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Federal Agricultural Marketing Programs

Educational Outline

Session 1. Why is the Federal Government Involved in Agricultural Marketing?

The purposes of this session are to introduce the concept of agricultural marketing policy and to examine three major marketing programs which are designed to facilitate the workings of the open, competitive marketing system.

Leaflet 1. "Agricultural Marketing Policy in Perspective"

Programs to Facilitate a Market-Oriented Agriculture.

Leaflet 2. "Public Price Reporting"
Leaflet 3. "Food and Agricultural Commodity Grading"
Leaflet 4. "Generic Advertising, Research and Promotion Programs"

Session 2. Programs to Strengthen Producer Influence in Marketing.

This session is designed to explain and assess marketing programs which help farmers join together for the purpose of collectively influencing the markets for their products.

Leaflet 5. "Fruit and Vegetable Marketing Orders"
Leaflet 6. "Milk Marketing Orders"
Leaflet 7. "Agricultural Marketing and Bargaining Cooperatives"

Session 3. Programs to Protect the Public Interest.

This session is structured around those programs which are designed to minimize costs to both market participants and the public which could arise from unregulated market behavior, and to provide insights into how programs are established and altered.

Leaflet 8. "Trade Practice Regulation"
Leaflet 9. "Assessment of Food Safety Programs and Federal Policy Options"

How Marketing Programs Are Established and Administered.

Leaflet 10. "Agricultural Marketing Programs: Issues, Options and Strategies for Change"

Federal Agricultural Marketing Programs

A Project of the National Public Policy Education Committee

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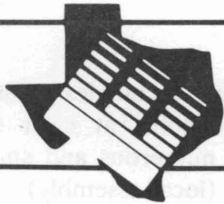
How To Use These Leaflets

These leaflets discuss eight different marketing programs that are authorized by federal laws and/or operated by agencies of the federal government, primarily the USDA. Also included are leaflets that explain the rationale for federal involvement in agricultural markets and methods that can be used to bring about desired changes.

Each program leaflet includes an explanation of the current program, an evaluation of what it has accomplished, a list of key issues of contemporary concern, and a discussion of ways in which it could be modified and the most likely consequences of such changes. If you wish to write an article, lead a discussion, answer questions, give a talk, or converse with people about the involvement of the federal government in agricultural markets, these leaflets help by providing background, evaluation and ideas. If you wish to conduct an educational program on these topics, you may find the following outline useful.

Federal marketing programs establish the rules of the game for buying and selling farm products. Many of the laws authorizing these programs were enacted in the 1930s. Tremendous change has occurred since then in the structure of markets, the transactions, and the functions involved in marketing farm products. The purpose of these leaflets is to describe contemporary marketing issues, identify marketing policy options, and evaluate their consequences. No position is taken on either the need for change or the preferred options.



Texas Agricultural Extension Service

Agricultural Marketing in Perspective

Harold F. Breimyer, University of Missouri-Columbia

The System

The marketing system for farm products is big, complex and dramatic in performance. The system takes raw products from the farm to consumers in an almost infinite variety of processed and packaged forms. It does so day after day, with clockwork regularity. It generates $312 billion annual income in the marketing sector, which is nearly four times the value of farm products as they leave the farm.

The system may also be identified by its institutions; that is, by the firms and people engaged in it as well as by the policies, programs and agencies that regulate or service its needs. These begin with local and central assemblers of farm products and continue with processors, handlers, brokers, shippers, packers and eventually retailers and institutional buyers.

For this review, however, the principal focus is on the rules, regulations and support services that shape the marketing system. The manifold operations in marketing are not bedlam. They are structured and synchronized. They take place according to patterns established partly by industry custom and partly by federal and state marketing programs and public policies.

The nature of federal agricultural marketing programs, their origin, the pressures to change them, and options for change are subjects of the other nine leaflets in this series.

Origins

Many rules of trading originate with market firms. But state and federal governments have long had a voice in marketing. Policies date back as far as the early 1800s when help was given in building canals and roads to get farm products to market.

The 1920s and 1930s were the most fertile period in marketing policy development. Among activities introduced or expanded were market news, grading, marketing agreements and orders, assistance to cooperatives, food safety rules and regulation of spot and futures markets. Most services to marketing since the 1930s have only built on what was in place. In fact, one of the criticisms heard today is that many policies are a half-century old and need review and possibly change.

Current Uncertainty

Reasons that public marketing policies are under fire in the 1980s may begin with the lower incomes received by farmers and by many market firms as well. Also, marketing is caught in the reexamination of government's role in the economy. But weightier issues also are being raised. Critics say the 50-year-old marketing programs best fit the earlier decentralized system of country markets and small traders. Marketing is dynamic and changing, it is pointed out, and public policy ought to be equally innovative.

Another criticism is that market regulations are unnecessarily complicated and unwieldy. Charges are heard, too, that market policies are indifferent to consumers' interests or that they are not supportive enough of farmers' interests.

Despite misgivings about the marketing system and a proper public role, the goals for the marketing system remain scarcely changed. The system is still expected to get products from the farm to the consumer efficiently and at relatively low marketing cost. It is also expected to accommodate product choice and provide market opportunities for a diverse group of producers and marketing firms. That is a big order.

Policies to Be Examined

This report is confined to public policies for marketing -- policies related to rules, regulations and services in the marketing system which help facilitate a market-oriented agriculture, strengthen producers' influence in their markets and protect the public interest. It focuses mainly on federal policies administered by the U.S. Department of Agriculture (USDA).

This is one of a series of articles on *Federal Agricultural Marketing Programs* developed by your state Extension Service as a component of the Land Grant University System in cooperation with the Texas Agricultural Extension Service, the Farm Foundation, and the National Public Policy Education Committee.

Among topics reviewed in the several leaflets are:

- Authority for farmers to market their products collectively, either in cooperative marketing or through collective bargaining.
- Legal provisions for marketing orders. These allow producers of a commodity in a region to impose common rules of marketing upon themselves, subject to monitoring by the secretary of agriculture. Orders for milk and for fruits and vegetables are sufficiently different that they are discussed separately.
- Grade standards and grading. These services are provided in order to establish uniform standards for product quality.
- Price reporting and related market information provided by the USDA. Price reporting disseminates price data useful to producers, marketers and consumers, and reciprocally, aids in the pricing process itself.
- Economic regulation of business marketing practices and commodity markets, both spot and future. The object is to ensure, insofar as possible, their competitiveness and integrity.
- Market promotion. A growing number of federal as well as state programs collect money from producers or market firms for advertising, promotion and research. Their object is to expand demand.
- Food safety programs. Various of these establish the nutritional quality, safety and sanitation of foodstuffs. Some spark controversy over the government's role in protecting the health of consumers.
- The legislative and administrative process by which marketing policy and regulatory decisions are made.

The Farm to Consumer Structure of Markets

The marketing system that gets products from farmers to consumers is made up of firms of various sizes and functions that bear a systematic relation to each other. This orderly framework of marketing firms is called the structure of the system.

Public policies for marketing are applied within the context of that structure. However, they also have a bearing on the kind of structure that prevails in the future. Thus, the structure of markets is a vital consideration in marketing policy.

Figure 1 illustrates the contemporary structure -- the orderly sequence of firms, their various competitive relationships and the heterogeneity of the system as well.

In the chart:

- Each rectangle is a firm.
- Firms compete at each of five stages in marketing.
- The number and size of rectangles illustrate varying competitive relationships at each stage. Generally, firms are most numerous and smallest at first sale from the farm (local assembly). They are fewest and largest at processing.
- Vertical relationships also are illustrated. In the absence of vertical integration, the product moves between stages by market exchange. An arrow represents contractual integration. A shaded band indicates integration by ownership.

Even though various relationship patterns are found in the chart, the actual marketing system is more diverse than shown. Certainly there are some very large firms at the first stage and some very small firms in processing. The system is much more tightly linked for some commodities than it is for others.

The traditional image of marketing for farm products is decentralized competition among firms that buy and sell on the basis of price. In the chart, this is represented by small firms (small rectangles) that engage in open trading (no band or arrow.) Much of marketing still conforms to that image. Independent small firms are scattered throughout the chart but are relatively scarce at some stages. Several of the marketing policies discussed in these leaflets were not only designed to fit a decentralized system but were intended to perpetuate it. This was true, for instance, of market information, grades and standards, and trade practice regulation.

In spite of these policies, market structure has undergone change. How much change varies from commodity to commodity, and even from market to market. The modern broiler industry bears no resemblance to the live fryer market of yesteryear. On the other hand, grain markets have not altered so dramatically.

Public policies and programs, and their associated rules and services, have not changed nearly so much as the marketing system. As previously indicated, many of the enabling laws date from the 1930s. To be sure, the regulations and services provided under those laws have been more flexible.

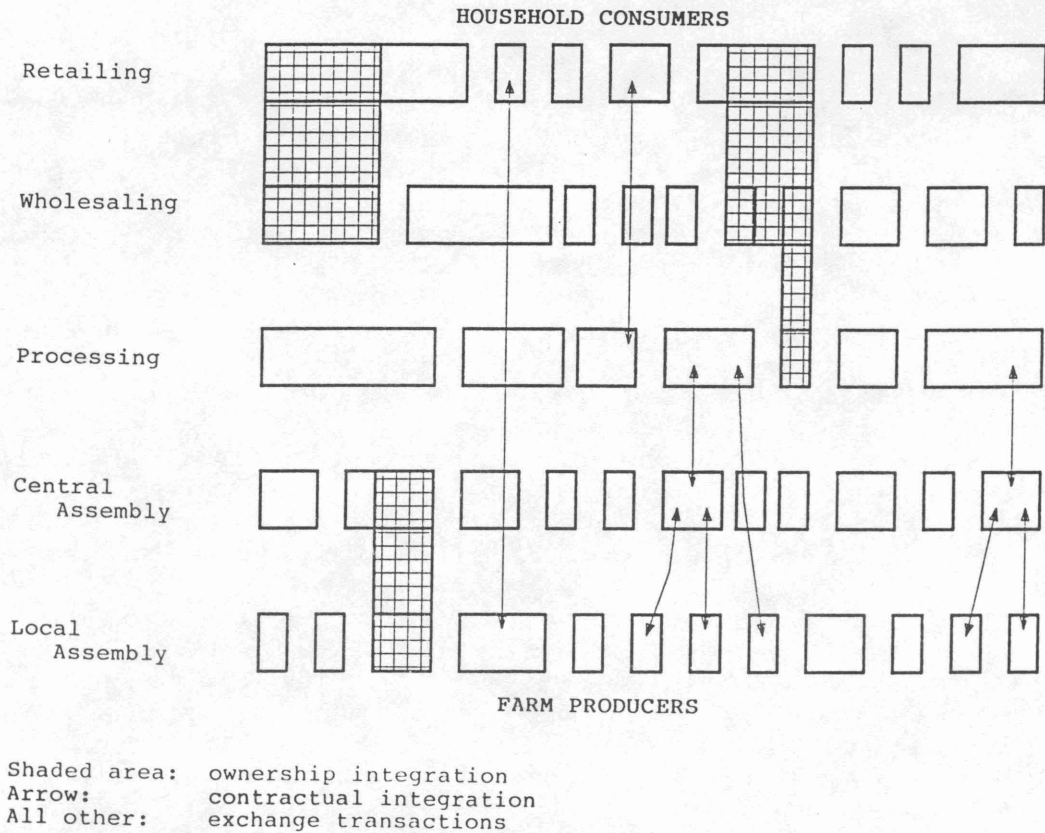
Issues arising from market trends lace through the leaflets of this report. The issues may be grouped into:

- vertical integration.
- terms of competition.
- pricing methods.

