pursuant to future mutual agreement or through arbitration.

The arbitration award was not signed by the distributor representative on the arbitration board although all distributors who signed the arbitration agreement were bound by the award.

Arbitration award of September 30, 1934. A further departure from the milk marketing plan incorporated in the Federal license was made by Dr. McBride in his role of arbitrator less than 2 months later. The meeting leading to this award or agreement was held in Columbus, Ohio, on September 30, 1934. ^{43/} Under the terms of his award, Kansas City, Kans., was separated from the rest of the sales area and special pricing provisions were made for Kansas distributors.

This award marked a decisive step for the milk industry of the Kansas City area. From this point, the terms of the Federal license were of secondary importance. The producers' association and distributors indicated their intention of using the license as a springboard for whatever marketing arrangements they cared to make, whether or not such arrangements might be in accord with the marketing plan under the license. This intention was further shown by the fact that the prices set forth in the award were to apply for the month of October only. A joint market committee was to be set up "to meet weekly or more often if necessary in an effort to consolidate all interests in the market upon a stabilization program."

Arbitration award of November 4, 1934. The Missouri part of the sales area was not affected by the arbitration award of September 30, 1934. This area was still governed by the license as modified by the award of August 11, 1934. On November 4, however, Dr. McBride, after meeting with producers and distributors, made a new award with the following provisions to apply to the "Kansas City, Missouri, milk market":

1. Class I price was set at \$2.40 per hundredweight. This was a reduction of 5 cents from the previous award price but was still 53 cents over the license minimum.

^{43/} Dr. McBride followed in the footsteps of his predecessor, Dr. King (see page 7). Both men tried to bring organized producers and distributors together to modify certain competitive aspects of milk marketing and to achieve what they believed were mutually beneficial agreements as to prices and other marketing arrangements.

2. Class II and Class III prices were to be the same as the license formula price. This meant a reduction of 15 cents from the previous award price for Class II.
3. The provision of the previous award limiting Class III to 10 percent of combined Classes I and II was eliminated "with the recommendation that producers dropped because of the above provision be reinstated on the market."

The prices established by this award were to "prevail for November 1934 and until changed by mutual agreement or arbitration." As in the case of the Kansas City, Kans., award, Dr. McBride recommended that a joint committee be created "to consist of an equal number of producers and distributors for the purpose of promoting market stabilization and increasing sales of milk." It was further recommended that a fund be created by equal contribution of producers and distributors to support the activities of this committee. The producers' contribution was not to exceed 5 cents per hundredweight deducted from the Class I price.

Arbitration award of May 31, 1935. The last of Dr. McBride's arbitration awards was made because of an impending break in resale prices due to competition of producer-distributors and country stands. "It was apparent," Dr. McBride said in his decision, "that present competitive conditions are not supporting the established price of 12 cents retail and 10 cents wholesale. It is the opinion of the arbitrator that under the existing conditions an effort should be made to stabilize the market at a somewhat lower level." The Class I price was therefore reduced to \$2.15 which was only 28 cents over the license minimum price for such milk. Class II and Class III milk prices continued to be calculated on the formulas in the license.

Industry Agreements, May 1935 to March 1936

A series of direct agreements between organized milk producers and distributors began to take place in May 1935. These brought about further changes in milk marketing and tended to create a greater degree of inconsistency between the marketing plan which was in actual operation and the plan provided under the terms of the Federal license.

The first of these agreements between the producers' association and distributors of Kansas City, Mo., was to establish what amounted to an extra classification of milk. It was called Class II "special" and was subsequently listed in the Market Administrator's reports as Class II-A. Class II-A milk was used to make fluid cream which was sold by distributors at a special sale price on Saturdays, Sundays, and holidays beginning May 25, 1935. Distributors agreed to sell this cream, containing 35 percent butterfat, at 25 cents a pint. Producers were to receive \$1.29 a hundredweight for all milk put to this use. This price was 19 cents under the license minimum price for Class II in July and subsequently fell further below the license formula price. Class II-A use was, of course, part of Class II usage according to the classification plan in the license.

The purpose of negotiating the agreement for a special cream price was explained to the members of the Association by its officers as follows: 44/

After careful deliberation the executive board of the Association decided that such a special cream sale would have a tendency to reduce the buying of milk and cream at road-side stands, and in all probability increase consumption of pasteurized milk and cream. Reports indicate that more and more consumers are driving out to these road-side stands to get low priced cream which is on sale there and at the same time purchase a supply of raw milk.

The second directly negotiated industry agreement dealt with the method of paying premiums which distributors had agreed to pay under the McBride arbitration awards. Under the award of May 31, 1935, distributors had agreed to pay 28 cents per hundredweight on their Class I sales. The Market Administrator, at the request of producers and distributors, computed the average premium for all distributors so that each distributor could pay this average premium to his producers. After a time, some distributors with a relatively low proportion of Class I sales refused to pay the average premium as computed by the Market Administrator and started to pay a premium based on their own Class I sales. A number of meetings were held during June and July resulting in a general agreement whereby each distributor would pay the premium on the basis of his individual Class I sales. The market administrator then computed a special pool for these premium payments so that all producers would get the same amount of extra money for each hundredweight of milk regardless of the Class I experience of the distributor to whom he sold his milk. While this premium pool was computed separately from the license pricing pool, it had the same effect as if the license Class I price had been increased by the amount of the premium. This carried out the probable intent of the arbitration award.

Another agreement between producers and distributors resulted in the suspension of the base rating plan of payment for milk, effective July 16, 1935. This meant that instead of computing a blend price on producers' base milk only, the Market Administrator computed a blend price for all milk sold by producers. The conflict between the agreement and the license as it existed at that time is clear. The license was amended to accomplish the same purpose but the effective date of this amendment was August 1, 1935 (page 30). The blended price during the pool period, July 16-31, 1935, was \$1.59 or 6 cents lower than the price for the first pool period of that month. The effect of this agreement was that producers whose production of milk was within their base received several cents per hundredweight less for their milk than they were entitled to receive under the license. Other producers, with

44/ Kansas City Cooperative Dairyman, May 1935.

excess over base milk, benefited proportionately.

In September of the same year, although the base plan had been eliminated from the license, producers and distributors agreed to restore it and the Market Administrator accordingly made his blend price computations on base deliveries beginning with the second pool period of September 1935. The blend price for this period was 14 cents higher than for the previous period largely because of this change. The reason for this change--the decision of producers and distributors to go back to the base plan--was an increase in the milk supply and a falling off of sales of buttermilk, chocolate milk, and cottage cheese. The possibility of returning to the base plan had been contemplated at the time the industry requested that it be dropped from the license. At that time, the Department of Agriculture was asked to suspend it pending restoration at any time at the joint request of producers and handlers. The amending of the Agricultural Adjustment Act on August 24, 1935, however, put an end to any further amendments to licenses, and prevented the restoration of the base plan in the license. The amended act provided that marketing agreements and orders would in the future be used instead of licenses as instruments for Federal regulation of milk marketing. Licenses issued prior to August 24, 1935, could remain in effect but no provision was made for amending them. (See page 77 for a summary of inconsistencies between industry agreements and the license with respect to the base-rating plan.)

In January 1936, producers and distributors made a new agreement with respect to the Class II-A price. This price which had been set by the agreement of June 1935 at \$1.29 per hundredweight was each month falling farther behind the license Class II price which was computed on a formula. In December 1935, the Class II-A price was 69 cents less than the license Class II price. It was even 17 cents less than the license Class III price. The January agreement was to the effect that the Class II-A price should not be less than the license Class III price.

Industry Agreements as an Outgrowth of Legal Uncertainties

The trend during this period for producers and distributors to rely on industry agreements and the tacit acceptance of such agreements by the Department of Agriculture is closely related to the legal difficulties encountered in the administration of the licenses. Because of adverse court decision, the Department had been compelled to withdraw entirely from a number of markets during 1935 and was faced with the necessity of relying on the consent of organized producers and distributors for whatever regulatory activity it continued to carry out. 45/

45/ A total of 52 licenses had been issued prior to the 1935 amendment but by the end of 1935 only 30 were still in operation. The reason given by the Department for most of the terminations was "because the degree of cooperation among the interests in the markets in carrying out the provisions of the licenses was insufficient to make them reasonably effective." Report of the Agricultural Adjustment Administration: 1933-1935. Page 268.

The 1935 amendment to the Agricultural Adjustment Act, previously mentioned, was passed in order to strengthen the regulatory program but new and more serious legal difficulties were encountered (page 42). 46/ The amended act required a public hearing, decisions related to evidence adduced at the hearing, and specific factual findings by the Secretary as well as a determination by him of producer approval before he could issue an order. The magnitude of the task in relation to the number of milk marketing specialists which the Department could assign to it would have precluded any very rapid change from licenses to orders in all markets. But the main cause of delay was legal uncertainty.

The policy regarding the continuation of licenses pending their replacement by orders was stated in the 1936 report of the Agricultural Adjustment Administration as follows: 47/

. . . In markets where there was much non-compliance and no general disposition to carry forward a supervised plan under a marketing agreement or order, or both, licenses have been terminated. In each case the license has continued in effect until it became clear that it no longer served a useful purpose and that there was not a sufficient desire for a marketing agreement or order.

The licenses still in effect at the end of 1936 remained because of a desire in the markets for continuation of assistance afforded by such plans and because there had not been sufficient time to complete, in each market, the necessary study for adequate determination of the content of a suitable marketing agreement or order.

Industry Agreement of March 1936

On March 24, 1936, the distributors and representatives of the Pure Milk Producers Association and of the Bates County Producers Association entered into a new marketing agreement which replaced the Federal license as an instrument of regulation in the Kansas City milk market. Heretofore, the license had been nominally the instrument of regulation even though it had been supplemented by, and in certain cases contradicted by, the terms of industry agreements. But the agreement of March 24 was a complete plan of market regulations. A field representative of the Department of Agriculture had helped to formulate the agreement and it

46/ "The increasing uncertainty as to the attitude of the courts relating to marketing agreements and licenses for dairy producers as well as other farmers led to the amendment of the act in 1935." Report of the Agricultural Adjustment Administration: 1937-38. Page 76.

47/ Agricultural Conservation, 1936. A report of the activities of the Agricultural Adjustment Administration. Page 71.

was administered by the Market Administrator. The contract covering the new agreement stated that it would "become effective April 1, 1936, and shall remain and be in effect until March 31, 1937." 48/

The supply contracts, which bound distributors and the producer associations to comply with the marketing agreement, also established a Supply Committee which was to be invested with authority over the marketing of milk to replace the authority of the Secretary of Agriculture. The Supply Committee was composed of 4 representatives of the Pure Milk Producers Association, 1 representative of the Bates County Association, and 5 representatives of contracting distributors. The Commissioner of Inspection and Sanitation of Kansas City, Mo., was an ex-officio member of the Committee. Among the powers of the Committee were the following:

1. To employ the Market Administrator to administer the marketing agreement.
2. To direct sales of milk or temporary transfers of producers between distributors so that, as far as possible, all distributors would have enough milk to meet their Class I and Class II requirements.
3. To determine when additional producers are needed on the market. 49/

The marketing agreement, itself, was drawn up along the general lines of Federal licenses. The term, Supply Committee, replaced the term Secretary throughout. Provision was made for administering the agreement by a Market Administrator with powers and duties set forth in the same way as under the license, only he was to be appointed by the Supply Committee and was to be subject to removal by that Committee. The agreement was similar to the amended license in definition of the sales, or marketing area. Three use classes of milk were established in the agreement and they were defined the same as in the amended license. The chief differences between the industry's marketing agreement and the amended license were as follows:

1. The minimum Class I price in the agreement was set at \$2.00 a hundredweight, 25 cents over the license minimum.
2. The minimum Class II price was set at \$1.70 a hundredweight,

48/ The Kansas City Cooperative Dairyman for February 1936 and March 1936.

49/ The precise wording of this significant function as contained in the supply contracts was as follows:

It is agreed that if and when the Supply Committee shall determine that additional producers are required to supply the Class I and Class II needs of the marketing area, the handler may arrange for additional fluid milk producers whose location and quality are satisfactory to the parties hereto, but before such producers are taken on they shall secure permits from the Kansas City, Missouri, Health Department, and shall become members of the Association.

whereas under the license this price was on a formula basis.

3. The minimum price of Class III milk was, in the agreement, established as the top bid submitted by a handler for milk for Class III use. Under the license, the Class III price was on a formula basis.
4. The agreement re-established the base-rating plan which had been dropped from the license and set up a monthly pricing pool to replace the semimonthly pool specified by the license.
5. The agreement made no distinction between new producers and other producers in payments for milk.
6. The agreement allowed a maximum assessment of 2 cents a hundredweight to be made upon handlers for administrative expense. The license allowed no more than 1 cent a hundredweight for this purpose and this was deducted from payments to producers.

