

R A N D A L K . S T O K E R

July 14, 2005

Ms. Deborah A. Garza
Antitrust Modernization Commission
1120 G. Street, N.W., Suite 810
Washington, D.C. 20005

Dear Ms. Garza

You have requested comments from the public regarding antitrust immunities and exemptions. I believe that all immunities and exemptions should be subject to a “sunset” provision, thereby requiring an evaluation at regular intervals (by the Antitrust Division of the Department of Justice or the Federal Trade Commission) as a condition of renewal. I believe those who support the continuation of immunity or exemption must bear the full burden of thoroughly proving, to the satisfaction of the evaluating agency, that benefits exceed costs. Such evaluations must consider all qualitative evidences including adverse economic spillovers, externalities, and side-effects.

You have specifically requested public information regarding the Agricultural Marketing Agreement Act (AMAA). Although I support the Capper-Volstead Act and the cooperative exemption allowing agricultural producers to voluntarily pool their resources, I strongly oppose the immunity and exemption to the milk price regulating provisions contained in Section 608c(5) of the AMAA. It is my personal opinion that the adverse social and economic externalities that result from this immunity and exemption far exceed any benefit.

As the Antitrust Modernization Commission (AMC) evaluates antitrust immunities and exemptions, I respectfully request the AMC carefully consider all of the adverse externalities consequent to the specific immunities granted to the milk price regulating provisions of the AMAA. I am confident that such an evaluation will lead to competition advocacy and a disciplined process of milk price deregulation.

Please note the accompanying documentation supporting my position in this matter.

Sincerely,

Randal K. Stoker

Over the past three decades my personal involvement in the dairy industry has allowed me to become very familiar with milk price regulation. I oppose the antitrust immunity and exemptions granted to the *milk price regulating provisions* contained in the Agricultural Marketing Agreements Act (AMAA). My opposition does not extend to other agreement and order provisions that authorize governmental *non-price* involvement (such as accurate and timely market and price information, transparency, standardization, and authority for oversight and enforcement).

To my knowledge, the price regulating provisions in the AMAA uniquely pertain to milk. The AMAA's milk price regulating provisions are contained in section 608c(5). Milk price regulations are administered by both State and Federal agencies. Milk price regulating provisions were declared lawful and immune from antitrust scrutiny by the Supreme Court during the "New Deal" era. State and Federal minimum pricing was declared constitutional in *Nebbia v. New York* in 1934¹ (See also Appendix A). Classified pricing, uniform pricing, and equalization pooling was declared constitutional in *U.S. v. Rock Royal* in 1939² (See also Appendix B).

I believe that the Antitrust Modernization Commission has sufficient justification for restoring the benefits of price competition to the dairy industry. The AMAA's milk price regulating immunities and exemptions have somehow survived in spite of plain and repeated repugnancy.

- ◆ The courts, clothed with the ultimate responsibility of interpreting the constitutionality of the milk pricing immunities, have frequently voiced their frustration and inability to understand and interpret the extreme complexity of milk price regulating provisions.³

¹ *Nebbia v. People of State of New York*, 291 U.S. 502 (1934)

² *United States v. Rock Royal Co-op., Inc.*, 307 U.S. 533 (1939)

³ A few examples:

1. In *Dairymen's League Coop. Ass'n, inc. v. Brannan*, 173 F.2d 57, 65-66, cert denied, 338 U.S. 825 (1949): "We are indeed aware how great an advantage familiarity with the multifarious ramifications of such a subject as milk regulation gives to administrators, and how much less favored are we who must plunge into it unequipped. Nevertheless, we should have to endow them with almost supernatural powers, if they were not, like ourselves, at the outset stunned and confounded by the fantastic proliferation which emerges, when one attempts to find a path through such a verbal mazes . . . The regulation of an industry such as this . . . is an undertaking of monstrous difficulty; yet it remains to be seen whether success is within the compass of human abilities."
2. In *Queensboro Farm Products, Inc. v. Wickard*, 137 F.2d 969, 975 (2nd Cir. 1943) and also quoted by 7th Circuit in *County Line Cheese Co. v. Lyng*, 823 F.2d 1127, 1133 n.1 (7th Cir. 1987): "The milk problem is so vast that to fully comprehend it would require an almost universal knowledge ranging from geology, biology, chemistry, and medicine to the niceties of the legislative, judicial, and administrative processes of government."
3. In *Zuber v. Allen*, 396 U.S. 168, 172 (1969): "Once again this court must traverse the labyrinth of the federal milk marketing regulation provisions."