Vertical Integration

Vertical integration by contractual arrangements or ownership is the most clear-cut departure from a system of market trading.In it, product moves from stage to stage not by competitive buying or selling

Figure 1. Farm to Consumer Market Structure



but under the terms of production contracts or through inter-division transfer within a large firm. Both contract prices and transfer prices are frequently based on market prices.

Production contracts are now the rule in broilers and are common in other poultry. They are the usual practice in production of vegetables for processing, and for some processed fruits. Contracts are found in cattle and hogs, various seed crops, and even in grains and cotton.

Approximately 20 percent of all farm products move from farmer to processor under some kind of production contract; and if production-delivery contracts with farmer cooperatives are included, the figure runs well over 30 percent. This is almost twice the level of the 1960s.

Some ownership integration is found at the farm level, as again, in poultry. At least 6 percent of U.S. farm products are transferred to the processing division of an integrated firm at some agreed upon price or one tied to market prices.

Vertical integration is found often at later stages in marketing. Retail food chains own most of their wholesaling facilities and may own or contract the production of private label foods.

What vertical integration means to marketing is not understood well, in spite of its growing prominence. The efficiencies, questions and complications it introduces are touched on in several leaflets. For example, how can farmers, and market firms too, be protected as well against certain trade practices in contractual integration as in open market trading? In market information, can and should the terms of delivery contracts for hogs or cattle be reported comparably with the price of slaughter animals sold at Omaha or St. Paul? Do farmers who raise broilers under contract, like the independent producers of an earlier era, need the antitrust and unfair trade practice protections of the Packers and Stockyards Act? If they do, how can those protections be extended?

In contractual production of fruits and vegetables for freezing or canning, producers often turn to collective bargaining. Yet procedural rules for bargaining are still in flux and often in dispute. How can they be clarified for efficiency and improved effectiveness?

Competition Among Firms

The marketing system of yesteryear had many firms competing actively and visibly. Changes since have been illustrated in comments above. Vertical integration is common, firms are fewer and larger, and prices are not arrived at in open trading as often as before.

Local markets are usually thought of as comparatively competitive. This is not always true. They

often are characterized as "local oligopsony" -- a situation where, for example, only two or three elevators are within trucking distance of a wheat or hog producer. They may become local monopolies as processors increase in size through buyouts.

Comments on quality of competition run through almost all the leaflets. How to correct or compensate for unbalanced trading relationships has plagued agricultural marketing for generations! Cooperative marketing and collective bargaining are a recourse for small farmers that face big buyers or processors. Marketing orders for milk, and for fruits and vegetables, give producers a degree of control they would otherwise lack. Generic advertising of farm commodities is patterned after the brand advertising that food processors engage in.

Big firms can make it harder to publish marketing information if they are unwilling to cooperate with voluntary reporting programs; hence the call for innovation in informational techniques. In large measure, trade practice regulation exists in order to improve integrity, equity and competition among firms of uneven size and power.

The state of competition has a great deal to do with policy for marketing.

Pricing

Wherever marketing takes place by buying and selling, a price must be determined. For commodities delivered under contract, price is determined by extending an offer, by negotiation or by a formula tied to some market price. The method of pricing is an important part of the marketing process.

In older days, most pricing was done either in auction or private-treaty negotiation on open markets. The practice is followed still today for many livestock sales. Grain is priced on mercantile exchanges, but local elevators generally post a non-negotiable price that is derived from those exchange prices.

Historically, the first major departure from open market pricing was in direct sale from the farmer to the handler or processor. Such pricing is usually bid-and-acceptance. To this day, however, both parties usually have used published prices as a starting point. As direct marketing grew it shrank the sources of published price information. A search for replacement data led to private market quotations (such as Urner-Barry's or the Yellow Sheet for poultry products and meats), futures market formulas, committee pricing systems and formulas for converting final-product prices back to the farm level.

Another route taken, although still small in the aggregate, is computerized communication for "central market" pricing without assembly of product. An example is the Telcot system for marketing cotton.

Questions about pricing, like those about quality of competition, enter into a number of the leaflets that follow. One particularly sensitive issue is private publishing of prices that essentially are established by the publisher.

Collective bargaining as a pricing system comes under scrutiny. It can substitute for open market pricing but it is most often turned to in contractual integration where the farmer's contribution is "priced" by the terms of the contract.

Beneficiaries of Marketing Services

In the early years of a public role for agricultural marketing, it is fair to say that farmers were seen as the principal beneficiaries. They were the small people in the system, the ones without knowledge or power they could bring to bear. Their interests were to be served and protected.

Farm producers are still given the most consideration when marketing policy is drawn up, for almost the same reasons. Yet farmers are not the exclusive target group they once were. Consumers' interests count for more than they once did. Also, producers of some commodities have formed cooperatives or other organizations that belie the notion of farmers as uninformed and powerless.

The question of who benefits from market rules, regulations and services can be viewed from several different perspectives. Many times, well chosen services can be said in reality to help everyone. They make the whole system work better. This rather idealistic note ought not to be discounted.

In other cases the effects are mixed and uneven. A great many regulations are applied to marketing firms. Those firms are forced to conform to rules that protect or assist the farm producer, the consumer, or both. While some costs are incurred by the firms, the results also may carry a feedback benefit to them. For example, standardization and quality-control of products build markets for both farmers and market firms.

Some rules protect marketing system participants against others in the system. They defend the economically weak and ethical marketer against the more powerful and unethical.

In recent years, consumers have spoken up more about marketing policy, particularly with regard to food safety. Consumers have also called for more consumer-oriented grade standards. However, except for grading of beef and a few other instances, most grading of farm products is still oriented to the farmer and wholesale trader.

Consumers' influence on food labeling and food

safety has led to reassignment of responsibilities among federal agencies. The stage has shifted away from raw farm products and their guardian in the USDA to food safety and labeling laws administered by the Food and Drug Administration, and laws related to competitive practices that are the province of the Federal Trade Commission or the Commodity Futues Trading Commission.

Marketing rules, regulations and services -- designed to help facilitate a market-oriented agriculture, strengthen producers' market influence and protect the public interest -- are not always highly selective in helping targeted parties or restricting certain activities. Yet the question of who benefits from marketing policy is important.

Contemporary Concerns

A climate that favors a reduced governmental role, and awareness of marketing's dynamic nature, can lead to several contemporary concerns. Most have already been referred to. In brief summary, those touched on in these leaflets fall under the headings of:

- structural change.
- trend toward deregulation.
- public expectations.
- conflicts of interest.
- the political process.

It is easy to enumerate the *structural changes* that are underway -- vertical integration instead of open-market buying and selling; direct marketing as a bypass of assembly markets; formula pricing in place of pricing when title is transferred. Questions arise as to what types of government marketing programs are required or warranted to deal with the newer arrangements. Should participants be helped and protected as before, and what costs are involved?

Some of the newer marketing techniques circumvent the intent of existing marketing policies. Is some modification of programs or policies needed or have the old policies become so obsolete they should be abandoned?

We must recognize the deregulation attitude that has prevailed widely in the 1980s. The discipline of governmentally-imposed rules in trading is resisted. In the 1982 *Economic Report of the President*, the Council of Economic Advisers declared its outright opposition to a role for government in market regulation and presumably in marketing services also. To what extent the Congress and citizens concur can hardly be known.

Yet there is little evidence that standards have been lowered for *what is expected* in marketing. Ironically, if anything the standards have been raised. Consumer interest in food prices and food quality has heightened. Consumer groups are showing more concern about marketing orders, grades and standards and the effects of cooperatives.

Farmers too are sensitive but for a different reason. If price and income supports are to be relied on less in future years to stablilize farmers' incomes, more attention will center on how well the marketing system is performing. It is possible that farmers will consider more aggressive group action in marketing, including wider use of marketing orders.

Even though *conflicts of interest* can be overstated, they run through much of the marketing system. What farm producers expect of marketing can differ from the interests of marketing firms and the goals of consumers. Marketing firms may believe they are being over-regulated for the benefit of farmers or consumers.

Interesting but complex circularities can arise. As an example, pure food laws supposedly help consumers most. They may also instill confidence and thereby benefit market firms and farmers. Nutrition information can be demand-building for some foods, even as it incurs the resentment of some producers and marketing firms by reducing demand for certain other products. In the formulation of marketing policy, potential conflicting interests among various groups cannot be sidestepped.

How marketing policy integrates with the *political process* is often neglected. It ought not to be. Traditional decentralized marketing fits with a decentralized, dispersed process of government. Whether coincidental or not, the trend toward larger firms in marketing was accompanied by centralization in government.

Both the climate and tactics of political action have been affected. Power struggles can emerge in the making of marketing policy. The possibility of coercive dominance by firms or organizations holding both economic and political power is now a fact of life. Some producer groups have activated themselves in the same big-organization setting. Milk producers have done so. Benefits can be gained, but political contests can be costly.

By the same token, the more traditional marketing programs and services such as information, grading and trade practice regulation enjoy a less organized base of support. Producers may be less attentive to the political viability of these services than their long-run interests justify.

Criteria for Evaluation

Marketing rules, regulations and services can be evaluated only if criteria -- standards of performance -- are held in mind. Criteria can be explicit or implicit, but they are never absent.

Four explicit criteria have been applied in the leaflets to evaluate how well federal marketing policies and programs have:

- facilitated market operations.
- eliminated unfair marketing practices.
- improved efficiency.
- redistributed costs and benefits.