Several amendments were made by the industry to their marketing agreement during its operation. The first amendment, which was made effective May 1, 1936, changed the method of computing the Class III price and also changed the method of applying the location adjustment to be paid by distributors for milk delivered to their country stations. The Class III price, which in the original industry agreement was on a "bid" basis, was changed and the license Class III formula was adopted. This was 3.8 times the average wholesale price per pound of 92-score butter at Chicago, plus 20 cents. The amounts of location adjustments as set forth in the agreement were not changed, but whereas they were formerly applied to the individual dealer's Class I and Class II sales, the amendment made it applicable to all base milk received from producers. 50/

An amendment effective July 1, 1936, gave a producer credit for part of his production in excess of his base in computing his future base during those quarterly periods when new producers were admitted to the market to help furnish Class I and Class II requirements of distributors. 51/

Two price increases took place during the months of July and August 1936. The first of these took place beginning July 16, when the following increases were made: Class I from \$2 per hundredweight to \$2.40; Class II from \$1.70 to \$2.05; Class III an increase of 5 cents over the formula as previously established. 52/

50/ The Kansas City Cooperative Dairyman, June 1936.

51/ The Kansas City Cooperative Dairyman, July 1936.

52/ The Kansas City Cooperative Dairyman, August 1936.

Producers requested a further increase in prices, but were unable to obtain an agreement by direct negotiation with distributors. The matter was therefore arbitrated and Professor R. B. Stoltz of the University of Ohio was asked to act as arbitrator. His decision called for further increases in producer prices, effective August 11, as follows: Class I, \$2.70 per hundredweight; Class II, \$2.15 per hundredweight; and Class III, a further increase of 10 cents per hundredweight over the formula as previously increased. 53/

The industry agreement did not specify how long a producer could remain off the market without losing his base. The Supply Committee decided, at a meeting sometime in August 1936, that "should a producer remain voluntarily off the market for a period longer than 30 days, he would have to establish a new base when again resuming shipments. 54

The strong tendency for producer price negotiations under industry agreements to be linked up with discussions of resale prices is illustrated by the negotiations which took place in connection with these price revisions. It was necessary to bring producer-distributors (who were not parties to the industry agreement) into the discussions in order to revise producer prices. At the same time that producers and distributors agreed to the July 16 increase, it was also agreed by distributors and producer-distributors to increase resale prices of milk and cream to consumers. A request by the producers association for further increases in resale prices and corresponding increases in prices to producers was refused by the distributors and producer-distributors and necessitated later arbitration. When producers did receive a further increase in prices through the arbitration procedure, the arbitrator's decision included an adjusted schedule of resale prices. 55/

Relationship of Department to Industry Agreements

During the license period the Department of Agriculture vested general administrative responsibility for milk marketing regulation in the Chief of the Dairy Section of the Agricultural Adjustment Administration. The market administrators for the various milk marketing areas maintained contact with the Dairy Section through the usual channels of written reports and correspondence and at times by wire and telephone. Field representatives of the Dairy Section visited periodically all the Market Administrators of their assigned territories and reported to the Chief of the Dairy Section on developments in these markets. During this period, when milk regulation by the Federal Government was in a formative stage and when basic legal questions were still unsettled, a high degree of responsibility was placed on each of these field representatives. While the general policy referred to on page 50 was

53/ The Kansas City Cooperative Dairyman, August 1936.

54/ The Kansas City Cooperative Dairyman, September 1936.

55/ The Kansas City Cooperative Dairyman, August 1936.

followed by the Department through this interim period, no effort was made by the Dairy Section to define a uniform relationship between the Government and the dairy industry which would be applicable to all markets. The several field representatives were directed to assist the producer cooperative associations in promoting stable marketing conditions pending a clarification of the broader legislative and legal issues. Thus, a considerable latitude was given to the field representatives and a certain amount of experimentation with different methods of approach took place.

The field representative of the Dairy Section for the geographic region which included the Kansas City market was Walter Hunnicutt who had been associated with Cooperative Pure Milk Association of Cincinnati, Ohio. This association was engaged through a subsidiary company in the milk distributing business, a background which gave him experience with problems of producers as well as distributors. Previous to his employment in the Department, he had joined a committee of the International Association of Milk Dealers which conducted a study of the various milk buying plans which were at that time used in various markets throughout the country.

During the period in which he acted as field representative of the Department, Mr. Hunnicutt tried to promote stable marketing and to serve dairy cooperatives in his markets primarily through assisting the cooperatives and milk distributors in reaching agreements on prices and other aspects of marketing. He achieved considerable success with his methods in a number of markets. He would bring producer and distributor representatives together at meetings some of which would continue for several days in an effort to settle differences. Frequently, compromises were encouraged whereby terms of a marketing program would be agreed to, which in certain respects might not be entirely satisfactory to all parties. However, if the outcome of the meetings was successful, all parties would agree to abide by all the terms of the marketing plan, and if a public hearing was called by the Secretary of Agriculture an obligation rested on each party at such a hearing not to oppose any aspect of the marketing plan to which he had already agreed.

The hearings held in the Kansas City market in May and July 1936 to consider a proposed Federal order, substantially followed this pattern. The proposed order on which the hearing was held was drafted to conform to the marketing plan already operating under the industry agreement with minor changes worked out at pre-hearing meetings between producers and distributors. Even where last-minute changes were submitted for consideration at the hearing, they had already been checked to make sure they were agreeable to all parties. The only exceptions to the unanimity rule noted in the hearing record were: (1) A handler representative who felt that the method of applying station differentials did not give adequate consideration to his company's type of operation, and (2) another handler representative who wanted the record to show that his company was perfectly satisfied with the voluntary agreement and did not see the need for confirmation by a Federal order. In the first case, the

hearing record indicates that the question of how the station differentials were to be applied was still in an unsettled state as far as the industry was concerned, and producer representatives were themselves divided as to the proper answer. A supplemental brief submitted by the Pure Milk Association after the hearing presented an amendment to the proposed order satisfactory to all parties in the market. 56/

Experiments with industry agreements, developed by the field representative of the Dairy Section, in Kansas City and in other markets provide some interesting material on what might have been the beginning of an alternative to the present type of public control of milk marketing. In his book "The Dairy Industry and the AAA" based on a study made for the Brookings Institution in 1935, John D. Black speculates on various alternatives to public control. Two of these forms, given consideration by Dr. Black, were based on industry agreements and were designated as: (1) Collective bargaining mostly under industry control; and (2) collective bargaining with effective public control. 57/

The type of industry agreements in the Kansas City market which were made during the license period tended to fall into the first of these forms. Although made under the general guidance of a Government representative, there was no Government policy setting clearly defined limits within which discretionary authority for devising marketing plans was vested in the industry.

56/ Record of public hearing held in Kansas City, May 6, 1936. Pages 17, 24, 26, 32, 36.

57/"The Dairy Industry and the AAA" by John D. Black, published by the Brookings Institution. 1935. Pages 257-261.

V. MILK SUPPLIES AND PRICES

Classification of Milk

License No. 40 originally (March 17, 1934) established three classes of milk as a basis for pricing. Class I was milk sold by distributors for consumption as whole milk; Class II was milk sold by distributors for consumption as fluid cream; and Class III was all milk used by distributors in excess of Class I and Class II milk. A summary of the modifications of this classification plan made by amendment to the license and by negotiation outside the license is shown in table 3.

The amendment of July 1934, added chocolate milk, chocolate drinks, flavored milk, creamed cottage cheese, and creamed buttermilk to Class II. Milk used for these products, under the original plan, was in Class III. A memorandum which was part of the docket on this amendment indicated that this change was desirable in view of the fact that these products were made from inspected milk and that a Class II price would be "more nearly in line with the market values of these commodities." 58/

Under the arbitration award of August 1934, a distributor was not allowed to account for more than 10 percent of the total of his Class I and Class II sales in Class III. Any excess over this amount, even when used to make Class III products, was to be paid for at the Class II price. Because of this provision, a distributor sometimes found it to his advantage to drop producers when his Class III utilization was high. This led to dissatisfaction, and the limitation on Class III was rescinded 3 months later with a stipulation that all producers who had been dropped because of it, should be reinstated.

The only other modification of the classification plan as set forth in the license was the agreement in May 1935 for setting up a special price for cream which was placed in Class II-A (page 47). This subclass continued in effect until the industry agreement of March 1936 when the classification plan reverted to that in the amended license.

Class I Price During License Period

The minimum price of milk for Class I (fluid uses) remained unchanged during the entire period of the license. When the license was first adopted, it was set at \$1.75 per hundredweight of milk containing 3.5 percent butterfat. In July, when the standard butterfat test of milk for pricing purposes was changed from 3.5 to 3.8 percent, the Class I price was established at \$1.87. This was merely the former \$1.75 price for 3.5 milk adjusted to the 3.8 basis by applying the butterfat differ-

58/ Memorandum to the Chief of the Dairy Section from Donald Hammerberg, Regional Consultant, July 11, 1934.

Table 3.---Classification plan under License No. 40 and its modifications by industry negotiations, March 17, 1934 through March 24, 1936

Class	First license classification	License amendment	Arbitration award	Arbitration award	Industry agreement	Industry agreement
	plan	7/17/34	8/11/34	11/4/34	5/25/35	3/24/36
I	fluid milk					
II	fluid cream	Products added: choc. milk, choc. drinks, flavored milk, creamed cot. cheese, creamed buttermilk			Class II-A established for fluid cream sold by distributors at special sale price	Class II-A dropped
III	all other uses	Class III limited to 10 percent of a distributor's Cl. I and Cl. II sales. Excess goes in Cl. II		Class III limitation removed		

ential (4 cents a point) which the license provided.

The rigidity of the minimum Class I price during this period, when several severe droughts occurred and when general economic conditions were undergoing considerable changes, reflected a serious deficiency in the operation of the Kansas City license. From August 1934 until the license was terminated in November 1936, there was not a single month during which the minimum Class I price established in the license was the actual price paid by the industry. For a number of months during 1935 and 1936, the formula price for Class II milk actually exceeded the minimum Class I price.

From an administrative standpoint, the failure to adjust the Class I price by amending the license may have been due in part to the difficulties in enforcing the license provisions. In any case, this was probably a decisive factor in permitting the center of gravity of administrative responsibility to pass from the Government in Washington to the industry in Kansas City. In this connection, it is interesting to speculate as to whether the Government would have been in a better position to exercise control of the situation if it had utilized the now widely adopted formula technique for pricing Class I milk. The formula pricing of Class I milk was not adopted in the Kansas City market until May 1942. Indeed, it was not until November 1935 that the Class I formula was adopted in Chicago, the first of the major milk markets in the country to use such a device. 59/

The premium price established for Class I milk by the industry and its relation to the established Class I price in the license is shown in figure 2. It may be noted that at no time after August 1934 did the agreed price fall to as low as 13 cents above the license minimum. Certain aspects of the price trends under industry agreements may also be noted from figure 2. There is little, if any, seasonal element in the Class I price established by the industry. Nor was there any serious attempt to relate the Class I price by some fixed differential to the Class II price for fluid cream or the Class III price for manufacturing uses. The difference between the Class I and the Class II price varied widely during this period, from less than 15 cents during one month to about 90 cents for several other months.

Class II Price During License Period

The Class II pricing formula in the license was changed only once during its entire period of operation. This change occurred in July 1934, about 4 months after the license went into effect. The purpose of the amendment to the Class II formula was primarily to

59/ Formula pricing of milk for fluid use by Edmond S. Harris and Irwin R. Hedges, Farm Credit Administration, U. S. Department of Agriculture. Page 8.

Table 4.--Minimum class prices provided by License No. 40 and class prices established by industry agreements in the Kansas City, Mo., milk market, April 1934-November 1936.