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- ◆ In 1977, the Department of Justice (DOJ) testified that regulated milk pricing is not serving the public interest and concluded that milk price regulation was “outdated”, “inequitable”, “inefficient”, and “ineffective.”⁴
 - ◆ In 1988, the General Accounting Office (GAO), at the request of Congress, testified that milk price regulation should be phased out: “The federal milk marketing system has contributed to the national milk surplus and [has] benefited producers in some regions of the country at the expense of others. . . We prefer [a] strategy of lessening government influence on milk prices so that market forces can play a greater role. . . There is substantially less need for extensive government regulation of fluid milk markets than in the past. . . We are suggesting that the Congress work with USDA to develop and adopt legislation necessary to accomplish the goal of reduced federal involvement in milk pricing.”⁵
 - ◆ Milk price regulating provisions and the associated antitrust immunities and exemptions have been seriously questioned by Secretaries of Agriculture. (See Appendix C)
 - ◆ As recent as 2002, Congress directed USDA to study alternatives to regulated milk pricing. USDA’s report, issued in July 2004 stated: “Seventy years of Federal intervention in dairy markets makes it difficult to quantify the full impacts of national dairy policy, since it is impossible to know how today’s industry would look in the

⁴ “There is a startling contrast between milk marketing in the 1930’s and today [1977]. Markets that were of necessity highly local in character had many small producers who were typically unorganized, facing few handlers. They have been replaced by markets of substantially greater size, wherein producers are represented by highly effective bargaining cooperatives and federations and typically have multiple outlets for their milk. Further, the current communication and information gathering capabilities bear little comparison with such capabilities in the 1930’s. Such contrasts alone should call into question the continuing need for the federal market orders.

Federal milk orders are a significant deviation from a free market economy which deviation creates substantial undesirable economic effects. . . The order system has evolved into a generally inefficient and ineffective means of achieving the broadly outlined Congressional goals. . . To the extent the transfer payments are viewed as a desirable goal of the order system, the fact that some farmers actually lose income to other farmers cannot be overemphasized. It is difficult to imagine that Congress intended this result. . . The system is not in the best interest of dairy farmers because not all of the benefits intended for them by Congress have been realized, and what benefits there have been bestowed in an inequitable or regressive fashion, or in an inefficient manner.” United States Department of Justice, Report on Milk Marketing, 1977, pgs. 497, 499-500

“Administering marketing orders imposes direct cost on taxpayers and the industry. The regulatory process is complex and there are costs to learning about and complying with current and new regulations. Given the substantial costs that milk marketing regulations imposes upon American taxpayers, milk producers and consumers, and the significant changes that have occurred since that regulatory system was established in the 1930’s, a reexamination of the regulatory system is called for. The claimed justifications of the extensive regulatory system are now irrelevant or invalid.” U.S. Dept of Justice, Testimony of Dr. Sheldon Kimmel on November 15, 1990 at the USDA Hearings on Proposed Changes in Milk Marketing Orders.

⁵ Milk Marketing Orders – Options for Change, March 1988, p. 66-67

absence of dairy programs. An examination of dairy program impacts suggests that Federal dairy programs raise the all-milk price by only about 1 percent.”⁶

It is thus evident that although numerous analyses have indicated that a competitive and market-oriented policy would be socially and economically beneficial, meaningful reform of the milk price regulating provisions has remained firmly stuck in the political quagmire where all three branches of government converge.

It is my hope that the AMC, the watchdog of public interest, will carefully consider all of the adverse economic spillovers that are so evidently manifest in today’s dairy industry. It is my hope that the AMC will courageously overcome the political barriers and restore the time-tested principles of unbiased competition to the dairy industry. It is also my hope that the AMC will be able to overcome the state action doctrine and abolish both the State and Federal milk pricing immunities and exemptions that disjoin our nation into self-interested factions and divert our focus away from the general welfare.

Adverse economic costs, spillovers, or externalities are difficult to measure and quantify. However, thoughtful and focused observations can easily demonstrate that these adverse externalities do indeed exist and do indeed have a significant social and economic cost. Some of the adverse externalities that are often overlooked include:

1. an excessive concentration of market power,
2. restrictions, obstructions, and inequities in the commercial trade of milk and dairy products,
3. inefficiencies in the transportation, marketing, and pricing of milk and dairy products,
4. an unnecessary administrative bureaucracy with its unnecessary unpredictability and economic costs,
5. suppressed product innovation and marketing flexibility,
6. unnecessary restrictions to economic and entrepreneurial freedom, and,
7. misallocation of capital resources.

1. Excessive concentration of market power

- ◆ Although concentrated market power and the exercise of that market power is a common element in free commerce, I do not believe that governmental agencies should aid and/or assist in the concentration of that market power. I believe that, although unintended, the AMAA aids and assists the concentration of market power in the dairy industry by equalizing fluid milk handler prices.
- ◆ As predicted in 1939 by Justice Roberts “as [milk price regulation] is drawn and administered it inevitably tends to destroy the business of smaller handlers by placing them at the mercy of their larger competitors.”⁷

⁶ Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing, USDA July 2004

- ◆ The milk pricing provisions contained in the AMAA have assisted in and encouraged the concentration of market power in both the supply and demand side of the fluid milk sector of the dairy industry.
- ◆ Excessive market power is evidenced by persistent and significant “over-order premiums.” It has been suggested that persistent over-order premiums are a clear indication that pricing provisions should be suspended.⁸
- ◆ Competition advocacy would allow unbiased market forces to equitably reduce concentrated market power in the fluid milk sector of the dairy industry and simultaneously reward innovation, niche marketing, and entrepreneurial ventures in the same sector.
- ◆ In the dairy industry, I believe that excessive market power is evident in:
 - a. California,⁹
 - b. A few multiregional dairy cooperatives, and,
 - c. A few large national fluid milk processors.
- ◆ In the dairy industry, I believe that the concentrated market power tends to exploit and disadvantage:

⁷ Dissenting opinion in *United States v. Rock Royal Co-op., Inc.*, 307 U.S. 533 (1939). Smaller fluid milk handlers are disadvantaged because, unlike larger multi-regional handlers, they cannot blend on multiple orders and across multiple processing plants where multiple classes of milk are processed.