Does a given rule, regulation or service *facilitate market operations,* or induce changes in market structure? The simplicity of this question disguises the impact of its answers. So many marketing activities have side or feedback effects that reach beyond their immediate significance.

Pricing policy involves not only how fairly buyer and seller are treated, but how well the resulting price conveys market signals from consumer to producer. Grade standards help sell products without costly personal inspection, but they can also enable small processors to stay in business alongside bigger ones. Food safety rules sometimes have an opposite effect: if they require elaborate and expensive food handling equipment, they favor large firms at the expense of small ones. Many other illustrations of interaction consequences of marketing policies could be cited.

The equity issue -- protection of weaker market participants from abuse or exploitation by *eliminating unfair marketing practices* -- runs deeply throughout marketing policy. Farmers and consumers, the "little people" at opposite ends of the marketing sequence, are usually seen as deserving protection. Food safety regulations protect consumers from harmful foods. Farmers are shielded from trade practices such as price fixing or buyers' default.

Protection often extends to market firms themselves. Small firms may be offered defense against big ones that employ predatory tactics. Sometimes roles reverse: big firms may be willing to uphold product identity or other industry-wide standards that smaller ones debase.

Manifestly, marketing programs should help *improve efficiency* in marketing. Trading rules ought to facilitate technical efficiency in marketing, or at least not impede it by adding unduly to costs. Equally important is the effect a rule, regulation or service may have on pricing efficiency and the communication system.

Often a major object is to improve competition. If that is achieved, marketing margins will be narrowed. In a well-functioning marketing system, the price of a product to farmers ought to reflect accurately the product value at later stages. Of course marketing firms will also be compensated for value added. Also, the price to farmers should be aligned well geographically, differing between areas only proportionately with transfer costs that include transportation, storage and related merchandising costs.

One of the more sensitive aspects of any marketing policy is its *effect in redistributing costs and benefits;* that is, how it affects costs paid, and prices and incomes received, by each participant in the system. Costs of marketing services such as grading are paid by the market firm, but an analytical question of "incidence" arises -- who ultimately bears the cost?

Authority for group action by farmers is obviously intended to help farmers obtain a larger share of the ultimate value of products marketed.

Just as perplexing is the choice between private versus public financing of governmental services. To what extent can taxpayers be expected to assume the obligation? Can the regulator be objective and even-handed if the regulated is paying for the cost? Generally, where the benefits of a service diffuse broadly among producers, marketers and consumers, the case is clearer for citizen-financing through taxes.

Equally significant is distribution of decision authority. What voice does each interest group have in the political process? Group action by farmers may redistribute decision-making as fully as income.

How fairly can a marketing rule be enforced, and how readily can a marketing service be provided? Operational feasibility is a vital consideration in making and administering marketing policy. This criterion may be capstone to the others and yet the most difficult to apply. Hence it is not an explicit criterion employed in the leaflets. It is not easy to predict how well a policy can be carried out.

In addition, costs and benefits must be carefully and objectively evaluated. There is risk that the costs of a program, which are fairly visible, are overemphasized while the benefits, which are often less readily seen, are underappreciated. Even so, costs and benefits must be weighed, irrespective of how approximate and fallible the weighing may be.

The Decision Process

In the final analysis, rules, regulations and services which affect the marketing of farm products are an outcome of the decision process. The nature of the complex process is sketched in a somewhat simplified form in the last leaflet of this series.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socioeconomic level, race, color, sex, religion, handicap or national origin.

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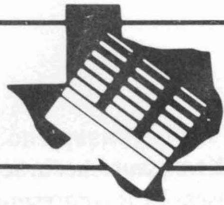

Texas Agricultural Extension Service

Public Price Reporting

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This leaflet reviews the public price reporting (PPR) program for agricultural products. It encompasses price reports issued by the U.S. Department of Agriculture, sometimes in cooperation with state departments of agriculture. Objectives are to describe how PPR currently functions, to delineate its accomplishments as well as its limitations, and to identify and analyze alternatives for improvement.

USDA reporters were not the first to report prices in markets for agricultural commodities. The Urner-Barry service, which still reports prices in poultry and egg markets, was begun in New York City in 1858. The "Yellow Sheet" report on meat prices was launched by a private publisher in 1923 at the behest of packers. Numerous private reporting firms, with varying reputations, served other markets. PPR was initiated on a small scale in 1916 to provide objective market information to farmers.

Price information was first disseminated primarily through the mail and farmer-oriented newspapers. Radio soon became an additional medium. Later, a leased telegraph wire system became the primary means of information delivery to local market news and mass media offices, followed by computer networks.

Terminal wholesale markets were the source of information on prices for most of the early PPR reports. As trading decentralized, price quotations from terminal markets became the base for settling prices in other markets. For a generation, arguments flourished about the dangers of pricing a large number of direct market transactions on an increasingly small volume of terminal market sales. This resulted in efforts by price reporters to expand their coverage to country markets and even to direct trading.

PPR began with the objective of rescuing isolated farmers from exploitation by more knowledgeable traders, at a time when farmers had meager telephone service and no radios. Within a quarter century, most farmers had both. This reduced concern about exploitation and led to the current emphasis on providing information that facilitates trade.

The Current Program

The type of information gathered, collection procedures and methods for disseminating price information vary among the several commodities covered by PPR. This discussion represents the typical situation, although it may make generalizations that do not apply everywhere.

Market Reporting

Public price reports are issued for most categories of agricultural commodities. Prices are typically reported at each level of distribution in which a farm-produced commodity retains its identity. For example, while livestock, grain and oilseed prices are reported at the processor level, prices for other processed products are not. Prices are reported for fresh fruits and vegetables but not for most processed fruits and vegetables or processed fruit and vegetable products. Where trade in a farm-produced commodity is not reportable due to producer-processor integration, reporting generally focuses on the point of the first sale of processed products.

Quoting Prices

The general policy is to report only prices which are negotiated on spot trades and are verifiable by both buyer and seller. There are important exceptions. Bids for grains and offers of turkeys are regularly reported.

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The least complex report is on the range of prices at an organized public market. When trades are privately negotiated, the reporter's role is expanded to find the trades and to evaluate the validity of the information received. When trading is decentralized, the dispersed locations further complicate the task.

PPR has long resisted reducing price data to a single number, in general arguing that to do so would change its role from price reporter to price maker. Nonetheless, the exchange of information necessary to obtain cooperation from buyers and sellers often involves the reporter in the price establishment process. For example, a price reporter is likely to provide some "tone of market" information to traders contacted while compiling information. This may affect subsequent pricing decisions by those traders.

Obtaining Price Information

Collecting price information is the least difficult at public auction markets where prices for each transaction are observable. Where private trading predominates, prices must be obtained directly from buyers and sellers on a voluntary basis. For competitive markets with relatively large trading volumes, voluntary reporting generally results in accurate reports. But in markets with few transactions or traders, participants are sometimes less willing to cooperate.

When gaps exist in prices that can be quoted on the basis of negotiated trades, prices from other locations or for related products may be adjusted to construct a particular price quote. For example, wholesale trade in beef now occurs largely in the form of boxed beef; that is, retail, subprimal and primal cuts in various boxed combinations, rather than in the form of swinging beef (carcasses). Yet, carcass price quotes are still considered important. Thus, carcass equivalent values have been constructed from boxed beef prices.

Gaps in reportable prices can also be filled by reporters' estimates. PPR procedures discourage this. However, it is probably not possible to eliminate some interpretation of non-price market information by reporters in instances where there are few confirmable sales.

Commercial news services are another source of price information on some commodities which are reported publicly as well as some which are not. In general, PPR does not use private reports as a source of information. An informal linkage does exist, however, in that questions about accuracy quickly arise when a public price report deviates substantially from a private quote which is known to be used for settling trades.

Assuring Reliability

The methods used by PPR to assure accuracy vary by commodity. In some cases PPR representatives audit the records of cooperating market participants after the fact. Being voluntary, this does not include all transactions. In other cases, reporters ask for the identity of the other party to a trade and verify price with that person. This also depends upon voluntary cooperation. Acceptance by or complaints from users are important indicators of quality. Experienced reporters learn to ascertain which traders provide reliable information. This assessment may be more important than any formal procedure.

Disseminating Price Information

PPR encourages extensive dissemination of its price reports by both public and private means. Interaction with traders by reporters while gathering data is an important means of information distribution. Also, PPR uses a network system to provide information to general news services, television and radio stations, commodity news services and print media. Printed reports are mailed, and recorded verbal summaries on automatic telephone answering devices have also become popular.

What the Program Has Accomplished

Public price reporting was born out of concern over unfair treatment of poorly informed farmers. It evolved in response to opportunities for improving efficiency in the distribution of farm and food products and in response to perceptions of the public good. It has co-existed with private price reports, but has not displaced them. It has responded to changes in marketing practices. It has attracted adamant supporters and equally adamant detractors. To some it represents an essential public service for the maintenance of a competitive agriculture; to others it represents unwanted government intrusion into private enterprise.

Actual impacts and consequences are not easy to assess: attributing the performance of agricultural markets to public price reporting presumes a unique importance to market information that does not exist. Nonetheless, market performance is influenced by PPR. Because market performance is influenced by many factors in addition to PPR, it is easier to identify the types of effects stemming from PPR than to measure their magnitudes. This assessment highlights the major consequences.

Facilitating Market Operations

One rationale for public price reporting is to maintain competitive markets. Market information is essential to the long-term survival of any firm.

Consequently, PPR reduces information search costs for all market participants, thus putting smaller firms closer to an information parity with larger firms. On a per unit of sales basis, search costs are reduced more for the small firm than for the large firm. This helps to maintain a competitive market structure. However, large firms enjoy the advantage of spreading the benefits of improved market information over a larger volume of sales. Therefore, reducing information search costs for everyone diminishes but does not eliminate size advantages in the collection and use of market information.

PPR has also affected the extent to which agricultural products are exchanged through organized markets, by private negotiation or by vertical integration. PPR reduces differences in the amount of market information that is available to all traders. This, in turn, increases the willingness of some to enter the market, thus helping to maintain open markets for agricultural commodities.

It is less clear what impact PPR has had on the transition from the predominant use of organized markets to private negotiations. Private trading and direct selling evolved in response to technological developments, such as truck transportation and telephone communications, and to reduced transaction costs resulting from elimination of commissions, more rapid and direct product shipment and reduction of overhead associated with central markets.