Month	Class I		Class II			Class III	
	License	By	License	By agreement		License	By
	minimum	agreement	minimum	Regular	Special 1/	minimum	agreement
1934							
Apr.	1.87	--	1.349	--	--	1.10	--
May	1.87	--	1.385	--	--	1.13	--
June	1.87	--	1.43	--	--	1.17	--
July	1.87	--	1.445	--	--	1.125	--
Aug.	1.87	2.39	1.63	1.78	--	1.20	1.225
Sept.	1.87	2.45	1.555	1.705	--	1.145	1.195
Oct.	1.87	2.45	1.605	1.755	--	1.18	1.23
Nov.	1.87	2.40	1.765	--	--	1.30	--
Dec.	1.87	2.40	1.795	--	--	1.32	--
1935							
Jan.	1.87	2.40	1.95	--	--	1.435	--
Feb.	1.87	2.40	2.07	--	--	1.525	--
Mar.	1.87	2.40	1.86	--	--	1.37	--
Apr.	1.87	2.40	1.96	--	--	1.445	--
May	1.87	2.40	1.61	--	--	1.19	--
June	1.87	2.15	1.485	--	--	1.095	--
July	1.87	2.15	1.49	--	1.29	1.095	--
Aug.	1.87	2.15	1.53	--	1.29	1.125	--
Sept.	1.87	2.15	1.585	--	1.29	1.165	--
Oct.	1.87	2.15	1.67	--	1.29	1.23	--
Nov.	1.87	2.15	1.895	--	1.29	1.395	--
Dec.	1.87	2.15	1.98	--	1.29	1.46	--
1936							
Jan.	1.87	2.15	2.005	--	1.48	1.48	--
Feb.	1.87	2.15	2.025	--	1.555	1.555	--
Mar.	1.87	2.15	1.88	--	1.385	1.385	--
Apr.	1.87	2.00	1.805	1.70	--	1.33	--
May	1.87	2.00	1.63	1.70	--	1.20	--
June	1.87	2.00	1.765	1.70	--	1.30	--
July	1.87	2.20	1.992	1.875	--	1.47	1.495
Aug.	1.87	2.60	2.058	2.10	--	1.525	1.641
Sept.	1.87	2.70	2.02	2.15	--	1.49	1.64
Oct.	1.87	2.70	1.89	2.15	--	1.39	1.54
Nov.	1.87	2.70	1.95	2.15	--	1.44	1.59

1/ See page 47

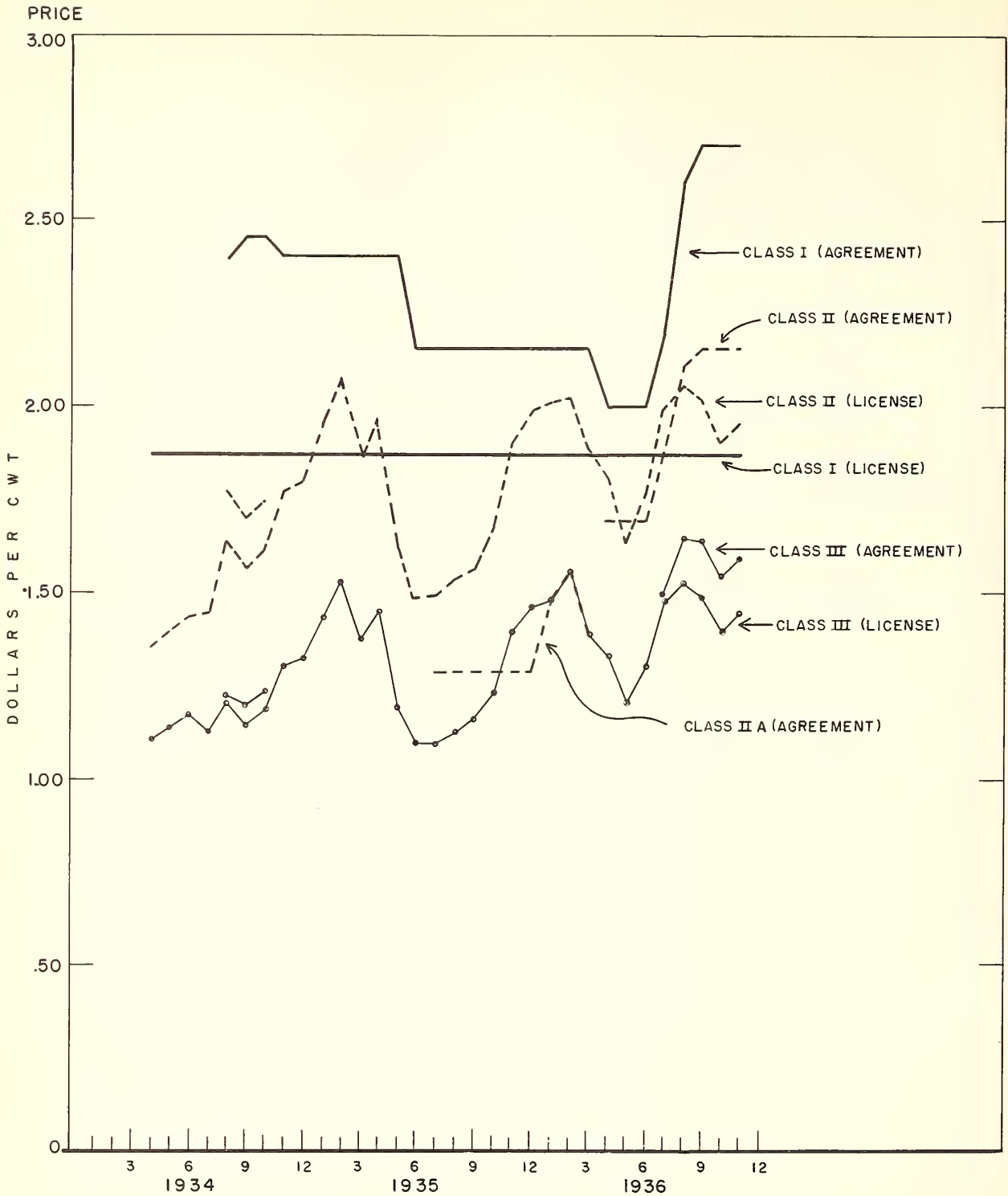


Figure 2--Minimum class prices provided by License No. 40 and class prices established by industry agreements in the Kansas City, Mo., milk market, April 1934-November 1936.

increase the price of milk used for fluid cream, but the new formula was further modified to apply to milk containing 3.8-percent butterfat rather than 3.5-percent butterfat which had been the previous basis to which class prices applied.

In justifying the higher price for Class II milk a memorandum prepared by the Dairy Section stated that Kansas City was not an open-cream market and that all the milk used to make fluid cream came into the sales area in the form of whole milk from the same farms or country receiving stations which supplied the market with its fluid milk requirements. Because of this fact, it was believed that the new formula would result in a price for Class II milk which would be more nearly in line with the market value of fluid cream which was made from such milk.

The Class II pricing formula in its original and in its amended form proved a fairly satisfactory method of pricing milk for fluid-cream use from the standpoint of industry acceptance. Because it was related to the price of butter (page 26) it resulted in a rather constant percentage differential over the manufacturing-use price and provided a strong seasonal pricing pattern (figure 2). The license formula price was used for a period of more than 2 years as the going price in the market for regular sales of cream, except for a 15-cent premium which was paid during 3 months in the fall of 1934. From April to November 1936, the industry disregarded the license formula and attempted to use a fixed price for this class of milk. This price, however, was changed three times during a 5-month period.

The widest differences from the license formula for Class II milk occurred when the Class II-A or "special" cream price was established in July 1935 and continued through March 1936. This price, as indicated in figure 2, was established at a level considerably below the Class II formula price and diverged more widely from the formula price during succeeding months until December 1935 and January 1936 when it actually fell below the Class III price. After that period, the Class III price became a minimum price for Class II-A milk. The competitive situation which the Class II-A price was designed to meet is described on page 48.

Class III Price During License Period

The pricing formula for Class III milk which was incorporated in the license remained unchanged throughout the period except for the necessary modification in July 1934 when the basis of pricing was changed from a 3.5- to 3.8-percent of butterfat basis. This formula was 3.8 times the price per pound of 92-score butter at Chicago, plus 20 cents. From the industry standpoint it proved to be a satisfactory method of pricing milk for manufacturing uses. It was modified only slightly by premium payments of from 5 to 15 cents for several months.

Butterfat Differential and Location Adjustments

The class prices paid by dealers under the Kansas City license (and industry agreements) were subject to adjustments for variation in the butterfat content of milk received from individual producers and for the location at which the milk was received from the producers. Each producer was required to pay the cost of hauling milk from his farm to the city plant or the country receiving plant of the handler.

The butterfat differential for the entire period of the license was 4 cents for each one-tenth of 1 percent variation in the butterfat content of the milk from the standard test to which the class prices applied. The reason for the change in the standard from 3.5 to 3.8 percent after the license had been in operation only a few months was that reports made by distributors to the Market Administrator showed that the latter percentage corresponded more closely to the fat content of the milk received from producers as well as to the fat content of the milk which was then being sold to consumers in the market.

At the time the license was made effective there were four country receiving stations, or plants, in the supply area for the Kansas City market. Three of these plants were located in the 30- to 45-mile zone and the distributors who owned these plants were entitled under the license to a deduction of 10 cents per hundredweight on Class I milk under the terms of the original license. The fourth plant located 67 miles from the market was entitled to a 12-cent deduction. Prior to the adoption of the license the owners of all these plants had been making a charge of 35 cents per hundredweight on all milk received from producers.

The question of proper charges for milk received at country plants had been the subject of considerable dispute in the market prior to the adoption of the license and the schedule of charges established by the license was not well received by all the distributors or producers in the market. Distributors who operated country plants felt that the charges allowed by the license represented too drastic a reduction from previous practice in the market and were now not sufficient to cover the actual cost of operating these plants plus the cost of transporting the milk to the city. The fact that distributors who received direct shipped milk at city plants were permitted to charge for the hauling of such milk was a cause of further dissatisfaction to the owners of country plants. They felt that this practice resulted in discrimination in favor of distributors who did not operate country plants.

Many producers were discontented with the charges made for hauling their milk. Some of these charges had remained unchanged for many years and at the relatively low prices of milk which were then prevailing, a larger proportion of the price was being deducted for hauling. Representatives of the producer association considered many of these charges to be arbitrary and they felt that the license should offer some protection to producers with respect to this phase of the marketing process (page 22).

The first step in meeting the criticism of producers and country station owners was taken in the amendment of May 1934 which gave each producer the right to furnish or select the means of transportation for his milk and required distributors to report hauling charges at the request of the Market Administrator. A further step was taken in July 1934 when the schedule of country station charges was increased. Plants located in the 30- to 45-mile zone were allowed to charge 17 cents per hundredweight on milk used to supply Class I and Class II sales instead of the previous charge of 10 cents on milk used for Class I sales only. For each 10-mile zone beyond 45 miles the allowance was increased to 1.5 cents per hundredweight on milk used for Class I and Class II sales (instead of 1 cent for Class I sales).

The Dairy Section recommended this change on the grounds that it placed producers delivering to country plants on a basis more nearly equal with those shipping their milk directly to plants in the sales area. The new deductions, it was stated, also corresponded more nearly to those which were allowed in other markets.

Use of Milk by Classes

During most months of the period of the license operation, sales of Class I milk in the Kansas City, Mo., sales area were close to 3.5 million pounds, as shown in table 5. In percentage terms, Class I sales varied from about 42 to about 73 percent of the total quantity of milk received from producers. In most months, even during periods of severe drought, less than two-thirds of the milk supply was used for fluid milk sales.

The recurrent complaints of insufficient milk supplies on the part of milk distributors during this period, as reported by the Market Administrator, arose in almost all cases from a shortage of milk to supply fluid cream rather than fluid milk requirements. The shortage of milk was not at all uniform among all distributors, a few distributors had milk enough to carry on surplus manufacturing operations although others did not have enough to supply their Class II requirements. In this connection, it must be remembered that from July 1935 to April 1936, an agreement was in effect between the producers' association and the distributors by which fluid cream sales were stimulated through the creation of a special low price which applied during certain days of the week (page 47). This arrangement helped to keep the supply of milk short in relation to the market's fluid milk and cream requirements.

The data on amounts of Class II and Class III milk in table 5 are not an accurate reflection of the actual breakdown of the utilization of milk between the two classes. This is because of the administrative practice of converting pounds of butterfat used in each of these classes to a whole milk equivalent and then adding or subtracting from the lowest class in order to reconcile a distributor's total sales with his total receipts. The data do show, however, the quantities of

Table 5.--Classification of milk received from producers by distributors in the Kansas City, Mo., sales area 1 during the operation of License No. 40, by months, April 1934--November 1936.

Month	Pounds of milk			Total	Percent			
	Class I	Class II	Class III		Class I	Class II	Class III	Total
<u>1934</u>								
April	4,114,871	2,073,667	1,358,654	7,547,192	54.52	27.48	18.00	100
May	4,388,083	1,921,030	2,140,647	8,449,760	51.93	22.74	25.33	100
June	4,075,186	1,499,521	2,151,065	7,725,772	52.75	19.41	27.84	100
July	3,865,301	1,543,548	1,834,061	7,242,910	53.37	21.31	25.32	100
August	3,636,829	1,627,274	1,403,979	6,668,082	54.54	24.40	21.06	100
September	3,511,380	1,700,480	899,395	6,111,255	57.46	27.82	14.72	100
October	3,734,315	1,805,796	1,251,098	6,791,209	54.99	26.59	18.42	100
November	3,462,696	1,755,253	1,222,515	6,440,464	53.77	27.25	18.98	100
December	3,544,977	1,700,693	385,023	5,630,693	62.96	30.20	6.84	100
<u>1935</u>								
January	3,647,589	1,684,348	404,555	5,736,492	63.59	29.36	7.05	100
February	3,311,533	1,611,022	354,112	5,276,667	62.76	30.53	6.71	100
March	3,623,807	1,874,991	987,156	6,485,954	55.87	28.91	15.22	100
April	3,396,264	1,829,875	2,115,791	7,341,930	46.26	24.92	28.82	100
May	3,404,117	1,947,811	2,768,551	8,120,479	41.92	23.99	34.09	100
June	3,297,868	1,878,861	1,655,309	6,832,038	48.27	27.50	24.23	100
July	3,470,938	1,592,297	1,510,985	6,574,220	52.80	24.22	22.98	100
August	3,522,469	1,696,553	1,599,454	6,818,476	51.66	24.88	23.46	100
September	3,494,304	1,801,751	863,849	6,159,904	56.73	29.25	14.02	100
October	3,633,765	1,676,033	168,375	5,478,173	66.33	30.60	3.07	100
November	3,518,214	1,273,781	29,059	4,821,054	72.98	26.42	.60	100
December	3,578,424	1,699,805	44,951	5,323,180	67.22	31.93	.85	100

See footnote at end of table.