⁸ We believe that it was the clear intent of the Congress that Secretary’s orders should provide public assistance to the private enterprise system rather than superseding it. But when free collective bargaining by strong cooperative associations results in negotiated marketwide premiums substantially and persistently above the uniform prices established in the order, an ambiguous and dangerous situation confronts the order system. Either the Class I price in the order is too low or the premium price too high by an “open market” standard. It may be argued under a mechanistic theory of market behavior, that, if free collective bargaining results in over-pricing, the process will be self correcting. But, experience shows that, with the less than completely free market conditions provided by the Secretary’s order and with dairy price supports, monopoloid distortions of the market and intermarket price structure may persist indefinitely. This would defeat the basic purpose of the order system to achieve as fully and promptly as possible a national milk price structure that would be internally consistent, serve consumers’ needs, and promote optimum allocation of the nation’s productive resources. We, therefore recommend that, in markets where negotiated market wide premiums or higher than order prices imposed by state agencies) exist, the Department institute hearings to review the level of Class I prices and any limitations on free access to the market. If, thereafter, such premiums still persist consideration should be given to suspension of the pricing and pooling provisions of the order.” Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, pg. 99

⁹ If California’s expansion were due to good competition and ingenuity, the States would not be filing this brief. However, in recent years, in order to compensate for losing the luxury of “geographic isolation,” California has begun to employ policies that are prohibited by the Commerce Clause. These policies have provided the California dairy industry with an improper competitive advantage over the dairy economies of every other state in the commercial union. . . . Because California so dominates the United States dairy economy, its ability to protect its dairy industry de facto shifts economic burdens of supply and demand onto its competitor dairy states. This occurs because of the complex regulatory mechanisms that govern milk pricing and pooling. . . . Dairy farmers in other states suffer significant economic hardship each year from lower milk prices driven by California’s industry dominance and protectionism. Brief of States of Nevada, Minnesota, Montana, Oregon, Washington and Wisconsin as Amici Curiae in Support of Petitioners, filed February 24, 2003, on Writs Of Certiorari To The United States Court Of Appeals For The Ninth Circuit.

- a. smaller, more local dairy cooperatives - especially cooperatives who are unable to obtain access to marketwide pools or balancing plants
 - b. independent milk producers (producers who are not members of dairy cooperatives) - especially manufacture milk producers and producers who are unable to obtain access to marketwide pools,¹⁰
 - c. smaller proprietary fluid milk handlers who are unable to pool across multiple classes and regions,
 - d. producer-handlers and other niche marketing ventures.
- ◆ Fixed Class I differentials (and the economic incentives that they create) together with marketwide pooling has caused the dairy industry to adopt a quasi-quota plan (with quota being defined as marketwide pool access through pooling standards).¹¹ The AMAA's uniform pricing provisions tend to equalize competitive forces between fluid milk handlers and thus lend artificial economic support for merging with or acquiring competitors. With fewer and fewer independent fluid milk buyers, and most those supplies committed by full/exclusive supply contracts with large multi-regional dairy cooperatives, small cooperatives and independent producers have fewer and fewer options for obtaining access to the marketwide pools. Thus the economically advantageous fluid milk market is increasingly dominated by multiregional cooperative supply organizations and by one or two national fluid milk processing companies. Those dominant supply cooperatives that are so privileged to have access, naturally, either prefer to limit entry, or else exploit their advantage by "encouraging" others to "elect" to join their dominant group or pay some sort of "marketing fee". In actuality, the economic rewards/penalties associated with marketwide pooling leave little choice to the minority but to join the dominate group¹² or pay the "marketing fee." The situation then breeds upon itself and fuels further concentration of

¹⁰ It is obvious that high prices under fluid milk marketing orders will induce and have induced increased production and offerings within the normal production area as well as from outside sources. The increased supplies resulting from such prices add to the total milk supply for all uses and are, therefore, specifically to the disadvantage of milk producers not under protective milk orders." Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, Washington, D.C. December 1962 Note by Edwin W. Gaumnitz p. 16

¹¹ An extensive study conducted by the Organization for Economic Co-operation and Development's Joint Working Party on Agriculture and Trade recently concluded that milk quota systems of any sort are inefficient and unsustainable in a global marketplace. An Analysis of Dairy Policy Reform and Trade Liberalisation, Trade and Economic Effects of Milk Quota Systems, COM/AGR/TD/WP(2004)19/FINAL, Contact: Pavel Vavra [REDACTED]