This transition has made PPR more complex, particularly in terms of price collection and reliability. Would the transition have occurred more or less rapidly in the absence of PPR? A reasonable argument is PPR has facilitated but not caused it. The existence of public price reports has increased willingness by buyers and sellers to enter into private negotiations. To the extent that publicly reported prices are used as reference prices in private trading, the transition has been assisted. To the extent that the public price reporter aids the price establishment process by interacting with traders, private trading is also facilitated. Private trading is assisted even further to the extent that public price reports serve as a check on the accuracy of private price quotes used in private trading.

Eliminating Unfair Marketing Practices

The record seems clear: prior to establishment of PPR there were many price distortions for farm commodities. By reducing information inequality, small traders are put on more equitable ground with large traders, which limits the ability of dominant traders to exploit others.

Today, however, public price reports are not as representative of an "alternative buyer" for a farmer as they were when reports originated at central markets. Some price quotes are constructed from trading in adjacent markets and do not represent actual trading, while others are based on private trading that may not be open to outside traders. Thus, public price reports may be less useful for identifying a specific pricing alternative to that offered in private negotiation. The extent to which dominant traders exploit this by offering "unique" or incomparable terms of trade is speculative; it likely occurs but less so than without PPR.

Where few traders exist, the traders may significantly influence private price quotes by threatening to withhold financial support for the private reporting organization. As a publicly financed and administered service, PPR is less subject to this type of economic pressure, which helps assure objectivity.

Improving Efficiency

Providing information to the marketplace increases economic efficiency. Other things equal, the addition of information reduces trading and transport costs and reduces the amount of negotiation necessary to complete exchange. This has encouraged direct selling which often has lower transaction costs than do organized markets.

The process of allocating resources to their most valuable or "best" use (allocative efficiency) is improved by using price reports to identify supply and marketing alternatives. Unbiased public price reports lower barriers to market entry, which improves allocative efficiency in the long run. On the other hand, formula-priced contracts make resource allocation decisions without negotiating product values. This may result in prices that do not always reflect the best use of resources. As formula trading thins the remaining market where prices are negotiated, the quality of price reports necessarily declines. This results in less accurate, less beneficial reports.

Redistributing Costs and Benefits

Market information will be generated, if not by the public, then privately. If the information is generated privately, access is controlled by the firms generating it. Clearly, access to market information is more equitable with PPR than without.

But neither does the impact of PPR fall evenly. Large firms often can afford the cost of accessing public information by tapping directly into the USDA's network, or by subscribing to a commercial wire that rapidly transmits public reports. Large volume traders generally have more frequent contact with reporters, in part because their large volume affords the reporter a broader view of the market,

with fewer contacts. If even reasonably subtle, this gives the large trader some ability to influence a market quote. One can argue that accurate information placed into the market by anyone will be noted quickly. But few would choose to be last rather than first to know.

The Key Issues

The above assessment reveals three broad issues of contemporary concern:

The Public Interest

The public interest is served by PPR, but the full value of this service is not known, hence little guidance is available for evaluating program costs. Price reporting yields public benefits. These include increases in economic efficiency, equity and fairness. However, the benefits are spread throughout the marketing system, which makes them difficult to measure relative to program costs. Furthermore, direct and complete attribution of these benefits to PPR cannot be shown either empirically or theoretically. The public benefits are real, but the magnitude is less certain than sometimes suggested by program advocates.

The Private Interest

Public price reporting was conceived in an era when most agricultural trading occurred in central public markets. Over time, private trading and direct marketing have become predominant. This has resulted in substantial reduction of transaction costs but raises questions about the equality of market access and the accuracy with which resources are allocated in the market to various uses. PPR has facilitated this transition. But the change has also made it difficult for PPR to remain only as an observer -- in order to find reportable prices it has had to interact more with traders, thus becoming an actor in the pricing process. Price establishment is viewed by many as an inherent task of private industry. Yet the viability of the private trading system could be seriously threatened without some public role for assuring objectivity and fair play.

The Public vs. Private Reporting Dilemma

Firms involved in commerce have a private interest in price information, so there exists a willingness to pay. Established, private price-quoting services supply such information for a fee and many traders pay that fee. Then why maintain a public system that subsidizes such information users? Could the task be turned entirely to the private sector, or at least put on a "pay-as-you-go" basis in the public sector? Unresolved questions include: 1) What would happen to the reliability of private reports in the absence of public reports? 2) If all users had to pay the full cost for price information, would information inequalities occur which drive smaller and more remote traders from the market? 3) Are there changes that could be made in PPR which would increase both its public benefits and its service to private industry?

The following potential modifications and alternatives to PPR are examined in light of these questions, issues and concerns.

Should the Program Be Modified?

Alternatives to public price reporting range from elimination to mandatory public trading in order to create a reportable base of observable prices. The consequences of any given modification are somewhat speculative. Nonetheless, past experience and analysis of 70 years of public price reporting offer insight into some likely results.

Curtailment or Termination

In a period of federal budget stringency, it is appropriate to consider cuts in any federal program. One uncertainty regarding cuts in PPR is the extent to which private news services would fill the gap. It is considered likely that commercial substitutes would arise and provide many of the same services in most national and regional markets, but probably not in many local markets. Whether these private enterprises would provide services of a similar quality is more problematic.

Hence, a cautious program of reduction could be tried. If results are satisfactory at each step, then the succeeding step could be taken. The following order may be reasonable:

Step 1. PPR could be scaled down to a "public monitoring" service wherever a commercial service is now used by many market participants. A public monitoring (archive/checkpoint) function would provide historic or archive information necessary for both public oversight of market behavior and private evaluation of commercial opportunity, and provide a check on accuracy of private reports.

Step 2. PPR could be reduced to an archive/checkpoint function for all markets beyond the farmer-first buyer level.

Step 3. In an area of highly specialized production, PPR could be scaled back to an archive/checkpoint function if and when commercial interests provide an acceptable substitute.

Consequences of this option are projected only for two possible outcomes: 1) adequate replacement and 2) a void of any price reporting. Obviously, stages between these extremes are possible.

Replacement

Private funding would substitute for public funding. Larger producers and buyers would be affected little -- they would simply purchase reports that had previously been free. Their cooperation in providing information might be improved if the commercial service made such cooperation a prerequisite for access to its reports.

Effects on smaller producers and buyers are more debatable. Because collection costs are much higher than dissemination costs, a commercial service could profit by price discrimination (lower charges to smaller customers). This could be of some help to smaller farmers and businesses. However, small-volume traders would likely have less information available and find their information costs on a per-unit-of-sales basis to be higher despite such a measure.

A Void in Price Reporting

It is difficult to imagine many markets existing for long without price reports of some kind. In many markets the price reporter is a vital link to the price establishment process. More phone calls would be the substitute for some traders, while others might choose to operate with less information. Generally, the greatest disadvantages would fall on the smaller and less specialized market participants.

If many expressed dissatisfaction with pricing behavior as a result of PPR curtailment, the USDA would seek remedies, including reinstatement of public price reporting. However, it can be very difficult to reinstate public expenditures after a program has been cut. If PPR were re-established, legislation requiring response to inquiries by public reporters would need to be considered.

It can be argued that there is a public responsibility for assuring some minimum level of reliability in private reports, particularly if they are encouraged as replacements for public reports. At a minimum, the public monitoring function seems essential. Discussion of other public oversight functions, such as licensing private reporters and periodic auditing, should be part of any decision to eliminate PPR.

Emphasis on Public Trading

Concerns about accurate sampling of prices in private sales and the price establishment role of reporters suggest the possibility of limiting public price reports to prices that result from organized, public trading. The basic idea is to restrict public reporting to those markets where there is open competition and observable trading. In livestock, for example, this would focus on terminal and auction markets and eliminate direct trading from the reported price base. There are different approaches: report only where a sufficient amount of public trading occurs, or mandate public trading in order to generate a reportable volume of transactions. A third option, requiring traders to respond to price inquiries by public reporters, could also reduce concerns regarding biased reports.

Only Report Existing Public Market Transactions

In most cases, this variation would restrict public price reports to a minority of all transactions. For most commodities, no report could be issued due to the lack of any organized public trading. For other commodities, price reports would be based on a relatively small portion of all transactions. However, there would be little room to question the accuracy of the reports due to the visability of trading on organized markets, and the reporter's role would be no more than that of reporter.

Mandatory Public Trading

Given that organized, public trading eliminates two major concerns about PPR -- accuracy of its reports and its role in price establishment -- this alternative would mitigate these concerns by requiring public trading. Such a requirement would be a substantial intrusion of public policy into the marketplace and has received little serious consideration as a public policy alternative in the past. But it could generate enough public trading to provide a very dependable source of information for public price reporting. Development of new organized exchange mechanisms such as electronic markets could help in implementing this policy. Substantial resistance would be expected from traders who have developed skills of private negotiation.

Accept Price Establishment Function

Recognizing both the public good aspects of price information and the use of price quotations to settle trades, PPR can be directed toward an active role in price establishment. This includes reporting base price quotes that can be used for pricing formula trades and other off-market transactions. It requires identification of key trading points and product definitions. Trades, bids or offers can be adjusted to the quoted base point using appropriate adjustment factors. Reporters could also make trade references. That is, they could suggest trading opportunities to those with whom they converse. In many regards this would be taking on some of the trade-facilitating functions now performed by private services such as Urner-Barry and the "Yellow Sheet."

Advantages of this approach include increased trading efficiency due to direct efforts by reporters to facilitate trading, and provision of the kind of price

interpretation desired by market participants. This discourages the use of fragmentary private reports which may be subject to bias. Assuming that the market's pricing needs are served, it may be that public involvement is the preferred means for assuring reasonably equitable treatment of all interested parties. It would be a serious disadvantage if this created thin markets by encouraging formula trading.

This kind of an activist role for PPR can generate controversy. Operating procedures are of much greater interest to market participants than the procedures for reporting only. If government procedures are not sufficiently flexible, this would be best left to the private sector.

Create Price Committees

Committee price quoting may be a viable alternative in highly concentrated markets or in situations where the price quote involves a great deal of judgment. Avoiding conflict of interest is a major problem. Those who possess the most knowledge of market conditions, and thus the factors affecting product values, are trade participants who also have a direct interest in the price outcome. Persons outside the trade typically do not have the knowledge necessary to do the job well.

A committee system is unlikely to duplicate the fine adjustment process of a competitive market. It will tend to under-compensate for change and delay the process of adjustment. Using the committee system to generate a spot price quote is tacit recognition that, in some commodities, a spot market is an anachronism.

Report Quantity Information

In situations where very few transactions are based on negotiated prices, prices that are negotiated may represent such a limited share of the total volume traded that they are relatively meaningless as indicators of actual product values. But this does not mean there is a shortage of information about value and changes in value. Information on quantity flows such as receipts from producers, processor inventories, movement of product to various markets and changes in inventories are examples. Such information can be used to assess the value of products to suppliers and users and thus, in the absence of viable price information, may be useful in lieu of price reports.