Table 5.--Classification of milk received from producers by distributors in the Kansas City, Mo., sales area 1 during the operation of License No. 40, by months, April 1934--November 1936---Continued

Month	Pounds of milk						Percent			
	Class I	Class II	Class III	Class I	Class II	Class III	Total	Class I	Class II	Class III
1936										
January	3,497,002	1,919,669	304,139	5,720,810	61.13	33.55	5.32	100		
February	3,316,229	1,908,182	307,310	5,531,721	59.95	34.50	5.55	100		
March	3,694,605	2,199,185	412,497	6,306,287	58.59	34.87	6.54	100		
April	3,548,910	2,258,732	942,394	6,750,036	52.58	33.46	13.96	100		
May	3,673,152	2,419,285	1,768,253	7,860,690	46.73	30.78	22.49	100		
June	3,602,391	1,950,303	1,157,217	6,709,911	53.69	29.06	17.25	100		
July	3,757,371	1,696,021	955,800	6,409,192	58.63	26.46	14.91	100		
August	3,667,524	1,560,577	976,819	6,204,920	59.11	25.15	15.74	100		
September	3,600,400	1,639,678	168,464	5,408,542	66.57	30.32	3.11	100		
October	3,689,656	1,802,668	530,770	6,023,094	61.26	29.93	8.81	100		
November	3,507,953	1,789,926	799,312	6,097,191	57.53	29.36	13.11	100		

1 One distributor operating in Independence, Mo. included from April 1934 through April 1935.

Compiled from reports of the Market Administrator.

milk in each class which were used as a basis for pricing milk to distributors.

The Milk Supply

The total amounts of milk received from producers by months is shown in table 5. The effect of the droughts which occurred in the supply area is indicated by the declines in the amounts of milk received during most months from April through December 1935 as compared with corresponding months of 1934. During the first 9 months of 1936, the tendency for production to decline continued and the general shortage of supplies from producers gave distributors an incentive to seek new sources of supply. Some new producers were recruited from within the existing supply area but, as most of the dairy farmers within this area were already on the market, it was necessary for some distributors to develop new routes in sections which had not previously supplied the Kansas City milk market. This resulted in a gradual expansion of the supply area. 60/

The seasonal variation in milk production varies considerably for individual farms and for different sections of the supply area. An analysis by the Market Administrator of production, during the period from July 1935 through June 1936, showed that producers near the outer fringes of the supply area tended to have a greater seasonal variation in their production. The total supply of producer milk shows a fairly wide seasonal variation in this market under normal conditions. During the license period, this was true, although the several droughts tended to distort the usual seasonal pattern to a certain degree. The Market Administrator reported the average number of pounds of milk delivered per farm per day for each month during 1935 and 1936 as follows:

<u>Month</u>	<u>1935</u>	<u>1936</u>
January -----	138	136
February -----	143	141
March -----	157	150
April -----	187	171
May -----	205	198
June -----	186	171
July -----	160	147
August -----	170	140
September -----	158	127
October -----	136	139
November -----	123	145
December -----	128	133

In the Kansas City market, especially during the license period,

60/ Annual report of the Market Administrator on the operation of Federal milk regulation, July 1936 through June 1937.

data on producer supplies do not reflect the complete milk supply situation in the market either in terms of the total amount of milk or in the seasonal aspects of the supply. As indicated in Section III (page 35) producer-distributors accounted for about 50 percent of the total supply of milk distributed within the market area. Additional quantities of milk were supplied by dairy farms owned by distributors. Roadside stands located just outside the city limits and supplied by nearby farms, sold considerable quantities of bottled milk and cream to Kansas City consumers who drove out in their cars to take advantage of the lower prices charged at these stands.

The seasonality of the total supply was somewhat less pronounced than that of producer supplies alone, because of the fact that producers who distributed their own milk, maintained more even production throughout the year than did the average producer who sold milk to distributors. This was probably the case also with milk supplied from the farms of distributors.

During the period of the license, the majority of the distributors purchased bottled raw milk from producer-distributors. In such cases, it was the practice for the distributor to buy almost the entire production of the producer-distributor. In consequence, during seasons of short production, the regular producers were called upon to take up whatever slack there was in producer-distributor production and in times of surplus this bottled raw milk would replace the Class I sales of regular producers and throw more of their milk into surplus categories.

The fact that handlers on this market buy raw bottled milk from producer-distributors has a bearing on the pool sales. There has always been a tendency to sell the bottled milk first and also figures show that in the times of greatest supply the larger the purchase of raw bottled milk. 61/

Sales of milk from roadside stands were a further factor in increasing the proportion of producer milk used in surplus categories during the spring and summer months. In those months, according to the Market Administrator, consumers were out in their cars in greater numbers and undoubtedly purchased greater quantities of milk and cream from roadside stands than during the winter months.

61/ Annual report of the Market Administrator on the operation of the Federal regulation from July 1936 through June 1937.

VI. OPERATION OF MARKET-WIDE POOL PLAN

Determination of Prices to Producers

During the license period, prices received by producers supplying milk to the Kansas City market were arrived at in accordance with a market-wide pool plan. Essentially, this meant that all regular producers on the market were paid for their milk in accordance with a uniform plan of payment. During the greater part of this period, the license and the industry agreements provided for a base-rating system under which quotas or bases were allocated to producers in relation to production records for the fall of 1930. 62/ Milk delivered by a producer up to the amount of his base was paid for at a blend price and milk delivered in excess of his base was paid for at the Class III price. Provision was also made during most of the license period whereby new producers who came on the market received the Class III price for all their milk for a limited period of time (page 80).

The marketing period for computing producer prices was at first on a semi-monthly basis but later monthly marketing periods were used. Essentially, this is how producer prices were arrived at for any marketing period: 63/

1. The Market Administrator computed the value of producer and new producer milk reported by each distributor. These values were based on the amounts of milk used in each class multiplied by the class prices (adjusted for location differentials) and added to arrive at the total value.
2. He computed also the total quantity of milk which represented the delivered base milk of producers, exclusive of new producer milk.
3. He then computed the total value of the milk delivered in excess of base (including all milk delivered by new producers) by multiplying the quantity of such milk by the Class III price.
4. The total value of all "base milk" was then arrived at by subtracting the value of "excess milk" (step 3) from the value of all milk (step 1).

62/ The license, as amended, effective July 1, 1935, has been followed for purposes of illustration but the method was essentially the same throughout the license period except for those months when the base rating plan was inoperative. At such times, a simple blend price was computed for all milk instead of having one price for base milk and one for milk delivered in excess of base.

63/ Except for new producers and adjustments made in individual cases for other producers.

5. An adjustment to the total value of "base milk" was made by the Market Administrator for location adjustments. That is, the amount of the deductions which were to be made in the uniform price for base milk to producers delivering to country plants, was added to the total value of base milk as computed in step 4. This was necessary in order to achieve a complete clearing of all the money in the pool among all producers when payments were made.
6. A blend or uniform price for all base milk delivered by producers was then computed by dividing this adjusted value (step 5) by the quantity of base milk (step 2).

The Market Administrator was permitted to make a slight adjustment in the blend price for the purpose of establishing and maintaining a reserve fund. This reserve was to cover: (1) The failure or delay of distributors in paying their full obligations to the pool through their equalization account; (2) errors in reports of distributors; and (3) errors in equalization accounts, including adjustments on delayed reports of distributors.

Payments to Producers

The Market Administrator was required to notify all distributors in the market of (1) the blend price for base milk, and (2) the Class III price. This notification was to be made on or before the seventh day after the end of the delivery period.

Each distributor was then required to pay producers and new producers, on or before the tenth day after the end of the delivery period and subject to location and butterfat adjustments, as follows:

1. The blend price for the quantity of milk delivered by each producer not in excess of such producer's base.
2. The Class III price for the quantity of milk delivered by each producer in excess of his base.
3. The Class III price for the total quantity of milk delivered by each new producer until the expiration of his trial period (page 80).

Two adjustments were made in the prices as set forth above. One was for variations in the butterfat content of milk received from producers, which amounted to 4 cents for each one-tenth of 1 percent variation from the 3.8-percent standard. The other was a location adjustment made in paying producers who delivered milk to country receiving stations. The schedule of such adjustments is described on pages 62 and 63.

Equalization Among Distributors and Audits

Distributors paid their obligations to the pool through a clearing system device known as an equalization account. The Market Administrator was required to maintain for each distributor an account wherein the distributor was: (1) Debited for the total value of milk which he received from producers and new producers; and (2) credited with the amount of his total payments to be made to such producers and new producers. The balance on the equalization account was the amount of net payment to be made by the distributor to the Market Administrator or to be made by the Market Administrator to the distributor.

While all prices and obligations of distributors were computed by the Market Administrator on the basis of the reports made by the distributors themselves, the entire system rested upon the Market Administrator's audits of the books and records of distributors. These audits permitted the correction of unintentional errors in distributors' reports and discouraged attempts on their part to submit deliberately biased reports. Following these audits by the representatives of the Market Administrator, adjustments were made in distributors' obligations as previously computed from their reports and they were required to make up any deficiency or, in some cases, the Market Administrator was required to make compensatory payments to the distributors.

The audit procedure and a general summary of audit results were given by the Market Administrator in his report for the year ending June 1937. A distributor's sales-use report was verified to make sure that it reflected the exact amount of milk purchased, and correctly accounted for its use. Verification was made by detailed examination of sales records, including sales summaries, route sheets, load-out sheets and invoices to other distributors. Amounts of milk reported purchased by distributors in these reports were verified by checks of producers' payrolls, and of weight sheets or receiving records. In this way, a determination was made that producers had been correctly paid in accordance with the published blend price, and in accordance with each producer's established base and the butterfat content of his milk as shown by verified tests.

According to the Market Administrator, discrepancies between reports submitted by distributors and their records were usually the result of clerical errors or wrong interpretations as to reporting procedure. The most common type of post-audit adjustment was caused by the under- or over-reporting of the amounts of milk in each use class. The differences in most cases resulted from clerical errors in compiling sales units, errors in conversion of cream sales to milk equivalent, incorrect interpretation of Class II and Class III sales, and the omission of certain route sales. Some distributors who purchased bottled raw milk from producer-distributors believed they were entitled to deduct all such sales from their Class I usage. Although the license was not entirely clear on this matter, the Market Administrator was able to achieve a general understanding whereby part of this

milk was deducted from Class II and Class III usage. Many post-audit adjustments were attributable to this particular point.

The Market Administrator reported that it was his practice to review audit findings with the distributor and his accountant so that there would be a clear understanding of the reason for adjustments. In the case of certain small distributors whose records were inadequate to furnish the necessary information for compiling correct reports, suggestions were made by the Market Administrator for improvement in their systems. Specific instructions were given from time to time directly to employees responsible for record keeping and, in almost all such cases, instructions were well received and the necessary improvements in record keeping took place. The Market Administrator summarized the accomplishments of his auditing work as follows: 64/

During the past year our auditing program has resulted in more correct reporting, uniformity of procedure, equality among distributors and a better feeling of good will and confidence on the market and between producers and distributors.

Payments for Administrative Expense

Under the license, distributors were required to make deductions from payments to producers amounting to a maximum of 1 cent per hundred pounds of milk which was turned over to the Market Administrator to pay for the cost of administration.

These deductions provided the Market Administrator with about \$13,000 for the first 15 months administration of the license. In his report for the year ending June 30, 1935, the Market Administrator commented that his receipts from the administrative check-off were sufficient to pay for the operation of the office and to purchase equipment needed. He did not, however, consider that they provided sufficient funds to employ accountants to audit adequately the sales and use reports of distributors.

The exemption of producer-distributors from the license after July 1, 1935, caused a drop in receipts but this was probably more than compensated by the reduction in the expense of auditing work which had been necessary to check the reports of these firms. For the year ended June 30, 1936, the Market Administrator reported receipts of \$8,397 from Kansas City distributors.

The industry agreements of March 1936 provided that the expense of administration should be borne directly by distributors without deductions from producer payments. It also raised the maximum payment from 1 cent to 2 cents per hundredweight.

64/ Report of the Market Administrator for the year ending June 30, 1937.

Payments for Marketing Services

The license provided that distributors were to deduct up to a maximum of 3 cents per hundred pounds from producer pay checks to be turned over to the Market Administrator to defray the cost of providing market information to producers, the supervision of weights and tests of milk delivered by producers, and to guarantee producers against the failure of any distributor to make payment for milk received from them. Provision was also made whereby the Market Administrator was to turn over these deductions to any association performing these services for its members. Further provision was made whereby the Market Administrator was permitted to employ agents to perform these services for nonmembers.