¹² The Supreme Court referred to this phenomenon when the Agricultural Adjustment Act was declared unconstitutional: "The regulation is not in fact voluntary. The farmer, of course, may refuse to comply, but the price of such refusal is the loss of benefits. The power to confer or withhold unlimited benefits is the power to coerce or destroy. If the [milk producer] elects not to accept the benefits, he will receive less for his [milk]; those who receive payments will be able to undersell him. The result may well be financial ruin. . . . It is clear that the Department of Agriculture has properly described the plan as one to keep a non-cooperating minority in line. This is coercion by economic pressure. The asserted power of choice is illusory." U.S. v. Butler et al., 297 U.S. 1

market power in fluid milk sector of dairy marketing (both the supply and demand side).¹³

- ◆ As illustrated in the proceeding paragraph, the milk pricing immunities and exemptions of the AMAA thus directly conflict with the Agricultural Fair Practices Act (AFPA). The intent of the AFPA is to provide and protect the freedoms of choice to agricultural producers in their election to join or not join a particular agricultural organization.¹⁴

2. Restrict, obstruct, and cause inequities in the commercial trade of milk and dairy products.

- ◆ Evidence that trade is restricted by the application of the milk pricing immunities and exemptions of the AMAA include the following:
 - a. The Supreme Court has repeatedly struck down certain state and federal milk pricing programs as violation of the Commerce Clause.¹⁵
 - b. Legal issues pertaining to the commercial sale of packaged milk products from California to Nevada¹⁶
 - c. Legal issues pertaining to the commercial sale of bulk fluid milk from Nevada and Arizona to California¹⁷
 - d. Pricing and competitive issues pertaining to the sale of bulk and packaged cheese and butter from California to other national markets¹⁸

¹³ “Dairy cooperatives’ market power is closely tied to the treatment of cooperatives under Federal Milk Marketing Orders.” USDA Report to Congress, July 2004, Economic Effects of U.S. Dairy Policy and Alternative Approaches to Milk Pricing. p. 22

“In the future development of the marketing order system, we must consider what cooperative structures and practices promote healthy competition and which, if any, have the purpose and effect of fostering monopolistic power.” Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, Washington, D.C. December 1962 p. 8

¹⁴ See Agriculture Fair Practices Act of 1967 (7 U.S.C. 2301-2306)

¹⁵ Examples include: *Baldwin v. Seelig* (1935), *Lehigh Valley v. U.S.* (1962), *Polar v. Andrews* (1964), *Zuber v. Allen* (1969), and *West Lynn Creamery v. Healy* (1994). The recent *Hillside/Ponderosa v. Lyons* case was remanded back to the 9th Circuit because of questionable Commerce Clause implications. On July 8, 2005, the California Department of Food and Agriculture (CDFA) dropped their appeal in compliance with Judge Garland E. Burrell, Jr.’s May 7, 2004, order that the CDFa regulations violated the Commerce Clause of the Constitution.

¹⁶ Unified Western Grocers, Inc., et al. v. Mike Johanns, Secretary, Department of Agriculture, et al. CV 04-8399 GPS (SHx)

¹⁷ “Nevada and Oregon dairy farmers who directly engage in raw milk transactions with California, are faced with direct interference by California in their economic transactions with California processors.” Brief of States of Nevada, Minnesota, Montana, Oregon, Washington and Wisconsin as Amici Curiae in Support of Petitioners, filed February 24, 2003, on Writs Of Certiorari To The United States Court Of Appeals For The Ninth Circuit. On July 8, 2005, the California Department of Food and Agriculture (CDFA) dropped their appeal in compliance with Judge Garland E. Burrell, Jr.’s May 7, 2004, order that the CDFa regulations violated the Commerce Clause of the Constitution.

¹⁸ “The protective web of California’s regulations allow California producers to price their milk used in nationally marketed cheese and butter significantly lower than required under the federal milk marketing orders that govern pricing in other dairy states. Conversely, California milk used in regionally marketed fluid milk products is priced relatively higher than federal milk marketing orders dictate. The result of

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- e. Legal and competitive issues pertaining to the sale of packaged fluid milk products originating in Montana and sold to areas outside the state of Montana that are regulated by the federal government.
 - f. Legal and competitive issues pertaining to the sale of packaged fluid milk products produced in unregulated areas and sold into state or federally regulated areas.¹⁹
 - g. Legal and competitive issues pertaining to the sale of fluid milk produced by exempt producer-handlers and sold in a state or federally regulated area.²⁰
 - h. Inequitable price issues between regionally regulated areas lead to proposals to either merge or split federal order areas.²¹ Although proposals to form one national order have been contemplated, section 608c(11) of the AMAA states “No order shall be issued . . . to all production areas or marketing areas, or both, unless the Secretary finds that the issuance of several [regional] orders . . . would not effectively carry out the declared policy of this title.”
 - i. Even though milk price regulation was a sustainable policy in the 1930’s, maintaining that policy in the globalised markets of today has

California’s system of cross-subsidization therefore has been to increase milk production beyond what uniformly regulated conditions would have generated. More milk production means more cheese and butter, and, thus lower prices for those products and for milk on which dairy farmers throughout the country rely for their livelihoods.” Brief of States of Nevada, Minnesota, Montana, Oregon, Washington and Wisconsin as Amici Curiae in Support of Petitioners, filed February 24, 2003, on Writs Of Certiorari To The United States Court Of Appeals For The Ninth Circuit. This state-federal phenomena is replicated on the national-international level.