Report Contract Terms

This option also is addressed in situations which lack a sufficient base of negotiated prices for price reporting purposes. In this case, however, the lack of price data is due to extensive use of grower-handler contracts. But the terms of grower-handler contracts include much value-related information, such as schedules of premiums and discounts, profit-sharing arrangements, quantity guarantees, timing of delivery, cost- and risk-sharing and the like. Under this option, information on the terms of individual contracts would be collected, compiled and disseminated. Such an approach presumes that the terms of any specific producer-handler contract are useful industry-wide and that there is enough similarity among contracts to allow for meaningful reports. Essentially, the purpose is to increase competition in setting contracts by reporting contract terms, including factors that affect settlement prices.

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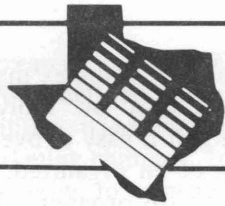

Texas Agricultural Extension Service

Food and Agricultural Commodity Grading

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Agricultural commodities have a wide range of quality characteristics because they are biological rather than industrial in origin. Quality obviously affects the value of commodities and often the use to which they are put. It enhances the process of trade to have a set of descriptive terms and standards which all buyers and sellers agree upon. Most marketing systems have informal and formal terminology generally referred to as grades and standards. For food and agricultural commodities in the United States, grades and standards have evolved over the last century from privately instituted efforts to highly organized programs fostered and managed by the federal government.

Descriptive terms were often developed to identify unique characteristics thought to have value to potential buyers. As individual efforts in states and regions proliferated, it became obvious that confusion and inefficiency resulted when trading occurred across state, regional or national borders. These problems were the primary motivation for developing uniform, national grades for several commodities. Federal grades and standards for other commodities were established so uniform price reporting and market news services could be created.

Several definitions have been adopted to aid the discussion of grades and standards programs. *Grades* are numerical or descriptive categories which have specific, common characteristics and are used to classify commodities. *Standards* are the values, the limits and measurement procedures which determine the grade of a product; i.e. the criteria by which a product is divided into its various grades. *Inspection* or *grading* is the monitoring and evaluating of product quality according to established standards at a particular point in the system in order to assign an appropriate grade.

Generally, grades and standards provide a basis for uniform product groupings that aid in establishing use characteristics and value.

More specific objectives of grades and standards include:

- facilitate trading by providing a limited number of homogeneous categories so that lots within each can be substituted readily at equal values in the market;
- facilitate information flows in the market system, including information on preferences, practices, values and costs;
- facilitate discovery of price-value relationships among various lots and qualities of product.

Evaluating the success of these programs is difficult and confusing because the different objectives are not always recognized nor explicitly stated.

Current Grades and Standards Programs

Federal involvement in grades and standards began in the first half of this century primarily in response to the needs of producers and traders. In the case of many fruits, vegetables and some specialty products, the intent was clearly to provide assistance to producers. Grades and standards were frequently used as part of supply control and orderly marketing, as with marketing orders. In cases such as grain, the primary influence came from marketing firms. For livestock, cotton and tobacco, grades and standards were developed in part to aid in price reporting.

Consumers, in general, were not primary motivators in establishing present grades and standards. However, benefits from grades and standards often are thought to be spread among all parties in the industry, from producer to consumer. This suggests

This is one of a series of articles on *Federal Agricultural Marketing Programs* developed by your state Extension Service as a component of the Land Grant University System in cooperation with the Texas Agricultural Extension Service, the Farm Foundation, and the National Public Policy Education Committee.

a means by which costs are also distributed to most of the beneficiaries. A government program frequently is seen as an appropriate method of accomplishing this.

The grading of food and agricultural commodities is administered primarily at the federal level by the Agricultural Marketing Service (AMS) and the Federal Grain Inspection Service (FGIS) of the U.S. Department of Agriculture (USDA). The National Marine Fisheries Service (NMFS) is delegated responsibility for grades and standards on fish, shellfish and seafood products. These agencies are responsible for administering programs but may have cooperative agreements, licenses or other administrative relationships with state governments or private entities which, in many cases, actually perform the grading function. The cost of grades and standard programs has been quite low, generally less than $150 million annually, with most of the cost borne by grading service users. Public costs of approximately $10 million per year are expended for program supervision.

The primary legislative support for federal grades and standards programs is found in the Agricultural Marketing Act of 1946 as amended. Other authority is found in the 1923 U.S. Cotton Standards Act, 1937 Smith Doxy Amendment, 1935 Tobacco Inspection Act and 1976 Federal Grain Standards Act.

Activities typically performed may be described in two broad groups -- standardization and grading services. *Standardization* includes a variety of monitoring and testing activities required to establish standards for new products or amend existing standards in response to changing commodity or industry conditions.

Grading consists primarily of the actual classification of commodities or products. Federal agencies may be responsible for organizing and supervising grading activities of state or privately employed personnel for some commodities, especially grain, poultry, fruits and vegetables.

Most grading service is provided voluntarily, with the important exception of grain for export, which has mandatory grading. The coverage of other commodities ranges from less than 10 percent for seafood to nearly 100 percent for cotton and tobacco.

What the Programs Have Accomplished

Federal grades and standards programs, having developed to serve a variety of needs for producers and marketing firms, do not lend themselves to easy analysis or evaluation. While there is general acknowledgement that such programs enhance trade and distribution, their specific benefits have not been estimated often. In an increasingly complex marketing system with greater emphasis on individual brands and specification buying, it is easy to overlook the broader, diffused benefits of an organized, publicly sponsored grades and standards program. These benefits are discussed below in four general areas: 1) facilitation of marketing operations, 2) elimination of unfair practices, 3) increased efficiency and 4) distribution of costs and benefits.

Facilitating Marketing Operations

The primary benefit of grades and standards programs is their impact on the availability and quality of information for marketing firms and producers. Grades provide a universal language in the marketplace, and facilitate the collection and dissemination of accurate market information. Improved communications in buying and selling increases the accuracy and efficiency of price discovery. Consumer preferences can also be communicated better through the market system.

Grading systems, while often the center of controversy, are not generally attacked as being totally useless or unworkable. Rather, specifics of the classifications, standards or nomenclature bear the brunt of criticism. This suggests broad agreement on the value of and need for grading systems even though controversial changes are sometimes recommended. The success of a grading scheme depends on enlightened selection of the character and number of attributes to be included. Systems which are used widely without constant adjustment or controversy are successfully accomplishing at least some of their objectives. Many federal grading programs fall in this group. All grading programs require periodic review and adjustment as the market evolves and changes. To the extent this is provided for, the system as a whole can continue to be successful.

Better communication in marketing has facilitated cross-country sale of fresh fruits and vegetables. Therefore, existence of grades can facilitate development of production in the most efficient location.

Eliminating Unfair Marketing Practices

Grades and standards programs can be traced to early efforts to protect buyers and sellers from unfair or abusive trade practices. The function of providing a common language and independent third party grading has certainly contributed to that goal. Buyers have recourse to the system which provides an impartial evaluation where needed. Isolated or small buyers are less vulnerable to unfair treatment or monopolistic practices in the marketplace.

Increased Economic Efficiency

Well-defined systems of grades and standards facilitate transmission of price signals through the marketing channel. In this way, grades and standards contribute to improved efficiency in the use of production and marketing resources. Price, quality and quantity information on particular lots and grades are conveyed to potential buyers and sellers.

Transaction costs are reduced as a result of buying by description, searching less for products of the right quality, and rapid settlement of quality disagreements. Grades also improve production efficiency by providing growers with accurate price information to guide future decisions. Some criticisms exist where grades foster an orientation toward minimum quality standards.

Distribution of Benefits and Costs

The existence of a well-functioning system of grades and standards insures that individuals in the market receive a return for their product that is commensurate with product quality. Along with more price information and better description of available supplies, there is less opportunity to gain excess profits in one level or area of the market channel.

The distribution of product qualities with respect to a given attribute may vary regionally. Because of this, the impact of changes in grade standards may be distributed unequally among producers on a regional basis. The result often is strong resistance to changes in grades even where warranted.

Hardly any request for a noticeable change in grade standard goes unchallenged. While those proposing change would be expected to gain, others may lose, particularly in the short-run. Successful administration of grades and standards programs requires careful weighing of unequal effects and the overall judgment of total public benefit.

The Key Issues

Several issues stem from recent administration and performance of government grades and standards programs for food and agricultural commodities. Some relate to the basic role of government, while others relate to the system's responsiveness to changing technology and the underlying nature of supply and demand relationships.

Selection of Grade Criteria

The question of which criteria or attributes to include in grade standards is the central issue in discussions about more consumer-relevant grading. Criteria selection depends on what information the grades are intended to carry and the marketing system level at which they are directed. For the most part, grades were instituted primarily to facilitate wholesale trade or marketing of unprocessed commodities. However, extending grading systems to the consumer level, or more accurately reflecting consumer preferences in grade standards, has often been discussed. To be valuable to consumers, different criteria might need to be selected. Consequently, adoption of additional grade criteria raises the issue of relative benefits to different market participants. For example, a change may enable consumers to better identify product quality, but may cost retailers in terms of greater product waste.

As products are traded more widely, particularly in international channels, market requirements may be expressed in different terms. For important export commodities such as grains, the adequacy of U.S. grade standards for maintaining a competitive quality product in foreign markets has been questioned. Another aspect of this issue is whether grades accurately reflect the value-in-use of a given commodity. This is particularly important in industries where processing utilization technology changes rapidly. It is also an area where instrumentation or measurement technology has improved significantly. However, end-use value is an elusive concept. Some fear that arbitrary changes in grade standards will disadvantage some individuals and reduce the grading system's total benefit because of a general loss in predictability or confidence.

Confusion in Nomenclature

Another important issue is the disparity in names used to describe grade designations -- names such as choice, grade A, U.S. No. 1 and so forth. Wholesale terminology is often the basis for existing grade names. Wholesalers know the terminology because they work with it regularly. However, conveying this grade information beyond the wholesale level may cause confusion among individuals who are not regularly involved in trade.

Another dimension of this nomenclature is the use of a sequence of letters or numbers which imply relative values. Some argue that this is inappropriate; that the forces of supply and demand should determine relative values free of the implied bias of grade names.