In actual practice most of these funds were turned over to the Pure Milk Producers Association which represented the majority of producers on the market and which had been performing these services for its members. Later, when the Bates County Association was found to be qualified in this respect, the marketing service deductions from its members were turned over to it.

The Market Administrator employed a full time tester for the milk of nonmembers at the Butler Receiving Station. In order to perform testing services for nonmembers delivering milk to other plants, he employed the regular testers of the Pure Milk Producers Association as his agents. Tests were made of nonmembers milk at a charge to the Market Administrator of 15 cents per test. In describing his services to nonmembers, the Market Administrator reported as follows: 65/

Marketing Service is rendered these nonmembers by the Administrator in the form of general marketing service, through form letters, and subscription to the Association's monthly bulletin. Weights and tests of milk delivered to handlers are checked at least eight periods during the year. In reality the nonmembers receive the same marketing service as member producers.

During the year ending June 30, 1936, \$18,213 was collected by the Market Administrator for performing marketing services to producers. From these receipts and from a balance on hand at the start of the year, \$17,123 was turned over to the two producers' associations which were performing services to their members and \$4,473 was paid out by the Market Administrator for services to nonmembers.

The Base-rating Plan

The base-rating provisions of the license caused dissatisfaction among both producers and producer-distributors. The allocation of bases

65/ Report of the Market Administrator for the year ending June 1937.

was administered by the Market Administrator under what amounted to an essentially "closed" system. That is, members of the producers' association received the bases which were on file in the offices of the association. These had been established several years before. Non-members and producer-distributors were to be given bases which, according to the terms of the license, "shall be equitable as compared" with those given to association members. Just how such "equity" was to be achieved, inasmuch as the bases of individual association members were already out-of-line with their current production, the license failed to specify.

The license included the following paragraph which authorized the Market Administrator to make a general revision of bases:

The Market Administrator may make such revisions in the bases of any and all producers as he may, from time to time, deem necessary or advisable, to the end that such bases may be equitable as among producers and that the total of all established bases may, so far as practical, be equal to the total quantity of milk sold or used by distributors as Class I and Class II milk.

In his report to the Chief of the Dairy Branch on the first 16 months of operation of the license, the Market Administrator stated that, prior to the license, the bases assigned to producers were often out of line with their actual production records and were inconsistent with the sales records of the distributors to whom they had been shipping their milk. He admitted that he could see no practical way out of this difficulty:

I have studied the base and surplus problem on this market and it has so many angles and complications that every line of thought runs up against a solid wall of opposition or impracticability. Most any plan means a market upset, not only meeting opposition from producers but from distributors as well. At the present time, I am unable to present a plan that will remedy the situation without creating too much opposition. 66/

The producer-distributors on the Kansas City market felt that it was unfair for them to be required to sell milk under the base-rating plan. They considered that under this arrangement pasteurizing dealers were given an advantage which they had not had prior to the issuance of the license. This position was expressed in a letter of December 4, 1934, written to the Chief of the Dairy Section by the manager of the producer-distributors' association of Kansas City, Kansas:

66/Report of the Market Administrator on the operation of License No. 40 from March 17, 1934, to June 30, 1935.

The greatest hindrance to beneficial progress, as the milk producers see it, is the continued efforts and manipulations of the large pasteurizing plants to perpetuate their unfair base-surplus system of buying milk in bulk . . . Every part of the system of operation employed by the pasteurizing plants in their competition with natural milk points to the extermination of the Grade-A raw milk branch of the industry.

The rigidity of the base-rating plan under the license was sharply emphasized during the drought period of the summer of 1934. The Market Administrator did not have sufficient data on hand to make a complete revision of producer bases. At the same time, distributors found it difficult to get increased supplies of milk from their regular producers when they could offer them only an excess (Class III) price for their extra production. The Market Administrator reported that some distributors were offering secret bonuses to certain producers to induce them to supply additional milk. These bonus payments, according to a regional consultant of the Dairy Section, were usually discriminatory against members of the producers association. In a memorandum to the Chief of the Dairy Section, he pointed out that the license permitted the payment of premiums by a distributor on an equitable basis among all his producers. He urged that it was up to the Market Administrator to enforce this provision more effectively. He expressed the opinion that the Class III price, which was the minimum license price for milk shipped by a producer, in excess of his base quota, was not high enough to induce all of them to ship their entire production. This, he felt could be remedied by distributors making premium payments on "excess" milk alone. Such premiums he felt would not be in violation of the license providing they were offered by a distributor to all his producers.

Some distributors were reported to be buying milk from new producers and paying such producers a base price for their entire supply. Some handlers were reported to have offered their producers an increased base subject to the approval of the Market Administrator. Inasmuch as the latter had not made a general revision of bases, this practice added to the difficulty of his position.

The Market Administrator made some effort to get those distributors who were receiving a supply of milk over and above their fluid milk and cream requirements, to transfer milk to other distributors who were short of milk. He was unsuccessful in these efforts and several distributors brought milk from outside sources which, according to the Market Administrator were in violation of the license:

They say that they have to have this milk to meet their requirements and are unable to buy it in this milkshed and other dealers, even though they have a large quantity of milk outside of their Class I and II, will not turn it over to them. To protect their business they have only one way, that is to go and get it where they can. 67/

67/ Letter, dated August 16, 1934, from the Market Administrator to the Chief of the Dairy Section, AAA.

In an effort to encourage increased production without encouraging distributors to take on new producers, the Market Administrator sought approval by the Dairy Section of a plan for granting a temporary increase in bases for the duration of the emergency. In a letter to the Chief of the Dairy Section dated July 3, 1934, the Market Administrator put the problem as follows:

It is the thought of the Pure Milk Association that if I could grant an emergency base which would practically cover the excess milk, the added inducement would cause the farmers to go to more expense and effort to hold up production. They realize this might lower the blended price but would tend to avoid the situation which is sure to arise by the fact the distributors in their panic to get milk would create so much base on the market that it would be a burden next fall and winter. The distributors are going clear out of the normal milkshed in contracting producers. This is, of course, antagonizing the present producers, especially those with a surplus and they can't see why a new producer will be allotted base when they have milk that they have been trying to get based for some time. I have a constant stream of them in the office every day.

In reply, the Market Administrator was told that there was no provision in the license under which he could grant an emergency base to any producer. The only way of dealing with the problem, according to the Dairy Section, was for the Market Administrator to revise the bases of all producers "as soon as possible."

The base-rating plan thus became increasingly difficult to administer. Many producers were shipping less than their base allotments while others, who were able to supply excess milk, were insistent in their demands for reallocation of bases. Excerpts from a memorandum by an economist of the Dairy Section on the operation of the base-rating provision, follow: 68/

The widespread drought in 1934 affected the production of milk for the Kansas City sales area drastically but not at all uniformly as between all producers . . . Many producers are unable to deliver the full amount of their bases . . . While many others claim they are able to produce milk considerably in excess of their bases and have requested increases of bases on the strength of this promised increase in deliveries. It is reported to the Market Administrator and the Pure Milk Association that producers with considerable quantities of production are skimming their excess milk, selling their cream to butter and ice cream factories, and utilizing the skim milk in the feeding of calves and pigs because such a method provides a better return than delivery of this milk to distributors at the Class III price for excess.

There is thus rumored to be an ample supply of qualified milk on producers farms but the Market Administrator is without

68/ Memorandum from W. P. Sadler, Senior Agricultural Economist, to the Chief of the Dairy Section, July 26, 1935. This memorandum was attached to the formal recommendation of the Chief of the Dairy Section that the base-rating plan should be suspended.

means . . . of revising bases of producers equitably in accordance with their actual production of milk.

The amendment provided that producers would be paid the blended price for all milk delivered to distributors regardless of their bases. This, of course, did not affect the cost of milk to distributors. The amendment did not delete provisions of the license requiring that records be kept of the deliveries of producers for the allotment and automatic revision of bases in case it should be desired to reinstate the base-rating plan at some future time.

The base-rating plan was not restored in the license. Producers and distributors restored the plan by mutual agreement a month and a half later, on September 16, 1935. After another $6\frac{1}{2}$ months operation it was again suspended for 1 month (April 1936) by agreement. Then followed another 2 months of operation of the base plan only to be followed by another suspension on July 1, 1936, which was not lifted during the remainder of the license period. The periods of operation of the base-rating plan under the license and agreements are summarized in table 6.

The suspensions and reinstatements of the base plan, according to the Market Administrator, were based on changing relationships of supply and demand in the market. However, these frequent changes in the plan of payment tended to discourage producers from adhering to long term production programs, supposedly one of the purposes of a base plan of payment.

The suspension in April 1936 is perhaps of special interest as it took place during the first month of operation of the most formal and carefully drafted industry agreement which specifically provided for the base plan. Thus, the industry actually made two agreements during the same month, one providing for the base plan and the other suspending the plan.

The amounts of milk purchased from producers, accounted for as delivered base milk and excess milk during the license period, are shown in table 7. This table shows also the prices received by producers for delivered base milk under the license or the current industry agreement.

Admission of New Producers

The procedure by which new producers were permitted to come on the Kansas City market under the license was the cause of dissatisfaction on the part of such producers and of distributors who needed their milk. In its original form, the license provided that a new producer must apply to the Market Administrator for a permit to sell his milk to a distributor on the Kansas City market. The decision, as to whether or not to issue such a permit was left to the discretion of the Market Administrator.

Table 7.—Milk purchased from producers in the Kansas City, Mo., sales area accounted for as delivered base milk and excess milk and monthly prices for base milk, April 1934 through November 1936

Year and month	Pounds of milk			Percent			Price of base milk		
	Delivered base	Excess	Total	Delivered base	Excess	Total	License	Agreement	
<u>1934</u>									
April	6,824,293	722,899	7,547,192	90.42	9.58	100.00	1.77		
May	7,433,657	1,016,103	8,449,760	87.97	12.03	100.00	1.76		
June	7,015,542	710,230	7,725,772	90.81	9.19	100.00	1.75		
July	6,090,121	1,152,789	7,242,910	84.08	15.92	100.00	1.72		
August	5,933,098	734,984	6,668,082	88.98	11.02	100.00	1.735		1.93
September	5,568,077	543,178	6,111,255	91.11	8.89	100.00	1.73		2.125
October	6,116,736	674,473	6,791,209	90.07	9.93	100.00	1.72		2.095
November	5,880,073	560,391	6,440,464	91.30	8.70	100.00	1.765		2.055
December	5,343,763	286,930	5,630,693	94.90	5.10	100.00	1.805		2.155
<u>1935</u>									
January	5,507,721	228,771	5,736,492	96.01	3.99	100.00	1.86		2.19
February	5,062,595	214,072	5,276,667	95.94	4.06	100.00	1.90		2.24
March	5,778,234	707,720	6,485,954	89.09	10.91	100.00	1.815		2.135
April	6,069,747	1,272,133	7,341,930	82.67	17.33	100.00	1.82		2.11
May	6,331,095	1,789,384	8,120,479	77.96	22.04	100.00	1.67		1.95
June	5,913,123	913,915	6,832,038	86.55	13.45	100.00	1.625		1.775
July	5,884,009	620,211	6,574,220	89.50	10.50	100.00	2/	4/	1.78
August	6,003,391	810,085	6,813,476	88.12	11.88	100.00	2/	5/	1.76
September	5,561,337	598,567	6,159,904	90.28	9.72	100.00	2/	5/	1.8625
October	5,365,562	112,611	5,478,173	97.94	2.06	100.00	2/		1.9725
November	4,753,585	67,469	4,821,054	93.60	1.40	100.00	2/		2.08
December	5,131,734	141,446	5,273,180	97.34	2.66	100.00	2/		2.07

See footnotes at end of table.

Table 7.--Milk purchased from producers in the Kansas City, Mo., sales area accounted for as delivered base milk and excess milk and monthly prices for base milk, April 1934 through November 1936--Continued

Year and month	Pounds of milk			Percent			Price of base milk ^{1/}		
	Delivered base	Excess	Total	Delivered base	Excess	Total	License	Agreement	
1936									
January -----	5,476,205	244,605	5,720,810	95.72	4.28	100.00	2/	:	2.055
February -----	5,239,880	291,841	5,531,721	94.72	5.28	100.00	2/	:	2.035
March -----	5,847,315	458,972	6,306,287	92.72	7.28	100.00	2/	:	2.00
April -----	5,894,929	855,107	6,750,036	87.33	12.67	100.00	2/	5/	1.80
May -----	6,517,472	1,343,213	7,860,690	82.91	17.09	100.00	2/	:	1.84
June -----	5,985,803	724,108	6,709,911	89.21	10.79	100.00	2/	:	1.85
July -----	6/	6/	6,409,192	99.32	.68	100.00	2/	5/	2.015
August -----	6/	6/	6,204,920	98.87	1.13	100.00	2/	5/	2.017
September -----	6/	6/	5,408,542	99.11	.89	100.00	2/	5/	2.50
October -----	6/	6/	6,023,094	99.53	.47	100.00	2/	5/	2.45
November -----	6/	6/	6,097,191	99.61	.39	100.00	2/	5/	2.41

^{1/} Monthly prices represent simple average of semi-monthly prices from April 1934 through March 1936.