¹⁹ H.R 1659, 108th Congress, 1st Session, “To ensure regulatory equity between and among all dairy farmers and handlers, including producers also acting as handlers, for sales of packaged fluid milk into certain non-federally regulated milk marketing areas from federally regulated areas.” April 8, 2003.

²⁰ See Producer-Handler recommended decision, (70 CFR 19636).

²¹ Elimination of price differences between handlers for milk used in the same class eliminates one of the prime incentives for disorderly marketing. This arrangement eliminates the buying advantage which some buyers could achieve by pitting producer against producer or by refusing to participate in the negotiated pricing plan. [To this statement Edwin W. Gaumnitz commented:] While agreeing with this statement, it should be noted that under the present situation the emphasis has merely been shifted to pitting producer against producer by edict in that preferred and protected producers under one order are now concerned about protecting the advantage attained under that order against those producers who receive the benefits of a second order. Both groups, however, seek to protect themselves against all other producers such as manufacturing milk producers. It should be noted that less than 200,000 producers deliver to handlers regulated “under” orders, while there are a total of about 1,000,000 farms from which milk or cream is sold. It is certainly difficult to square this statement with the objectives of equity so nicely stated elsewhere and to which lip service is given throughout the report. Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, Washington, D.C. December 1962 p. 43. Proposals have been made to merge the Southeast and Appalachian federal orders and to split the Southeast and Central orders.

serious implications for national economic welfare since higher input costs make US milk products less competitive in world markets.²²

3. Inefficiencies in the transportation, marketing, and pricing of milk and dairy products

- ◆ Transportation – although it is suggested that Class I differentials reflect transportation factors, competitive market forces would constantly and more accurately update to the true cost of moving milk from adequate to deficit areas. In addition, it can be demonstrated that transportation credits and performance standards can result in unnecessary transportation costs.
- ◆ Marketing – the AMAA and the supporting judicial sanctions assume that fluid milk should always be the highest valued class. The AMAA’s milk classification scheme with its mandated and supported value of Class I fluid milk has resulted in adverse economic spillovers that have been evident since before 1962.²³ Modern milk marketing evidence indicates that fluid milk does not always command the highest valued use for raw milk.²⁴
- ◆ Pricing – price efficiency is the ability of prices to reflect supply and demand conditions. Milk supply and demand imbalances caused by the false milk price signals has prompted Congress and others to establish or authorize export subsidies, mandatory promotion programs, government purchase programs, diversion programs, a whole-herd buyout, regional dairy compacts, support price extensions, federal order reform²⁵, and, most recently, the

²² See “State Action Doctrine” Box 2, paragraph 3, Updated Report on Competitive Law and Institutions (2004), United States, Office of Economic and Cooperation and Development’s 1999 “Report on the Role of Competition Policy in Regulatory Reform”

²³ It is important that there be set forth here the long-run consequences of establishing Class I prices at levels higher than those necessary to call forth an adequate supply, and thus using this device of price classification for enhancement of producer income to levels which “overreach the bounds permissible if there is to be long-run stability and orderliness in the national fluid milk market. These consequences are:

- a) Higher prices to consumers, with consequent smaller volume of fluid milk consumption.
- b) Supplies at higher levels, resulting in larger surpluses because of the increased supply and reduced consumption.
- c) The development of
 - a. More vexing problems in handling surplus,
 - b. Excess capacity, particularly in surplus handling,
 - c. Uneconomical expansion of production in high-cost areas,
 - d. Capitalization of such enhanced income in increased land values and other costs, and
 - e. Additional surpluses of manufactured dairy products – to the detriment of the producer of manufacturing milk and butterfat.

Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, Washington, D.C. December 1962 Note by Edwin W. Gaumnitz p.28)

²⁴ For example, in Italy, milk used to produce specialty cheeses commands the highest valued use of milk. In addition, modern advances in milk fractionalization now demonstrate higher values for milk components used for pharmaceutical and medicinal uses.

²⁵ An Assessment of the Experience with and Future of Interstate Dairy Compacts, Texas A&M, Ronald D. Knutson, Oral Capps, and Robert B. Schwart, “Dairy Reform, as authorized in the 1996 Farm Bill, held the potential for modernization of dairy policy... The potential was not realized because of a combination of a *lack of congressional and administration understanding of the adverse effects that policies*

expensive Milk Income Loss Contract (MILC)²⁶. All of these efforts and programs demonstrate and compound price inefficiencies. Frustrated with the side effects of dairy policy, Congress requested the General Accounting Office (GAO) study and make recommendations to reform milk pricing.²⁷

4. An unnecessary administrative bureaucracy with its unnecessary unpredictability and economic costs

- ◆ Although many of the administrative costs of the milk price regulating programs can be assessed and aggregated, many of the associated social costs are not as evident or measurable.²⁸ A cost analysis should also include:
 - i. Opportunities to exploit the regulatory price system lead to additional policing and antitrust investigation costs, antitrust fees, fines, and settlements (which ultimately are transferred to consumers, producers, and society)
 - ii. Border regulations and the associated costs (export subsidies, import restrictions, inspections, duties, etc.)

enhancing the economic position of one region or industry sector can have on another... The effect is not only to distort industry structure and misallocate resources, but also to benefit one industry segment at the expense of another.” (emphasis added)

²⁶ The Milk Income Loss Contract (MILC) is the first program that provides direct assistance to dairymen. Although the MILC still influences milk prices indirectly, direct assistance to individual dairymen is less disruptive to market mechanisms and milk prices.