Mandatory Versus Voluntary Grading

For the most part, grading of food and agricultural commodities is voluntary. Whether these programs should be made mandatory to insure greater availability of grade information has sometimes been an issue, particularly in discussions of consumer grades. While useful in consumer decisions, mandatory

grades could reduce the responsiveness of markets to changing demand and technology. In addition, for many products it is very difficult or impossible to assure that products graded fancy at the wholesale level will remain of equal quality while sitting on the supermarket shelf.

Who Should Pay the Costs?

While grading services for many food products have been paid for by industry groups since their inception, others have not. There are also basic administrative costs which are born by the public in general and these costs are sometimes called into question. The trend in recent years has been to shift as much direct costs for grading and inspection services as possible to those who use the grading services.

Should the Programs Be Modified?

Depending on what are perceived to be significant issues and the appropriate role of the federal government, many alternative public policy approaches to grades and standards are possible. Some represent major departures from past policies. Others involve modifications or evolutionary steps which could be taken to address key issues. Alternatives discussed here represent a range of approaches and are not intended to be an exhaustive list of possibilities for administering grades and standards programs.

Establish Scheduled Review Procedure

Considering grade changes has an ad hoc appearance. The process of changing grades is initiated formally only when requested by a producer or trade group. This typically happens when some threshold of need for change has been reached. For various reasons, this threshold may be different among commodities or across levels of the marketing system.

One administrative alternative which could make the system more responsive would be to institute a regularly scheduled review process for all grade standards. This review would occur according to a schedule, whether there were pressures for change or not. Specific procedural rules would ensure that all relevant data and comments were obtained. Such a review system is in place for grain standards and regulations. It could be expanded to other commodities.

With this review system, grades and standards more likely would reflect the attributes of greatest importance to facilitating exchange. New technology in grading would be reviewed regularly and adopted more rapidly. Termination of out-dated grades and standards would be facilitated. To the extent that all market participants were involved in the review process, a more equitable system of grades and standards could be ensured.

There would be costs of instituting and maintaining such a mandatory review procedure. Because information flow is enhanced through the use of consistent, predictable grade standards, the frequency of review would need to be carefully analyzed. If the current grading system is performing effectively and in the public interest, mandatory review procedures should be unnecessary.

Create Uniform Grade Nomenclature

This alternative has been examined in detail by USDA. Initially the names given to each grade were derived from common usage and have become established over many years. It is within the federal government's authority to adopt a policy to make grade names uniform across all commodities.

This action would reduce confusion in purchase decisions for several commodities. It also would reduce the appearance of grade name "inflation" where all the names have a connotation of very high quality, such as Grade A and Grade AA. It makes little sense to have the lowest of three grades designated as No. 1 or Grade A.

Many have argued, however, that no real benefits would be derived unless these grades were made available to, and used by, consumers. The primary objection is that the transition would cause confusion in wholesale trade where these grades have provided a vital "common language" for years. A USDA study concluded that the costs of imposing such a system would be greater than the benefits. However, a policy was adopted to guide future grade name changes in the direction of a more uniform system.

Develop Consumer Grades

If one accepts the idea that grades and standards at the wholesale level have improved economic efficiency, then it could be inferred that additional gains would result from extending the concept to consumers. More information would then be available to assist consumers in their purchase decisions.

However, the switch to consumer grades would disrupt existing wholesale grading systems and potentially discourage innovation by adding rigidity to the system. Advantages would be counteracted to the extent that consumers base purchases on physical product inspection, product brand names or the reputation of the product maker.

However, for many fresh commodities and processed food products, consumers may not be able to judge quality by physical inspection. The addition of internal quality, palatability indicators and similar modifications of existing grades, where information is

available, could facilitate consumer use of grades without significantly changing the usefulness of grades to the wholesale trade.

The federal government could adopt a policy encouraging development of consumer grades just as it encourages name uniformity. Consideration of consumer-oriented criteria could be required whenever grade changes are reviewed. However, this could discourage review of needed grade changes.

Make Grading Mandatory

The benefits of improved information from grades and standards could be extended more broadly if a mandatory system were adopted. For some uses, such as grain exports, grading is already mandatory. Where price reporting at the producer level was desired, such as for cotton and tobacco, extensive use of grades was mandated legislatively and initially fostered by making the service free to the user.

Under existing legislation, USDA does not have the authority to initiate mandatory grading of many commodities or foods. Imposition of such an alternative would have a significant cost impact. This cost would be incurred directly by the user and partially passed on to the consumer. It is not likely that tax revenues would be used for this purpose.

Summary

Grades and standards have been a function of the federal government for more than half a century. They were developed and used most for the wholesale level of trade. Their benefits and impacts extend to both producers and consumers.

Recent adjustments in the system and the broadening of user fees have helped meet the needs of changing industry conditions, technology and political considerations. However, there is a continuing need for regular review of all specific grade standards and their associated grading systems. Emphasis could be placed upon development of more meaningful grade information for consumers. Mandatory grading systems would change substantially the traditional nature of voluntary grading systems and the role of government in markets for farm products.

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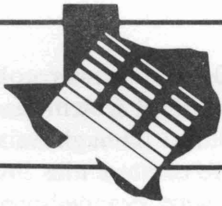

Texas Agricultural Extension Service

Generic Advertising, Research and Promotion Programs

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This paper explains federal programs for generic advertising and promotion of agricultural commodities, examines program accomplishments, identifies key program issues and explores program alternatives. The information and analysis will be helpful to producers involved in or considering such programs to promote their commodity, as well as to participants in private and public policy decisions about generic advertising and promotion programs.

Advertising and promotion play an important role in the marketing of agricultural products. The major purpose of advertising and promotion is to increase product demand by encouraging existing consumers to consume more and by attracting new consumers.

The terms advertising and promotion carry specific meanings. Advertising is any paid form of nonpersonal presentation, generally using print or broadcast media to call attention to the ideas, goods or services of an identified sponsor. Promotion includes marketing activities, other than personal selling or advertising, that stimulate dealer effectiveness and consumer purchases.

Advertising and promotion may be either brand-oriented or generic. The primary objective of brand advertising is to gain market share for the advertised brand. Generic programs promote the general commodity -- eggs, milk, potatoes, etc. -- with no reference made to specific brands.

Generic food advertising and promotion are designed to achieve long-term market expansion for processed and fresh agricultural commodities, in both domestic and foreign markets. Advertising and promotion are seen as an effective means to strengthen the long-run demand for a commodity. They are viewed as an attractive means for producers to have more direct effect on the marketing of their products.

Generic advertising and promotion are often funded in conjunction with provisions for research. Research programs may involve processed product improvement and development projects, analysis of market demand, improvement of the delivery system, or development of improved commodity characteristics. Basic research sponsored on an industry basis may then be extended or adapted to specific brands or company use.

The role of government vis-à-vis generic advertising, promotion and research for agricultural goods varies with the commodity and specific enabling legislation.

Government-enforced marketing orders and other laws facilitate generic advertising and promotion programs by providing a funding support base, often referred to as a "check off" since funds are withheld at the point of first sale to a handler. Federal involvement in agricultural promotion evolves from industry requests. On the other hand, international programs such as those of USDA's Foreign Agricultural Service (FAS) represent direct federal participation through partial funding from taxes.

One may ask why producers should be given special authority to mandate support of advertising and promotions through marketing orders and check off programs, and why the federal government should be involved. First, the programs are facilitative -- they enable producers to pool their financial resources to develop programs which expand markets. This contributes to the "orderly marketing" concept underlying marketing orders and other government programs which help agricultural producers strengthen their role in the agricultural marketing system. In voluntary programs, "free riders" who benefit but do

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not contribute present an important equity problem. The role of government then becomes one of assuring that all potential beneficiaries help pay program costs, thus eliminating "free riders."

The Current Program

Most federal involvement in the generic advertising, promotion and research of agricultural products falls under one of three mechanisms: research and promotion acts, marketing orders and joint promotion ventures for international market development. While state involvement is substantial, this paper focuses only on federal programs.

The federal policy toward generic programs has varied from outright opposition to a generally favorable attitude. USDA's goal to increase farm income through greater sales does not necessarily encompass programs that increase U.S. per capita food consumption, and consequently, consumer expenditures. This conflict is more likely to cause trouble for domestic promotions than for international promotions which benefit U.S. producers without necessarily creating costs for U.S. consumers. Generally, research funded under check-off programs is perceived as positive and is unopposed by government.

Research and Promotion Acts

Federal research and promotion acts are designed to provide specific agricultural sectors with collective authority to develop and support advertising, promotion and research programs for their products. While the details of each commodity act differ, they all collect funds from producers via a "check-off program," and refund provisions are outlined for each. The secretary of agriculture may terminate or suspend any activity authorized under the legislation if he finds it does not serve the declared purpose of the act. Commodity programs are implemented through industry administrative boards.

Research and promotion acts are currently in effect for wool and lamb, cotton, potatoes, eggs, and dairy. A 1977 act for wheat and wheat foods which focused on nutrition education was terminated December 1, 1986. Authority for a floral industry program was established in 1981, but a proposed program failed in a 1986 referendum. An act in 1984 authorized a honey program which was activated in early 1987. A beef research and promotion program was authorized under a 1976 act, but proposed programs failed twice in national beef producer referenda. As part of the Food Security Act of 1985, popularly known as the Farm Bill, national advertising and research programs have been activated for beef and pork, and authorized for watermelons.

In 1986, a total of $110 million was collected under these programs, 79 percent of which was spent for advertising and promotion. Though relatively small compared to sales of the commodities involved and to advertising expenditures on branded products, the dollars available for generic advertising continue to increase. Between 1974 and 1980, cotton assessments have more than doubled. The dairy program established in 1984 collected $79 million of the $110 million 1986 total. Under the programs activated late in 1986, projected collections for the beef program are $60 million dollars annually and $20 million for pork.

Marketing Orders

A marketing order is a legal mechanism allowing the secretary of agriculture to issue regulations which bind all handlers of a product in a specific geographic area. Federal authorization for marketing orders was included in the 1937 Agricultural Marketing Agreement Act to establish and maintain orderly marketing conditions as well as achieve parity prices for farmers.

Marketing orders are much broader in scope than promotion acts. Orders can directly or indirectly influence product quality and quantity, and provide a number of market support functions. While research and promotion acts pool resources nationally, marketing orders give producers within a designated region some power over the marketing of their products.

Some marketing orders provide refunds to industry members who do not wish to support generic advertising. For example, under the milk marketing orders, refunds are made only if income exceeds expenses. For fruit and vegetable orders, no refunds are permitted.