^{2/} Base rating plan suspended by industry agreement July 16, 1935.

^{3/} Base rating plan dropped from license August 1, 1935.

^{4/} July 1-15, \$1.81 for base milk, July 16-31, \$1.75 for all milk.

^{5/} Price for all milk.

^{6/} Total receipts from producers not broken down into delivered base and excess milk in reports of market administrator.

Compiled from reports of the Market Administrator.

The amendment of May 16, 1934, replaced the permit system with the so-called 90-day clause which was then becoming the standard procedure for admitting new producers to fluid milk markets under licenses. It was noted by the Dairy Section that the Market Administrator had not issued any permits to new producers in the short period since the license became effective and that although this policy was supported by the organized producers in the market, it might eventually lead to difficulty. It was recommended by the Dairy Section that market administrators should be relieved of responsibility in handling such matters. The Pure Milk Producers Association was opposed to this particular change although they approved other aspects of the amendment.

The amended license provided that all producers whose milk was not sold on the Greater Kansas City market 90 days before the effective date of the amended license must, if taken on the market by distributors, be reported to the Market Administrator and the milk furnished by such new producers would be paid for at the Class III price for 6 full delivery periods following the date of first shipment. Delivery periods, at that time were semi-monthly, so that 6 delivery periods were equivalent to 3 months.

Distributors Under the Pool Plan

Under the marketwide pool plan, as previously described, those distributors with high proportions of fluid milk sales in relation to their total sales were required to pay money into the pool and those with low proportions of fluid milk sales drew money from the pool. Producers delivering milk to both types of distributors received payments on the same basis. This arrangement was entirely new and, from the standpoint of distributors, it was the most important feature of the license. Although it was the source of some dissatisfaction on the part of distributors who were required to pay money into the pool, it is significant that as far as the distributors of pasteurized milk were concerned, the market-wide pooling plan was not altered by any of the numerous industry agreements which were entered into during this period.

There were, at the time of the license, 14 distributors of pasteurized milk. Their business was fairly well concentrated. The largest of them distributed about one-fourth the pasteurized milk in the market and the 5 largest dairies accounted for about 70 percent of market sales. Two of these 5 were affiliated so that they could, from the standpoint of control, be considered a single organization.

Surplus operations in the Kansas City market were not confined to the largest distributors. The list of dairies in order of the amount of Class I (mainly fluid milk) sales and their rank in terms of percentage of Class I sales to total sales for the first month of license operation (April 1934) is shown in table 8.

Table 8.--Rank of milk distributors in the Kansas City, Mo., market by: (1) amount of Class I sales, and (2) percentage of Class I sales to total utilization of milk, April 1934

Name of distributor	: Rank by total : of Class I sales :	: Rank by percentage : of Class I to total : utilization
Chapman Dairy	1	5
Arctic Dairy Products	2	3
Home Dairy	3	4
Aines Farm Dairy	4	10
Country Club Dairy	5	2
Summe Dairy	6	9
Protected Milk Products	7	1
Campbell-Sheffield Dairy	8	12
Forest Dairy	9	7
Gray Gables Dairy	10	6
Hook & Sons Dairy	11	14
Westport Dairy	12	13
Northeast Dairy	13	8
Harvey Dairy	14	11

In the fall of 1935, 2 distributors discontinued business. One of these was Gray Gables Dairy and the other the Northeast Dairy. Both of these dairies were among the smaller distributors on the market. Their class utilization of milk was not markedly different from the average of the market so that their payments to and from the equalization fund were too small to have been a significant factor in their continuation on the market as distributors. Both of these distributors owed their producers for 15 days' milk at the time they discontinued operations and it was necessary for the Pure Milk Producers Association to reimburse the producers all of whom were members of the association. 69/

Several of the larger distributors were affiliated with regional or national dairy organizations. Chapman Dairy was part of National Dairies and Home Dairy was part of the Borden Dairy Products organizations. Protected Milk Products was affiliated with Western Dairies and both Aines Farm Dairy and Arctic Dairy Products were affiliated with American Dairies. 70/

As described previously, the producer-distributors as a group were dissatisfied with a market-wide pooling plan (page 36). Almost all the

69/ Report of the Market Administrator for the year ended June 1936.
70/ Report of the Market Administrator for the year ended June 1936.

335 producer-distributors on the market at the time the license began had a high percentage of Class I utilization and they resented having to make payments into a pool to enable distributors of pasteurized milk to pay higher prices to their producers. Their dissatisfaction culminated in almost complete noncompliance, which led to their eventual exemption from the payment and equalization provisions of the license. Although they were still required to make reports to the Market Administrator, very few of them actually did so and the Market Administrator was not able to get their compliance even in this respect. He attributed their lack of cooperation partly to a holdover of antagonism to the equalization requirements of the license. 71/

Many producer-distributors ceased distributing operations during the license period although it was not possible for the Market Administrator to determine the exact number 72/ Some of these had come on the market during the period immediately prior to the license in order to find an emergency outlet for their milk and these were again shipping milk to distributors of pasteurized milk. Several others were reported to have discontinued dairy operations because of the severe droughts which occurred during those years.

Comparison with Payment Plan Prior to License

Prior to the license, the producers' association attempted to set up a classified price plan. Class prices were established through collective bargaining with the distributors but, in the absence of statements from distributors as to how the milk was actually used, all distributors paid for milk on the basis of agreed upon percentages of Class I, Class II, and Class III milk. The percentages were not applied to all milk but to established base milk only. Milk delivered by producers in excess of established base was paid for at the Class III price.

An analysis made by the Market Administrator showed that from January 1931 to the adoption of the license in April 1934, not only had class prices been declining but also the percentages of Class I and Class II milk which distributors paid had been declining. For the year previous to the adoption of the license, distributors were paying for only 38 percent of base milk at the Class I price and 16 percent at the Class II price. The remaining 46 percent was paid for at the Class III price.

This system had been subject to considerable criticism in the market not only on the part of producers who considered that they were underpaid because the assumed utilization of Class I and Class II milk was less than the actual utilization of such milk, but also by some distributors who felt that they were penalized in relation to their competitors who actually used a greater proportion of milk in the higher priced classes than they themselves were using.

The audited reports under the license provided the first accurate

71/ Report of the Market Administrator for the year ended June 1936.

72/ In his report for the year ended June 30, 1936, the Market Administrator stated that Independent Dairies, the producer-distributors association, reported that 25 producer-distributors had quit operations and 7 had started business during the year.

basis for pricing milk on a class use basis. The Market Administrator in his report for the period ending June 30, 1935, pointed out that a comparison of the payment plan prior to the license with the actual percentages of milk shown in the April reports under the license "marked more clearly what effect the license has had in regard to payment to producers than any other illustration I can give."

Table 9 shows the class use of milk by distributors in the Kansas City, Mo., market for April 1934. It may be noted that among the 14 handlers the use of milk in Class I varied from 28.8 percent to 76.8 percent, milk in Class II varied from 9.2 percent to 61.2 percent, and in Class III the range of variation was from zero to 43.8 percent. Taking the combined utilization of all the handlers, 54.6 percent was used as Class I, 28.1 percent was used as Class II, and only 17.3 percent in Class III.

The class use of milk by distributors in the Kansas City, Mo., sales area during the first 12 months operation of the license (April 1934 through March 1935) was as follows:

<u>Class</u>	<u>Pounds</u>	<u>Percent</u>
I -----	44,916,567	56.07
II -----	20,797,623	25.96
III -----	<u>14,392,260</u>	<u>17.97</u>
Total	80,106,450	100.00

Producers Under the Pool Plan

The comparison of the payment plan prior to the license with the payment plan under the license shows the financial benefits to Kansas City producers when payments were made on the basis of audited statements of utilization by distributors. It illustrates the fact that under a classified price plan the class prices which are agreed upon can lose much of their significance unless accurate statements of the use made of milk by distributors are available.

The market-wide-pool plan also provided a uniform basis of payment for all producers in the market. Prior to the license, pricing plans were applicable to association members only and it was not possible for the association to extend its plan to the entire market.

The aim of uniformity of payment under the license was to some extent nullified by the operation of the base-rating plan. The discussion of this plan in the previous section indicated that bases were not equitably assigned among producers and that no satisfactory provision was made for equitable reassignment of bases in relation to the current production records of producers. Also, the repeated suspension and reinstatements of the base plan under the license and industry agreements interrupted whatever consistency there was in

Table 9.—Classification of milk received from producers by distributors in Kansas City, Mo., market, April 1934

Distributor	Pounds of milk				Total	Percent		
	Class I	Class II	Class III	Class I:Class II:Class III		Class I:Class II:Class III	Total	
Aines	333,015	304,119	187,739	824,873	40.4	36.9	22.7	100
Arctic	635,102	254,241	105,272	994,615	63.8	25.6	10.6	100
Campbell-Sheffield	193,952	183,682	123,454	501,088	38.7	36.7	24.6	100
Chapman	1,030,649	487,563	234,372	1,752,584	58.8	27.8	13.4	100
Country Club	320,646	149,507	21,219	491,372	65.3	30.4	4.3	100
Forest	118,225	69,708	18,743	206,676	57.2	33.7	9.1	100
Gray Gables	100,250	16,173	58,347	174,770	57.4	9.2	33.4	100
Harvey	26,002	41,042	---	67,044	38.8	61.2	---	100
Home	571,989	240,685	144,400	957,074	59.8	25.1	15.1	100
Hook & Sons	89,737	85,270	136,296	311,303	28.8	27.4	43.8	100
Northeast	59,855	40,926	13,246	114,027	52.5	35.9	11.6	100
Protected Milk	244,819	57,926	15,985	318,730	76.8	18.2	5.0	100
Summe	281,752	81,522	182,142	545,416	51.7	14.9	33.4	100
Westport	66,385	86,614	46,463	199,462	33.3	43.4	23.3	100
Total	4,072,378	2,098,978	1,287,678	7,459,034	54.6	28.1	17.3	100

Compiled from reports of the Market Administrator and corrected by him from his records.

this payment method.

Cooperative Recognition Under the License

The position of the Pure Milk Producers Association was strengthened under the license. As sponsor of the license, its wishes carried considerable weight with the Department of Agriculture as to the terms which were included. Almost all important terms were at least submitted to the association for its opinion prior to incorporation in the license or in the various amendments. The association was further strengthened by the fact that marketing service check-offs were made from producers who were not members of the association (page 27). The marketing service check-off helped to make equal the returns of association members and nonmembers.

Soon after the license was issued, a new association was organized called the Bates County Dairy Improvement Association. The members of this association were shippers to the Butler Receiving Station owned by the Chapman Dairy Company. The officers of this association felt that it was entitled to the 3 cents per hundredweight deduction provided in the license.

They filed a written report with the Market Administrator giving him the history and activities of the association and requesting that the deduction of its members be turned over to them to enable them to perform these market services. Failing to achieve a favorable decision from the Market Administrator, the president of the association on August 6, 1934, filed an appeal with the Chief of the Dairy Section. This was one of the earliest cases involving recognition of a cooperative. The Market Administrator was asked to report on the "status of the organization, its ability to provide services required in license, and your recommendations for handling these funds." On the basis of the Market Administrator's report, the Chief of the Dairy Section refused to recognize the Bates County Dairy Association as a cooperative which was entitled to the use of the marketing service deductions. In his letter to the president of this association dated August 14, 1934, he stated his reasons for his decision.

We have made considerable effort to investigate the request of your association that the deduction of 3 cents per hundred pounds of milk from your members be turned over to your association for its use. The reason this deduction is made is in order to assure certain services to producers and certain reasonable checks upon the accuracy of the weights and tests of milk as it is purchased from producers by distributors. This means that impartial checks should be made currently and that adequate reliable market information should be furnished to the producers.

We have required that these services be rendered in a satis-

factory manner either by a well-established cooperative association serving a considerable portion of the market, or by the Market Administrator.

From information at hand we cannot recommend at this time that these funds be paid over to your association.

During the summer of 1935, the Market Administrator met with the manager and officers of the association and helped them to reorganize under the cooperative law of the State of Missouri. When they had done so, the new association was recognized and received marketing service deductions to be used to provide services to its membership. A full-time tester was employed by the association and its representatives sat in with those of the Pure Milk Association on all price and other discussions with distributors.

VII. APPRAISAL OF LICENSE AND INDUSTRY AGREEMENTS

Several rather distinct stages in milk regulation in the Kansas City market are discernible from the beginning of 1931 through 1936. The period from January 1, 1931, to the end of March 1934 was one of attempted industry control of milk marketing under the King Agreement. This was followed by a relatively brief period, a little more than 4 months, of Federal license control without industry agreements. From August 11, 1934, to March 31, 1936 (a period of almost 20 months), may be designated as a period of Federal license control supplemented by industry agreements. The last period, beginning April 1, 1936, may be looked upon as marketing control by the industry with assistance by the Federal Government.