²⁷ Milk Marketing Orders, Options for Change, issued on March 21, 1988. The GAO report concluded: “The milk marketing order system should be changed because its provisions have contributed to excess production and treat some producers unfavorably compared to others. GAO believes that the premises for milk pricing under federal orders are outdated. ***The Congress should consider setting a goal of decreasing the federal role in milk pricing.***” (emphasis added)

²⁸ The mere absence of disorderliness for protracted periods does not necessarily assure that economic efficiency is being accomplished within individual markets or for the system as a whole. Any administered marketing or regulatory system may impede or promote innovation and adoption of improved technology in the long run. Short-run stability and orderliness may involve public cost in terms of loss of long-run efficiency. Furthermore, certain regulatory devices established for ease and convenience of administration can magnify this problem. The quantitative significance of such short and long-term impacts of regulatory practice may be impossible to measure. Nonetheless, such qualitative evidence as is available should not be ignored. (Edwin G. Norse, Report to the Secretary of Agriculture by the Federal Milk Order Study Committee, Washington, D.C. December 1962 p. 43)

Justices Frankfurter and Rutledge dissenting from the Supreme Court majority opinion in *H.P. Hood & Sons v. Du Mond*, 336 U.S. 525 (1949) said: “As matters now stand, however, it is impossible to say whether or not restriction of competition among dealers in milk does in fact contribute to their economic well-being and, through them, to that of the entire industry. And if we assume that that some contribution is made, we cannot guess how much. Why, when the State has fixed a minimum price for producers, does it take steps to keep competing dealers from increasing the price by bidding against each other for the existing supply? Is it concerned with protecting consumers from excessive prices? Or is it concerned with seeing that marginal dealers, forced by competition to pay more and charge less, are not driven either to cut corners in the maintenance of their plants or to close them down entirely? Might these consequences follow from operation at less than capacity? What proportion of capacity is necessary to enable the marginal dealer to stay in business? . . . We should, I submit, have answers at least to some of these questions . . .”

- iii. The costs of the additional and unnecessary market risks derived from regulation itself (unnecessary market risks are those risks that are not associated with the *unavoidable* risks associated with production and marketing). These additional market risk costs include the risk of an administrative price adjustment or price formula change, the risk of reduced price support, the risks associated with the existence or non-existence of a government stock of storable dairy products, the risk of regulatory status change, the risk of losing pool status, the risk of quota devaluation, and, the risk of price deregulation.²⁹

5. Suppressed dairy product innovation and marketing flexibility

- ◆ The administrated classification of every dairy product into a specific class creates an unnecessary restriction, cost, and suppression of creative innovation. The total costs associated with the administrative process are not measurable and are therefore not aggregated and made public. The most recent examples include the processes to redefine Class I fluid milk and to modify the Class III and Class IV formulas. The effected businesses not only have the burden of collecting and reporting detailed usage but also must bear the burden of proposing, defending, and/or holding back further restrictions and regulation. Individual operations are subject to unpredictable consequences, especially if their product is not mainstream.

6. Unnecessary restrictions to economic and entrepreneurial freedom

- ◆ Economic – The economic viability of individual businesses are often enhanced and/or suppressed by regulatory price provisions (imposed on themselves and/or their competitors).
- ◆ Entrepreneurial – local niche dairy enterprises that process and market directly to consumers are restricted if provisions prohibit balancing (the ability to purchase milk in times of shortage and sell milk in times of surplus). Recent decisions propose price regulation of entrepreneurial producer-handlers who have successfully reached a specified volume of sales and marketing.

7. Misallocation of capital resources

- ◆ There is adequate evidence that milk production and processing capital investment has been encouraged by governmental regulation (California is a prime example). At the same time, existing capital investments (i.e. in

²⁹ The Nobel Prize winning economist, Fredrick August Von Hayek, said it best when he stated: “So long as government has the power of benefiting particular groups, there is no way of stopping it. You can only take the power from government. As long as government has the power to interfere in economic lives, it will be forced to do so by the mere need of buying the support of particular groups. You cannot with a potentially omnipotent government obtain a majority to support it unless you buy the support of particular interests. To make government independent of economic pressures requires that government be deprived of the conceding privileges to particular groups. As long as it has the power to do so, it will be forced to do so.” The Road to Serfdom, Frederick August Von Hayek, 1974

traditional dairy states like Wisconsin and Minnesota) have encountered difficulty in competing with the “subsidized” industries.