Under milk marketing orders, each advertising and promotion program is governed by a board composed of elected milk producers and representatives designated by producer cooperatives. Assessments are collected by market administrators who set aside an amount equal to the total advertising and promotion assessment for all producers when computing the minimum price to be paid producers under the orders. In 1987, five of 47 federal milk marketing orders contained advertising and promotion provisions, down from 16 in 1980. These five orders act as collecting agents for the national programs under the National Dairy Promotion and Research Board.

Under fruit and vegetable marketing orders, assessments more than doubled from $3.9 million to $8.5 million between 1974 and 1980. Approximately 61 percent of the funds were allocated for advertising and promotion in 1980. Expenditures for advertising

and promotion totaled $14.5 million in 1986 and for research $1.7 million. In early 1987, the USDA administered 47 fruit and vegetable marketing agreements and orders, 17 of which have advertising and promotion programs. Only ten lack some form of research and development emphasis.

Export Promotion and Market Development

The rationale for federal non-brand promotion programs for agricultural products in export markets is similar to that for domestic markets. Export market development provides the added incentive of U.S. government financial participation. Benefits of international promotion accrue to those directly involved in export and to the U.S. economy in general through an improved balance of payments.

The FAS implements the Foreign Market Development Program as a cooperative effort with industry to develop new export markets for existing and newly-developed products, and to provide the sales of products in existing markets. Nonprofit producer organizations work with FAS to plan, finance and implement development activities overseas. Qualifying organizations must enter a cooperative agreement with the FAS to participate in this program. These agreements currently involve some 50 organizations and specify the obligations of both FAS and the participants, as well as the specific market development activities that will be performed. Approximately 35 percent of all market development funds come from importers, trade associations and foreign "third-party cooperators," such as governments, who were likely to benefit from increased trade.

The FAS also cooperates with private U.S. firms through its Export Incentive Program. The major objective of the Export Incentive Program is to promote the sale of branded, rather than generic, U.S. agricultural products. The financial contribution of the cooperator in the Export Incentive Program must be at least equal to the FAS portion. Unlike the Cooperator Program, the Export Incentive Program is generally short-term.

What the Programs Have Accomplished

There is a range of opinions on what generic advertising and promotion programs have accomplished or are capable of accomplishing. Some agricultural commodity groups such as the Florida Citrus Commission have a long history of support and use. Several commodity groups have initiated programs in recent years, while others have rejected proposed programs or turned down assessment increases in referenda.

The evaluation of research, advertising and promotion program effectiveness is incomplete. Many of the programs are relatively new or the level of expenditures quite low. In addition, the promotional activities often occur simultaneously with other authorized functions, making measurement of the impact of each component extremely difficult. Marketing orders, for example, may allow quality improvement, quantity control and promotional programs to be conducted simultaneously.

In addition, evaluation requires definitions of performance criteria. However, the dimensions of performance are numerous; they differ in importance with each affected group; and they may conflict with each other. For producers and the industry, increased sales and returns are the major criteria for evaluating advertising and promotion effectiveness. For consumers, food prices and product availability are major concerns.

Despite problems associated with program evaluation, a number of analyses have been undertaken. Most analyses of federal marketing orders have addressed the effects of order activities on available supplies. One study revealed some increase in demand as a result of generic advertising and promotion under federal fruit and vegetable marketing orders. The study also suggested that considerable time may be required for the effects of such promotions to be realized.

Generic program information and product quality improvements or innovations attributable to checkoff funded research may lead to increased consumer demand. Generic promotion and advertising programs that increase domestic consumption of a given food commodity may accomplish that gain at the expenses of other food items. When another commodity group is affected, it is reasonable to expect the group to avail itself of the self-taxing authority available to offset its losses. From a public policy perspective, therefore, analysis of these substitutions is important.

The issues of inter-commodity substitution and effects on U.S. society from generic food commodity promotion in export markets are different, but also difficult to evaluate. Public policy questions about generic promotion of fibers revolve around the ability of individual producers to compete with large firms in the marketing system. In this case, substitution occurs between agricultural fibers and heavily advertised synthetic fibers.

While criteria for evaluating effectiveness are not universally agreed upon, some general analyses are possible of program effects on facilitating market operation, eliminating unfair market practices, improving efficiency and redistributing costs and benefits.

Facilitating Market Operation

Theoretically, generic programs enhance the competitive process in domestic markets by reducing brand differentiation. Most often, generic advertising and promotions emphasize product characteristics, uses and attributes, thus increasing consumer information and helping consumers evaluate advertised and non-advertised brands. However, ineffective generic programs, can increase costs without providing such benefits.

Producers and the general public are both likely to benefit from international promotion activities. Expanded foreign demand usually leads to more trade and more favorable trade balances. However, if foreign market expansion forces domestic prices up, the program causes a direct cost to domestic consumers. The potential gains and likely price effects of direct USDA contributions to foreign market development are not easily measured.

It is possible for producers to promote generic agricultural commodities through cooperatives or voluntary trade organizations. However, those who do not join also benefit from any gains achieved. To the extent that federal government involvement eliminates the "free rider", it leads to more effective market power for commodity producers. The programs thus affect the marketing process.

Government-sanctioned programs transfer authority to make spending decisions about advertising, promotion and research activities from individual producers to producer groups. Decision authority also is created for USDA, which is given administrative responsibility over the programs. In some cases the specific authority of an administering board is spelled out in the legislation. In others, USDA is given discretion to establish operational ground rules for the administering boards. The question of where USDA authority ends and commodity group authority begins is frequently unclear and occasionally controversial.

Eliminating Unfair Market Practices

Generic advertising may reduce the potential for market abuse resulting from product differentiation. The generic advertising message is developed to cover a broad range of interests. Generic promotions usually are developed in conjunction with industry quality standards. Frequently, the advertising message includes a seal of quality approval (e.g., the Florida sunshine tree). Such indications of quality help consumers. However, branded products which are heavily advertised by private companies are often perceived to have superior qualities.

Improving Efficiency

Advertising and promotion are a form of non-price competition, especially among brands, and result in a less economically efficient market outcome than for markets with competitively-determined prices. During periods of weakening demand or excess supplies, advertising and promotion programs may substitute partially for price promotions. Strong generic programs help offset brand advertising, thus reducing the brand price differential to the benefit of consumers. And market entry by potential competitors should be less difficult since generic advertising tends to weaken strong brand identities.

Research funded under mandatory programs could have collective benefits, such as improved production and marketing efficiency, for individual producers and marketing firms that alone could not capture the same benefits. How much funding collected under generic programs could be directed profitably toward new product research or improved marketing methods instead of advertising and promotion is a question that has not been widely studied. That question should be of interest to any commodity group collecting check off funds.

Redistributing Costs and Benefits

The effect of advertising on substitution of one commodity for another and demand for food needs empirical analyses. The effects of advertising on prices, profits and total sales have been studied, but not in a manner that identifies the general social benefit of *food* advertising. This is particularly true for *generic food* advertising. Does the price inflation caused by advertising force lower-income consumers to substitute less desirable products? Is the potential for more consumption of nutritious foods offset by the addition of promotion costs to food prices? Is greater funding of such programs desirable for the general economy or even the aggregate agricultural community? Does the availability of advertising reduce consumers search cost?

Questions remain unanswered about the effects at the farm level from expending private money and tax funds to develop export markets which may ultimately raise the price of a commodity for domestic consumers. Economic analyses of the relative effects of advertising programs on small versus large producers, small versus large handlers, and high versus low income consumers are also lacking. One merit of mandatory generic programs is the sharing of costs among those who receive program benefits.

The Key Issues

Four key issues follow explicitly or implicitly from the preceding discussion of generic advertising research and promotion programs.

Economic Benefits

Economic benefits obtained from generic advertising are a prime concern for affected producers, competing producers and consumers. In several economic analyses, some positive short-run producer gains have been attributed to advertising and promotion programs limited in scope of time and geographic area. But few studies have been done regarding the effects of program proliferation across agricultural commodities, the distribution of program benefits among producers within a commodity group, and the redistribution of income between producers and consumers. In the absence of such analyses, establishing programs is tantamount to granting public policy authority to specific groups without accountability even to those who provide funding. An alternative policy could require that analyses be conducted and made available for use in policy decisions and by individuals voting in referenda. The Dairy and Tobacco Adjustment Act of 1983 contained such a requirement.

USDA Supervision

Because USDA is charged with administering generic promotion and advertising programs, the appropriate level of USDA supervisory authority and commodity group autonomy also deserves attention. There is a public responsibility associated with such transfer of power to private groups.

Whether the role of USDA supervision should vary among generic commodity programs deserves close scrutiny. Commodity groups generally favor less government authority over program management, and some legislation has granted near autonomy to the commodity board involved. It may be appropriate for USDA supervisory responsibility and authority to be reexamined in light of past experience and an increasing number of programs. Particular attention should be paid to whether some criteria can be applied to all programs for refund procedures, referendum procedures, economic analyses and permissible activities to be funded under the generic promotion programs. In the case of separately authorized programs, specific requirements could be included. Alternatively, areas of USDA authority could be identified generally to clarify that normal rule-making procedures would develop specific requirements and authority.

Domestic Versus Export and Food Versus Fiber Programs

With export promotions the main issues are price increases in domestic markets due to increased exports, and redistribution of income between consumers and producers. Detailed analysis of the sales potential in a country and its effect on the U.S. market is important before a commodity is promoted in an export market.

It is entirely plausible that export promotions have greater benefits with fewer trade-offs in the domestic market than do domestic promotion programs. The same may be said of promoting agricultural fibers rather than food commodities.

Amounts Spent for Advertising Versus Research

Research provides different public benefits than advertising. The allocation of funds collected under generic promotion and advertising programs varies. Some programs fund substantial research to improve product quality or marketing system operations, while others use all available funds for advertising. Recent studies have found high rates of return for a variety of such research expenditures at land grant universities.

Public policy authority for programs carries with it certain responsibility. For generic advertising, research and promotion programs, it could insure that a certain amount of research be conducted to benefit the public welfare through improved products or marketing efficiencies. Since an industry is likely to fund less than socially optimal levels of research, particularly if it cannot capture all the resulting benefits, guidelines could be established by USDA.

Should The Programs Be Modified?

A number of modifications are possible to deal with these key issues. Each would have different effects on the agricultural sectors involved in generic advertising, research and promotion programs and on society generally. While other approaches may exist and even be preferable from various perspectives, some options for dealing with the key issues are discussed in this section. The unstated option in all cases is to continue along existing lines.

Require Economic Analysis and Periodic Review

An economic analysis of benefits and costs which conforms to specific guidelines relating to content, scope and objectivity, could be conducted on all proposed generic promotion and advertising programs before USDA takes a position. Effects on competing agricultural commodities, on consumers and on different sizes of producers and marketing firms could be included. Such analysis could be made public

record before a referendum to better inform voting producers. While analytic difficulties would preclude definitive results, the information would provide an improved base for both public and private decisions regarding generic programs.