Evaluation of the King Agreement

The King Agreement marked the first effort on the part of the dairy industry of Kansas City to achieve stability in milk marketing by means of a formal agreement. That it did not succeed must be attributed in part to the extremely adverse economic conditions which developed in the early 1930's. However, the agreement itself contained some rather serious weaknesses which tended to undermine its usefulness in promoting orderly milk marketing. Two of these were: (1) Failure to provide some form of equalization of payments for distributors in conjunction with a classified price plan of payment; and (2) failure to provide an effective means of administering the plan.

Under the King Agreement, serious inequities developed among distributors because their costs of procuring milk supplies were neither uniform (as under a plan requiring all distributors to pay the same price per hundredweight) nor related to their own individual utilization experience (as under a classified price plan in conjunction with either a market-wide or individual-handler pool plan). The capricious differences in costs of milk which developed under the King Agreement caused general dissatisfaction among distributors and were a factor in resale price instability (pages 9, 13 and 82).

The dual responsibility of the producers association and of a marketing committee proved to be an unsatisfactory type of administration of the marketing plan under the King Agreement. The class utilization reports of distributors were not audited and, as a result, producers were underpaid and were not assigned to the various distributors in such a manner as to maintain producer bases in the same relation to each distributor's Class I and Class II sales (pages 8 and 82).

Several aspects of the King Agreement involved questions of possible infringement on the public interest. Among these were: (1) The attempt to limit the territory from which the market was to be supplied with milk; (2) the laying out of conditions under which new shippers

would be admitted to the market; (3) the setting up of a code of fair practices to govern the conduct of distributors; and (4) consideration from time to time of producer prices in relation to the resale price structure and efforts to adjust resale prices by agreement. The possibility that these aspects of the King Agreement would infringe the public interest arises from the lack of any form of check by that part of the public which had an interest in the consumption, production or distribution of milk in the market and which was not a party to the agreement (pages 7-10).

In retrospect, the main accomplishments of the King Agreement appear to have been, first, to set up a uniform basis of producer payments, and second, to have given producers and distributors some experience in trying to adhere to a milk-marketing plan. Although the plan did not accomplish its objectives of achieving what might be considered orderly milk-marketing conditions, it did crystallize some of the essential concepts of orderly milk marketing, such as equal rates of payment to producers, equity among distributors in costs of milk supplies, and the necessity of accurate reports of distributor utilization. Experience with the King Agreement encouraged the industry to attempt other marketing plans which could go further toward achieving these objectives.

Accomplishments of the License

The following paragraphs summarize what appear to be some of the benefits derived from the operation of the license in the Kansas City market. The appraisal is made both from the standpoint of meeting the emergency situation which prevailed in the early 1930's and of the extent to which it laid the groundwork for the more permanent program of Federal order operation which followed.

1. The license provided the first effective milk-marketing plan in the Kansas City area. It gave effective meaning to the classified price system by requiring periodic reports from distributors and by providing a means of checking their accuracy by systematic audits of books and records. It gave the market the first market-wide plan for pooling payments of distributors with a method of paying all producers on the same basis. These key features of the marketing plan as incorporated in the license were not changed either by the industry agreements which were made during the license period or by the Federal order which followed, but they were in sharp contrast to marketing practices which preceded the license (pages 68,69 and 70).

2. The license provided a means of impartial administration of the marketing plan. In spite of all the difficulties encountered by the Market Administrator during this period, he was able to satisfy producers and distributors of his impartiality in administering the license and the industry agreements which supplemented it. The auditing

work of his office gave assurance that all distributors were paying for milk in accordance with the provisions of the license and that the required payments were made to producers. The provision for impartial administration of the marketing plan corrected one of the serious weaknesses of the King Agreement.

3. The marketing plan materially improved the returns of producers. The raising of producer returns during the emergency period was the main purpose for which the license was issued. That this purpose was achieved at the beginning of the license is demonstrated by the analysis of percentages of milk paid for by classes prior to the license and those paid for on the basis of audited reports of class usage after the adoption of the license. The droughts which occurred during the license period undoubtedly had a considerable effect in supporting the producer price structure but the impact of the marketing plan in this respect should not be minimized (pages 29 and 82).

4. Producers benefited from the marketing service provisions of the license. For the first time all producers were given the protection of check-weighing and check-testing of milk. The lack of such protection had frequently led to dissatisfaction among producers supplying the market. The King Agreement had provided that the association could check the weights and tests of milk delivered by its members but nonmember producers were not given such protection because the deduction of 3 cents per hundredweight from checks of nonmembers was to be used for general education or promotion work in the market (pages 10 and 72).

5. The license put all distributors on a clearly understood competitive basis in the purchase of milk. Under the license, distributors paid for milk in accordance with a plan which they considered fairly apportioned the costs of handling milk for nonfluid uses and which enabled each one of them to ascertain his procurement costs in relation to those of his competitors. Each distributor knew the minimum prices he and his competitors would have to pay for milk used in each class and was assured that no competitor could gain an unfair advantage by under-reporting the use of his milk in the higher priced classes. The marketing services provision of the license prevented any distributor from gaining a competitive advantage through underweighing or undertesting of milk.

6. A valuable body of experience with milk-marketing plans was developed. During this period, milk distributors gained their first experience with equalization on a market-wide basis. They learned to adapt their operations to this system and found that it put them on a more equal basis in the purchase of supplies. Market-wide equalization has continued in this market to the present time.

The Market Administrator gained valuable experience in administering the marketing plan and in carrying out the necessary auditing procedure. He administered, with a high degree of success, a type of "outside" regulation which, in certain respects, was new to the market, although during much of the time he was unable to rely upon legal authority for enforcing

its provisions. His ability to work with distributors and producers and to make the marketing plan effective during the emergency period brought prestige to his office which assisted materially in his later work as Market Administrator of the Federal order.

During the license period, officials of the Department of Agriculture gained valuable experience in the drafting of milk regulations, in defining policies with respect to various types of administrative problems, and took the first steps in relating marketing plans more closely to economic conditions. The need for supporting the license provisions with economic information and analysis had been repeatedly emphasized by the legal division. The amendment of July 1, 1935, to the Kansas City license was the first instance, with respect to this market, in which a memorandum setting forth in detail the economic justification for each of the provisions accompanied the docket to the Secretary. This does not mean that previous actions were not based on economic information, but the more conscious effort to relate decisions on amendments to the economic facts marked a definite step forward.

Deficiencies of the License

The accomplishments of the license and industry agreements were indicated by the analysis in the preceding sections. Their shortcomings are summarized in the paragraphs which follow.

1. The principle of equality of payment to producers was not achieved because of the type of base-rating plan. Although it was one of the accomplishments of the license that it provided a single method of payment applicable to all producers supplying milk for the Kansas City market, this method was deficient in that all producers did not have an opportunity to qualify for bases on an equal footing. This fact was brought out in the description of the base-rating plan. Production records of producers for a period several years prior to the license were used for the purpose of allotting bases and no method was provided for adjusting bases to keep them related to current production records. This meant that two producers could produce the same quantities of milk with the same seasonal pattern of production and one of them could receive the base price for practically all his milk while the other one could receive the base price for only a small part of his milk and a lower surplus price for the rest of it. The base-rating plan was used primarily to discourage increases in total production, rather than to encourage seasonally even production (pages 72-76 and 83).

2. The license was not sufficiently flexible as an instrument for assuring an adequate and well-distributed supply of milk in the market. Most of this deficiency could be attributed to the operation of the base-rating plan. Because bases were held rigid, many farmers who could have produced additional supplies of milk when needed, were discouraged by the fact that they had to accept a surplus price for such additional supplies. This was a serious handicap to the market during the drought

periods which occurred during the license years. The fact that the license Class I price was established on a fixed dollars and cents basis and that it was not adjusted by any of the amendments to the license was a further factor in making the license a rather inflexible instrument for keeping milk supplies in a proper relationship to market needs. The industry agreements helped to provide some flexibility but at no time during this period was the Class I price as responsive to changes in economic conditions as it was made later on by the use of pricing formulas. The Supply Committee made up of industry representatives performed an important function during the latter part of this period by helping to shift producers from distributors with an ample supply of milk to those distributors whose supplies of milk were not sufficient to meet their sales requirements for fluid milk and cream (pages 51, 72-76).

3. The failure to hold hearings for a full discussion of the license provisions proved a serious handicap. The only hearing held with respect to the Kansas City, Mo. market was the 1933 hearing called by the Department of Agriculture to consider a marketing agreement program. As described in Section II, no hearing was held which dealt specifically with the license which was issued in March 1934. Nor were any hearings held with respect to the amendments to the license program. This lack of a hearing procedure handicapped the Department because many of its administrative decisions had to be made without adequate factual knowledge of market conditions. As previously pointed out, the emergency conditions which prevailed and the pressure for action may well have prevented the Department from utilizing a full-fledged hearing procedure. Nevertheless, it is quite probable that a decision such as that of combining the Kansas City, Kans., and Kansas City, Mo. areas into a single market would not have been made if such a proposal had been subjected to discussion in a public hearing. The lack of such hearings was the prime reason why the Department was unable to get the facts required in making adjustments in the Class I price. It undoubtedly contributed to some of the early difficulties in handling the producer-distributor problem where an adequate expression from the producer-distributors themselves might have led to a quicker settlement of policy by the Department. It is also likely that if the abuses of the base-rating plan had been thoroughly aired at public hearings, some of them might have been eliminated (pages 25, 40 and 72-76).

This conclusion is not meant to imply that the Department was operating in the dark. It had a continuous flow of reports from the Market Administrator and its field representative. These, however, were insufficient for many purposes because they were not based on full factual evidence which can best be brought together by some sort of hearing procedure where all parties at interest have an opportunity to present all the facts which are available to them.

4. The lack of sufficient economic analysis accompanying recommendations to the Secretary was a further weakness in arriving at the most satisfactory decisions with respect to license operation. This was partly an outgrowth of the lack of a public hearing procedure. However, it is possible that, even without a hearing, more could have been done by those

responsible for recommending policy decisions to bring together the facts at hand and relate them to the policy decisions recommended. The discipline involved in following such a method would have been beneficial. Using the example cited above of combining the Kansas City, Kans., and Kansas City, Mo., areas into one market, the necessity of relating this decision to the facts at hand would have shown that the only facts available were those presented at the 1933 hearing in Kansas City, Mo., and that these were such as to indicate that the two areas did not in any sense comprise a single milk market (page 22). As previously noted, the first economic memorandum was used in this market in connection with the amendment of July 1, 1935.

5. The weakness in enforcement authority was probably the most serious deficiency of the license operation. Most of the weaknesses cited had a tendency to diminish as time went on and the Department gained experience with the Kansas City license and with the operation of licenses in other markets. The desirability of hearing procedures and of relating administrative decisions to economic facts were becoming plain to responsible officials. This would have led to a gradual improvement of the licenses as instruments of regulation of milk marketing. The enforcement weaknesses, however, tended to become greater as time went on and the legality of the legislation under which the licenses were issued was called more and more into question in the courts. This led to greater dependence of the Government upon the industry to carry out the marketing program and eventually led to the complete eclipse of the license by industry agreements (pages 45, 49, and 53).

Major Government Policy Decisions

The Federal Government was thrust into the field of milk regulation by the economic emergency of the early 1930's. However, as has been indicated earlier in this report, the marketing of milk for bottled uses was beset by serious difficulties which existed prior to the economic depression although they were greatly aggravated by it. It was not surprising that, with the alleviation of the economic emergency, organized milk producers and many milk distributors supported a continuation of Government administration of local milk marketing plans on a more permanent basis. Some of the policy decisions made by the Department of Agriculture relating to the Kansas City and other fluid milk markets during the license period had important effects on these more permanent regulatory operations. Some of the most important of these decisions follow:

1. The abandonment of resale price fixing. This decision made in January 1934 represented a clear-cut handling of what at the time was a difficult administrative problem. Proper margins for distributors could not be ascertained on the basis of available factual information and the enforcement difficulties were very great. In giving up this phase of regulation and concentrating on setting prices and establishing plans of payment at the producer level, an important step was taken toward a practical basis of regulation. A maximum degree of freedom of private

enterprise was maintained consistent with providing protection for the interests of dairy farmers. The experience under this policy during the license period was the basis upon which Congress omitted any authorization for resale price fixing when it amended the Agricultural Adjustment Act in 1935. (Pages 23-25).

2. Provision for admitting new producers. The Agricultural Adjustment Act contained provisions which authorized crop restrictions. These were later declared invalid by the Supreme Court and, as previously described, brought a consequent weakening of the legal basis for milk marketing regulation. The policy of trying to arrest the decline in prices by reducing output in agriculture and industry had strong public support at that time. To those engaged as sellers in each segment of the economy, the idea was particularly appealing.