- ◆ The misallocation (due to non-naturally occurring market forces) extends and is magnified by its effects upon the supporting infrastructure and institutions that are likewise misallocated (feed suppliers, equipment suppliers, professional and technical support, milk and feed testing labs, etc.)
- ◆ Whenever governmental regulation misallocates capital resources by artificial support, “surplus” production results. The “surplus” production then creates a strong incentive to “dump” the surplus of the subsidized products so produced upon “outside markets” where no such subsidization exists and/or is possible. There is evidence of this in the dairy industry on both a state-national basis as well as on a national-international basis.
- ◆ Even the independent producer-handlers actually receive an indirect price support that is derived from fixed Class I differentials defined in section 608c(5) of the AMAA. This is due to the fact that their competitors are required to pay the regulated Class I price and the producer-handlers are therefore also able to sell their “unregulated” milk at a higher price. Regulated handlers claim that producer-handlers enjoy an “unfair advantage.” All claims of “unfair advantage” become moot if fixed Class I differential are eliminated.
- ◆ Many in the dairy industry describe the negative “burden” of balancing the market. These so-called “balancing costs” are an economic spillover that is really the cost of “dumping” the surpluses associated with a subsidized product. Price deregulation would not only make such claims moot but would also convert these economic “burdens” into economic “opportunities.”

For the reasons outlined above, I respectfully propose a careful but deliberate revocation of the milk price regulating immunities and exemptions contained in the AMAA.

Respectfully,

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Appendix A

Notes on Nebbia v. New York

Fixation of the price at which A, engaged in an ordinary business, may sell, in order to enable B, a producer, to improve his condition, has not been regarded as within legislative power. This is not regulation, but management, control, dictation – it amounts to the deprivation of the fundamental right which one has to conduct his own affairs honestly and along customary lines. If it be now ruled that one dedicates his property to public use whenever he embarks on an enterprise which the Legislature may think it desirable to bring under control, this is but to declare that rights guaranteed by the Constitution exist only so long as supposed public interest does not require their extinction. To adopt such a view, of course, would put an end to liberty under the Constitution.

Not only does the statute interfere arbitrarily with the rights of the little grocer to conduct his business according to standards long accepted – complete destruction may follow; it takes away the liberty of 12,000,000 consumers to buy a necessity of life in an open market. It imposes direct and arbitrary burdens upon those already seriously impoverished with the alleged immediate design of affording special benefits to others.

The Legislature cannot lawfully destroy guaranteed rights of one man with the prime purpose of enriching another, even if for the moment, this may seem advantageous to the public.

The ultimate welfare of the [milk] producer, like that of every other class, requires dominance of the Constitution.

The Fourteenth Amendment wholly disempowered the several states to “deprive any person of life, liberty, or property, without due process of law.” The assurance of each of these things is the same. If now liberty or property may be struck down because of difficult circumstances, we must expect that hereafter every right must yield to the voice of an impatient majority when stirred by distressful exigency. Constitutional guaranties are not to be “thrust to and fro and carried about with every wind of doctrine.” They are intended to be immutable so long as within our charter. Rights shielded yesterday should remain indefeasible today and tomorrow. Certain fundamentals have been set beyond experimentation; the Constitution has released them from control by the state.

Appendix B

Notes on U.S. v. Rock Royal

It is held by high authority that even though a statute may be constitutional on its face and may be valid when enacted or when given a particular application, it may be invalid under changed conditions. . . or when its operation results in the taking of property of one without compensation and transferring it to another. . . The acts of Congress under the commerce clause are subject to the 5th Amendment. . . Congress has not the power under the commerce clause, or otherwise, to take without compensation property of one and transfer it to another. And this is so, even though it be for a valid public purpose as is claimed here and as the statute intends. . . There can be little doubt that the statute, as applied in the order by means of the Producers Settlement Fund, takes the money from one group without compensation and transfers it to another, however disguised that transferring and taking may be, by representing it to be necessary to stabilize milk production and to take care of surplus milk. . . The statute as applied in the order is unconstitutional as to all the defendants in its application to the situation and conditions here existing and . . . the order . . . should not be enforced. U.S. v. Rock Royal, et al. 26 F. Supp. 534, Feb. 23, 1939

First. Congress possesses the powers delegated by the Constitution – no others. Ancient doctrine sufficiently demonstrates the absence of Congressional authority to manage private business affairs under the transparent guise of regulating interstate commerce. True, production and distribution of milk are most important enterprises, not easy of wise execution; but so is breeding the cows, authors of the commodity; also, sowing and reaping the fodder which inspires them.

Second. If perchance Congress possesses power to manage the milk business within the various states, authority so to do cannot be committed to another. This is not government by law but by caprice. Whimseys may displace deliberate action by chosen representatives and become rules of conduct. To us the outcome seems wholly incompatible with the system under which we are supposed to live.

I have expressed my views as to the unconstitutionality of the provisions of the Agricultural Marketing Agreement Act of 1937 in view of their attempted delegation of legislative powers. . . . I am of the opinion . . . that [the] order, . . . if authorized, deprives the appellees of their property without due process of law in violation of the Fifth Amendment.

It is evident that the order freezes the minimum price which is to be paid by many handlers and leaves the price of others who compete with them open to reduction by the device of blending [pooling]. There is nothing in the Act which authorizes the

discrimination worked by the order permitting handlers, whether proprietary or cooperative, to blend the prices of unpriced milk with that of milk sold in the marketing area. As the order is drawn and administered it inevitably tends to destroy the business of the smaller handlers by placing them at the mercy of their larger competitors. I think that no such arrangement was contemplated by the Act, but that, if it was, it operates to deny the appellees due process of law. U.S. v. Rock Royal Co-op., Inc. et al. 307 U.S. 533 (1939)

Appendix C

Statements and notes from Secretaries of Agriculture

- (1) Secretary Ezra Taft Benson stated in 1956: “The principles of economic freedom are applicable to farm problems. We seek a minimum of restrictions on farm production and marketing to permit the *maximum dependence on free market prices* as the best guides to production and consumption.” (Farmers at the Crossroads, 1956)
- (2) Secretary Orville Freeman appointed a Federal Milk Order Study Committee to analyze and make recommendations to the milk marketing order program (1962). This Report to the Secretary of Agriculture by the Federal Order Study Committee has become known as the “Norse Report”. Edwin G. Norse was the committee chairman. The report provides a candid and thorough investigation into the philosophies and basis for federal milk marketing orders. I am amazed that the committee’s recommendations are as applicable today as they were in 1962. This committee made eight concluding remarks. Each of the eight concluding remarks goes into greater depth and explanation and although I am quoting directly from the report, I am quoting only those portions that I feel captures the committee’s main idea. (*emphasis is added*)
 1. *We believe that local income enhancement in combination with dairy price support levels established has been allowed to overreach bounds permissible if there is to be long-run stability and orderliness in the national fluid milk market.*
 2. *The special interests of local groups and personal preferences of individual leaders should not be allowed to cramp the public interest.*
 3. *We believe that it was the clear intent of the Congress that Secretary’s orders should provide assistance to the private enterprise system rather than superseding it.*
 4. *We believe that market “rights” should be recognized but administratively safeguarded against abuse contrary to the public interest or the like interests of other producers.*
 5. *We believe that certain current order provisions harbor possibilities for abuse.*
 6. *We believe that, in general, technological and commercial development presage an expansion of milk supply at least as fast and probably faster than any foreseeable expansion in demand at present price levels. Hence, the problem of price-depressing surpluses will not go away but must be dealt with sooner or later in some definitive manner.*
 7. *We believe that the Secretary must exercise care to avoid short-run partisan positions in the interests of fluid milk producers as may run counter to other dairy interests of the general economy, or the long-run interests of the fluid milk producer himself.*
 8. *The Agricultural Marketing Agreement Act gave broad discretionary power to the Secretary. Administrative considerations appear to have played a major role in shaping the policies and directions of some aspects of the order program. The Secretary must be vigilant to be sure that administrative considerations are put in proper perspective with other factors and not allowed to override issues of principle.*
- (3) Secretary Edward Madigan, still unsatisfied with the massive amounts of information gathered from a series of regional USDA hearings invited additional and more directed comments from the dairy industry and the general public regarding the future of milk price regulation. The following Press Release was issued on November 15, 1991. (*emphasis added*)

SECRETARY MADIGAN CALLS FOR PUBLIC COMMENTS ON MILK MARKETING ORDERS

On November 15, Acting Secretary Roland Vautour announced that Secretary of Agriculture Edward Madigan is inviting comments from the dairy industry and the general public regarding the future of the U.S. Department of Agriculture’s milk marketing orders.
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"Recently, concerns have increased about the cost, efficiency and rationale of milk marketing orders," Madigan said. "Are there more efficient, more competitive ways to give consumers a dependable supply of milk and, at the same time, give dairy farmers a fair return for their product?"

"I am not satisfied that all of the issues were thoroughly aired during the AMS hearings, so ***I am posing a number of questions*** to the dairy industry and the general public which are ***aimed at a more fundamental assessment of milk marketing orders***," Madigan said.

The questions are:

-- Would producers, processors and consumers be better served with less regulation or strengthened regulation under federal milk orders? What would be the impact of less regulation, stronger regulation or no regulation on producers, processors and consumers?

--What institutions have other countries used in milk marketing that shed light on our own system? Are there particular aspects of milk marketing that are carried out more equitably or efficiently in other countries than in the United States?

--Could contractual arrangements between cooperatives and handlers replace some of the functions now performed by the federal order system? If so, which functions?

--If federal orders are changed to impose less regulation, what types of changes should be made? For example, should the following changes be implemented?

-- Lowering of minimum Class I differentials.

-- ***Removal of pricing regulations*** that cause purchasers to pay more under the order for milk brought into a market than would otherwise be necessary to attract to milk to that market.

-- Establishing the lowest class price under federal orders (usually Class III) equal to the federal support price for milk (instead of the Minnesota-Wisconsin price)?

--If the orders should be strengthened, what specific additional rules are warranted?

--Should the orders be terminated? If so, should this be done immediately or should the orders be phased out over a period of time; and, if so, how much time?

Responses should be sent by March 2, 1992, to the Secretary of Agriculture, Milk Marketing Orders, USDA, Washington, DC 20250

- (4) Secretary Dan Glickman, commenting on federal order reform in 1997 stated that "Anyone who's followed the dairy debate knows that this is a highly complex, regionally divisive, politically explosive issue. ***We have an outdated 60-year-old dairy program.*** There are structural changes underway. At the same time, milk production in the United States is eight percent higher than it was a decade ago which tells us that ***the status quo for milk marketing orders isn't helping a whole lot.***" (*emphasis added*)