It is not surprising, therefore, that the concept of the "closed" market was strongly developed by the milk industry in Kansas City by 1933. This attitude was indicated by a number of developments described in earlier parts of this report. The attitude toward Protected Milk, a new distributor which was unwilling to accept some of the marketing practices of the older distributors, was a case in point. The restrictions against new producers under the King Agreement which preceded the license was another instance where the "closed" market concept was supported by the industry. Still another instance was the testimony of producers at the 1933 hearing proposing that the Federal Government should establish a definite area from beyond which milk could not be shipped for distribution in the Kansas City market (pages 8, 17-21, 22).

The license issued in March 1934 tended to accept a good part of this restriction philosophy. It established a base-rating plan with bases related to production records for a period several years prior to the license. The license provided that a new producer could only come on the market if he received a written permit from the Market Administrator who must first "ascertain whether its issuance will tend to prevent the effectuation of the policy of the act or of the purpose of this license" (pages 27 and 72).

Experience with the permit type of provision for new producers in the Kansas City and other markets soon demonstrated that it placed the Market Administrator in an extremely difficult position. It would have forced him to make a decision in the case of each new applicant and it would have made him the focal point of pressures from the producers' associations and from the distributors who often disagreed on the advisability of taking on new sources of supply. The April 16, 1934, amendment eliminated the permit requirement and replaced it with an automatic procedure by which a new producer would be paid a surplus price for a limited period of time (page 76).

While this new provision did provide a certain financial deterrent for a new producer to come on the market, it represented a substantial acceptance of an open-market concept. Inasmuch as the license provided

minimum prices only, any distributor could, if he wished, pay premiums to induce new producers to come on the market. Such premiums were actually paid to obtain additional milk supplies during the drought periods (page 74).

The new provision was later nullified by the industry agreement of March 1936, which gave authority to the Supply Committee similar to that previously given to the Market Administrator. However, the "new producer" clause in the amended license set the pattern for later Government regulatory programs and it was adopted by Congress as the only special provision applicable to new producers which the Department of Agriculture was authorized to adopt.

3. Exemption of producer-distributors. The first license in Kansas City attempted to regulate the operations of producer-distributors along much the same lines as it regulated proprietary distributors. The difficulty inherent in this policy, as previously described, proved its impracticality. Producer-distributors, in general, sold a higher percentage of their milk in fluid form than did the proprietary distributors and their marketing operations were to a certain extent separate from those of the proprietary distributors because the former served consumers of raw milk whereas the latter supplied the pasteurized milk requirements of the market. Also, the producer-distributors were in most cases able to adjust their production operations more closely with the fluid milk and cream requirements of their customers than were the producers supplying the proprietary handlers. This brought up the question as to whether it was fair to compel producer-distributors to pay money into the equalization pool and whether they could be compelled to do so without unduly raising the cost of administration.

The relaxation of the license requirements relating to producer-distributors and the eventual elimination of the requirement for equalization (although not the requirement for reporting to the Market Administrator) was based on the trial and error experience of the license period. It led to a workable program of regulation involving proprietary distributors without the necessity for involving dairy farmers who wished to distribute milk of their own production. The decline in the number of producer-distributors in Kansas City and many other city markets (due to local requirements for pasteurization and to a variety of competitive factors) lessened the importance of their operations upon the marketing of milk. This further established the effectiveness of the revised policy with respect to producer-distributors as a basis for a long-term regulation of milk marketing.

4. Policy regarding industry agreements. As the legal authority of the Federal Government which regulated the marketing of milk under the Agricultural Adjustment Act was brought more and more into question, the need grew for a clear interim policy on the part of the Government pending new legislation which could be upheld in the courts. The 1936 report of the Agricultural Adjustment Administration mentioned the criteria which would be used in determining whether to terminate a license. One was the degree of compliance (presumably with the license). The other was a

"general disposition to carry forward a supervised plan under a marketing agreement or order, or both," under the amended Agricultural Adjustment Act (page 50).

In practice, milk licenses remained in force in numerous markets where many of their provisions were not complied with or where, as in the case of Kansas City, the license had actually been superseded by an industry agreement. These licenses remained in effect because of a sincere desire on the part of the Department officials concerned, to continue assistance to producers and distributors in maintaining orderly milk-marketing conditions. Keeping the license on the books after February 1936 in Kansas City, for instance, appears to have been a device for giving Government support to the industry agreement. It kept the prestige of the Federal Government behind the agreement, particularly through the person of the Market Administrator who continued to act as an appointee of the Secretary of Agriculture but whose function was that of administering the agreement.

In retrospect it appears however, that this kind of Government assistance was not rendered in a clearly defined and unambiguous manner. The legal authority for it was tenuous. The status of licenses was left unclear as far as the public was concerned, as was that of the Market Administrator. It fostered an attitude toward the Market Administrator and the Government which was not beneficial in administering more permanent regulatory programs.^{73/} It became obvious to all concerned, that Government authority behind the Market Administrator was weak and that he required industry support for all his actions. The attitude of the industry was reflected at the public hearing in May 1936 to consider a proposed marketing order. At that time, the producers' association frankly indicated that it wished to have the authority of the Federal Government for its marketing plan but that it supported an order only if it was "so prepared and/or issued as to synchronize with all existing contractual arrangements." ^{74/}

Function of Industry Agreements During License Period

The primary service of the industry agreements in the Kansas City market was that they bridged the gap in Federal milk marketing regulation during the period when enforcement of Government programs was not yet confirmed by the courts. While the provisions of the industry agreements were in various ways inconsistent with those of the licenses, they did provide the same type of marketing plan which was then being developed under the licenses and which later continued under the orders. They continued the essential features of pricing milk to distributors according to use, pooling the proceeds of sales, and paying producers a blended return per hundredweight of milk on the basis of these pooled proceeds. The marketing

^{73/} As late as May 1938, an industry agreement was made in Kansas City which was in several respects inconsistent with the Federal Order.

^{74/} Record of public hearing, May 6, 1936, page 5 of brief presented on behalf of Pure Milk Producers Association.

program continued to be administered by a single market administrator and he was empowered to audit reports of distributors, to check weights and tests of milk, and to see that all distributors complied with the marketing plan.

The shortcomings of the industry agreements were those which are likely to be found in any industry agreement unless the area within which agreements may be sought by the industry is clearly defined by some public authority and the terms of agreement evaluated by such authority to determine whether the interests of the public or the rights on nonparticipating elements of the industry are protected. In the case of the industry agreements actually consummated in the Kansas City market, our report indicates at least three questionable aspects from this standpoint: (1) Provisions limiting the entry of new producers in the Kansas City market; (2) the special pricing of milk used to promote sales of cream to compete with roadside stands; and (3) the consideration of, and attempts to adjust, resale prices simultaneously with consideration of producer prices (pages 46, 48, 51, and 53).

A word should be added about the experimental policy of the Department in Kansas City and in several other markets during the latter part of the license period whereby the industry was assisted in reaching agreements on marketing plans prior to the holding of public hearings by the Secretary on the issuance, or amendment of a Federal order (pages This type of procedure undoubtedly brought certain advantages during the period of legal uncertainty with respect to Federal regulation. It promoted harmony in the industry and it expedited action on the part of the Government with some assurance that it would not meet with opposition from the important elements in the market.

This policy, if continued, however, would have resulted in a very different relationship between the Government and industry from that which exists today. Public hearings held subsequent to an agreement by the industry cannot be relied upon as a means of getting all the available facts before the Secretary regarding the various provisions and the probable effects of a proposed order. In fact, it is a reasonably sure method of limiting some of the important factual testimony at a public hearing. The agreement reached by the industry prior to the hearing involved a good deal of compromise, and implied an understanding by all parties not to oppose publicly any aspect of the program. The continuation of this policy would have tended to keep controversial issues within the confines of industry meetings and would have prevented them from getting into the record of a public hearing. Under such conditions, the Secretary of Agriculture or whatever public agency may be responsible for the issuance of regulations would be relegated to a passive rather than an active role in issuing regulations. It would leave to the judgment of the industry the determination of a proper level of milk prices and the determination of marketing policies which would best promote marketing stability.

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APPENDIX

ILLUSTRATIONS OF PAYMENT PLAN UNDER THE KING AGREEMENT

For purposes of illustration, we assume there are 3 distributors in the market: A, B, and C. Distributor A is supplied by producer (or group of producers) a, distributor B is supplied by producer b, and distributor C is supplied by producer c. As a further step in achieving simplicity of illustration, we assume that only 2 use classes are provided: Class I (fluid use) and Class II (manufactured use). Given these simplified conditions, we arbitrarily select the following prices and amounts of milk used in each class by each of the distributors:

Class Prices

Class I -- \$3.00 per cwt.

Class II - 2.00 per cwt.

Use of Milk by Distributors

<u>Distributor</u>	<u>Class I</u>	<u>Class II</u>	<u>Total</u>
A	10,000	0	10,000
B	7,500	2,500	10,000
C	5,000	5,000	10,000
Total	22,500	7,500	30,000

The King Agreement provided for a uniform producer price to be computed for base milk. To show the effect of the relationship between base and excess deliveries by producers upon the base price, producer returns, and cost of milk to distributors, 3 different cases are analyzed:

Producer Deliveries

<u>Producer</u> <u>(or producer group)</u>	<u>Case I</u>		<u>Case 2</u>		<u>Case 3</u>	
	<u>base</u>	<u>excess</u>	<u>base</u>	<u>excess</u>	<u>base</u>	<u>excess</u>
a	8,000	2,000	10,000	0	10,000	0
b	8,000	2,000	7,500	2,500	7,500	2,500
c	8,000	2,000	5,000	5,000	9,000	1,000
Total	24,000	6,000	22,500	7,500	26,500	3,500

Producer Prices

Under the King Agreement, the uniform producer price for base milk in our illustrations would be computed by multiplying the Class I price by the total hundredweight of milk used in Class I by the 3 distributors, adding an amount computed by multiplying the Class II price by the remaining hundredweight of milk in the total delivered base of all producers and dividing by the total hundredweight of delivered base. The producer price for excess milk would in each case be the Class II price or \$2.00.

Base price (case 1):

$$\frac{225 \times \$3.00 + 15 \times \$2.00}{240} = \$2.938$$

Base price (case 2):

$$\frac{225 \times \$3.00}{225} = \$3.00$$

Base price (case 3):

$$\frac{225 \times \$3.00 + 40 \times \$2.00}{265} = \$2.849$$

Producer Returns

The return for each producer (or producer group) are found by multiplying the base price by his base deliveries and the excess (Class III) price by his excess deliveries. In each case used in our illustration, the respective returns would be as follows:

Producer	Case 1		Case 2		Case 3	
	total	per cwt.	total	per cwt.	total	per cwt.
a	: 275.00	: 2.75	:: 300.00	: 3.00	:: 284.91	: 2.85
b	: 275.00	: 2.75	:: 275.00	: 2.75	:: 263.68	: 2.64
c	: 275.00	: 2.75	:: 250.00	: 2.50	:: 276.41	: 2.76
All	: 825.00	: 2.75	:: 825.00	: 2.75	:: 825.00	: 2.75

Cost of Milk to Distributors

The King Agreement did not provide for equalization of payments among distributors. Therefore the cost of milk to handlers A, B, and C in our illustration was the same as the payments made to their respective producer groups.

In case 1, the proportions of base and excess milk for each distributor are the same. Therefore, the cost of milk per hundredweight for each distributor is the same, regardless of the fact that each of them uses different proportions of milk in Class I and Class II.

In case 2, the proportions of base and excess milk for each distributor are different but they are the same as their respective uses of milk in Class I and Class II. Their costs of milk vary directly with their proportions of fluid (Class I) and non-fluid (Class II) uses. This was the way in which the King Agreement was supposed to work by continually transferring producers among distributors.

In case 3, the proportions of base and excess milk are the same for distributors A and B as they were in case 2 (that is, in proportion to their class uses of milk), but the base deliveries for distributor C are considerably higher than his Class I use of milk. The effect upon the relative cost of milk for the three distributors is apparent from the table of producer returns. Distributor A and B pay less per hundredweight and distributor C pays more than in case 2. Because distributor C's producers are delivering a greater proportion of base milk than distributor B's producers, in this example, distributor C's cost exceeds distributor B's cost although distributor B uses a greater proportion of milk in Class I. This case, illustrates the type of discrepancy which occurred in practice under the King Agreement.

Other Dairy Branch Publications Available

- (1) Flexibility of Operation in Dairy Manufacturing Plants, Joseph M. Cowden and Harry C. Trelogan, September 1948.
- (2) The Pricing of Surplus Milk in the Chicago Market, Robert W. March, November 1949.
- (3) The Philadelphia Milk Supply, July 1950.
- (4) History and Analysis of Milk Supply Problems in the St. Louis Market, Glenn W. Freemyer, GPO-O-PMA 256, October 1950.
- (5) Federal Milk Marketing Orders and Dairy Programs in World War II, Gertrude G. Foelsch, Agriculture Monograph No. 12, August 1951.
- (6) Federal Regulation of Milk Marketing in the Duluth-Superior Area, Edmond S. Harris and Joel L. Blum, AIB No. 68, August 1951.
- (7) Economic Effects of Federal Regulation of the Minneapolis-St. Paul Fluid Milk Market, Alexander Swantz, May 1952.