The economic analysis could be renewed once at least every five years and a continuation referendum held. The economic analysis and supporting research could be funded from program receipts. Following program initiation, USDA could be reimbursed for the initial economic assessment. This could apply equally to all generic promotion programs, whether authorized by free-standing legislation or marketing orders subject to renewal referenda under current USDA guidelines. This would provide an opportunity for contributing program participants to reevaluate their position and provide a more informed basis for public policy decisions.

Define USDA Supervisory Authority

USDA supervisory authority could be standardized rather than varying for each commodity program. It could require prior approval of a market or promotion plan, based on compliance with established guidelines. Procedures for establishing programs; conducting referenda; carrying out economic analyses; providing refunds; and allocating funds among research, advertising, promotion and economic impact analysis, could be required to meet guidelines established by USDA in consultation with interested parties. This would assure more equitable treatment of producers under various programs and provide a better basis for judging private and public impacts of the programs.

Limit Promotion to International Markets or Fibers

Limiting federal programs for generic advertising and promotion of food commodities to foreign market development is a viable public policy option. This would largely eliminate the difficulty of determining intercommodity producer trade-offs and consumer/producer trade-offs related to domestic advertising and promotion programs. The effects of exports on availability and price of domestic commodities would still need attention, but the implications are less complex.

Similarly, domestic programs could be limited to items such as fibers, for which competition occurs between agricultural and non-agricultural commodities, or for which consumer/producer transfers of wealth are of minimal concern.

Specify Minimum Research Expenditures

Benefits from research expenditures are diffused among producers and consumers, as well as over time, while promotion and advertising benefits accrue primarily to the involved producer group.

Since producers traditionally have spent less than socially optimal amounts on research, public policy could specify minimum percentages of collected monies to spend on research or education, in relation to that spent on advertising or promotion.

Conclusion

Generic advertising, research and promotion programs have become more pervasive as producers seek to improve their incomes. Yet benefits derived from funds expended under the programs are not well documented. The allocation of funds among authorized uses might be improved with better information about relative gains from research versus advertising. The question of whether expenditures on foreign market development offer greater benefits to producers and domestic consumers than expenditures on domestic programs has been addressed only in a limited way. The extent of USDA's responsibility is not always clearly defined. The preceding alternatives deal with important issues associated with the programs. Other issues and alternatives may exist, but adopting the alternatives discussed here, either as presented or in modified form, would deal with the issues focused on in this paper.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socioeconomic level, race, color, sex, religion, handicap or national origin.

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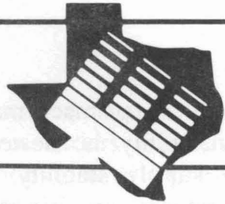

Texas Agricultural Extension Service

Fruit and Vegetable Marketing Orders

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Federal marketing orders were created by Congress to help farmers maintain orderly marketing conditions and achieve parity prices. Marketing orders are legal mechanisms under which regulations issued by the secretary of agriculture bind all handlers of a product in a specified geographic area to specific marketing practices. These orders are established only after approval by affected growers, but their mandatory nature distinguishes them from other forms of collective marketing.

The Current Program

Fruit, vegetable and specialty crop sales are regulated extensively by marketing orders, which restrict the quality and quantity of product that may be marketed. Orders may specify package and pack standards, minimum grades and sizes, quantity limits on shipments to certain markets or during certain marketing periods, and limits on products flowing to the market. Handler fees are assessed to pay administrative costs and to finance authorized research and promotion.

In 1987, there were 47 federal marketing orders covering production in 34 states. In terms of crop value, more than half of U.S. fruits and tree nuts and 15 percent of vegetables are covered. The estimated farm value of commodities marketed under these orders was $5.2 billion in 1980, representing 8 percent of total farm receipts from crop sales and about $23 per U.S. citizen.

Though some state marketing orders exist, this report deals with federal orders, which generally employ stronger controls. Legislative authority for federal marketing orders is provided by the Agricultural Marketing Agreement Act (AMAA) of 1937, as amended. Over time, the AMAA has been strengthened modestly and extended to cover additional commodities, but its basic provisions remain practically unchanged.

Marketing orders create various tradeoffs among and between producers, handlers, distributors and consumers. Because the tradeoffs are usually difficult or impossible to evaluate, it cannot be said with certainty whether marketing orders are good or bad for "society." However, their general effects can be identified.

The types of provisions used and the nature of the commodities covered determine the effects of the various marketing orders. Three broad categories of provisions are authorized: 1) quality control, 2) quantity control, and 3) market facilitating. *Quality controls* restrict shipments of a commodity to certain sizes, grades and maturities. *Quantity controls* regulate either the volume sold in certain markets or the seasonal flow to market. *Market facilitating* provisions regulate packaging requirements and establish "checkoff" programs to finance research and advertising.

Quality Control

Quality provisions permit an industry to set minimum grades, sizes and maturity standards enforced through mandatory federal inspection. Some form of quality control is used in most federal fruit and vegetable marketing orders. Methods of employing quality standards vary considerably among orders and within the same order over time.

Quality standards affect both supply and demand. Consumer demand may be increased by imposing minimum standards to prevent poor quality shipments which diminish a commodity's image. Marketing costs and margins also may be reduced when minimum standards lead to consistent quality, fewer rejected shipments and less marketing channel spoil-

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age and waste. Standards also can reduce commodity shipments and thus increase price, possibly encouraging subsequent excess production.

Quality standards which remain unchanged over several marketing years, apparently are intended to maintain minimum levels of product quality. Standards which change from season to season, or within the shipping season, may indicate an intent to manage the total quantity sold, to make the best of an off-grade crop or to promote quality improvements over time.

A team of economists appointed by the secretary of agriculture to review federal marketing orders concluded that the grade, size and maturity standards under fruit and vegetable marketing orders generally have not affected total supplies significantly. Standards may reduce the range of consumer choice, since some consumers might be willing to purchase restricted fruit if they could buy it at a discount. However, growers may not find it profitable to ship all their production, regardless of whether a marketing order exists.

Section 8e of the Agricultural Marketing Agreement Act requires that, for specified marketing orders containing quality, size or maturity control provisions, imports must meet the same or comparable quality standards. In 1987, such import regulations applied to six fruits, three vegetables and five nut and specialty crops.

To efficiently regulate markets, orders cannot specify a minimum grade and size standard for domestic production while ignoring imports. At the same time, import standards may constitute nontariff trade barriers which affect importers, exporters and foreign governments, as well as the domestic production, marketing and consumption sectors.

Import standards do prevent some lower-priced produce from reaching consumers, just as domestic quality minimums do. However, current research does not tell how substantial a trade barrier marketing order import standards represent, how costly the standards are to foreign suppliers, or how much wholesome produce is kept from U.S. consumers. Nor does research quantify the benefit which producer and consumer derive from less uncertainty about product quality.

Quantity Control

Quantity control provisions include 1) volume or sales management, and 2) market flow regulation specifying maximum shipments permitted in a given week. These two strategies are designed to obtain a higher and more stable price than would exist in the absence of the order. They are used for commodities with demand characteristics which bring producers greater total revenue from reduced primary market sales, and where revenue instability is viewed as detrimental to the long-run supply stability of a commodity. *Volume management* provisions are designed to influence price by reducing the quantity sold on the primary market in a marketing season. *Market flow* provisions regulate the within-season pattern of sales in the primary market, rather than controlling total quantity sold.

Volume Management

Three methods of volume management are authorized under the AMAA:

- producer marketing allotments,
- market allocation, and
- reserve pools.

Producer marketing allotments raise farm prices by restricting the total amount of commodity sold. Currently, only the marketing orders for Florida celery and spearmint oil use producer allotments. While authority exists, allotments have never been used for cranberries. The order for hops, which also included allotments, has been terminated. Individual producer allotment bases are determined by sales during a previous period. The total quantity to be sold is based on the projected market. Each producer's sales allotment is then a percentage of the base period sales.

Producer allotments can impede new entrants or prevent existing producers from expanding in response to price signals. The two active producer allotment orders permit transfer of allotments. But the cost of purchasing or leasing allotments, reflecting the capitalization of higher prices received, sometimes is high and the creation of new allotments is limited. Hence, there is evidence that producer allotments periodically restrict supply, raising prices above levels that would otherwise prevail. Allotments tend to set lower bounds for prices and producer incomes, but producers are still subject to price and income variability associated with weather effects.

In contrast to allotting a predetermined amount to sell, *market allocation* programs specify maximum sales in one of two or more different market segments for the same commodity. Such programs can raise producer returns when prices in the separate markets respond differently to changes in sales. Market allocation typically is used to divide the total supply between the preferred or primary market and the less lucrative or secondary market -- for example, between domestic and export markets, or between fresh and processed markets.

Market allocation programs are used for storable crops like nuts and dried fruit. A form of market

allocation also is used in three California/Arizona citrus orders (naval oranges, Valencia oranges and lemons), with weekly fresh market "prorates" on handlers during most or all of the marketing season. Other marketing orders set seasonal marketing quotas for handlers, usually a percent of producer deliveries to handlers that may be marketed without restriction. To be effective, market allocation schemes must be applied to market segments where natural or program-created barriers to arbitrage exist.

Market allocation can stabilize growers' prices and returns, thus reducing risk. This may lead to a larger product supply at the same price. On the other hand, such provisions may effectively tax consumers to subsidize producers. Further, initial high prices to producers may quickly be built into the costs of land and other fixed production assets, thereby taking away any long-term gains. Benefits from reduced price instability relative to increased costs from resource misallocation probably vary markedly among orders and over time.

Other effects of market allocation are less direct. For example, orders that allocate handler marketing allotments on a regional basis may prevent production from shifting to lower-cost locations. Assigning marketing allotments to handlers may reduce competition among them, may prevent achievement of scale economies and may penalize lower cost handlers by slowing their rate of growth.

Market allocation may cause some edible commodities to go into nonfood uses which are specified as noncompetitive outlets. However, even unrestricted, secondary food outlets such as food processing, cannot always fully utilize available quantities. Hence it is impossible to determine whether food waste is induced directly by marketing orders.

Reserve pool programs are similar in principle to market allocation programs. They differ in that restricted portions are set aside as a reserve pool rather than diverted to secondary markets. Like market allocation programs, reserve pools are used for storable crops. Crops in the reserve pool can be sold to the primary market if demand conditions improve or supplies fall short of initial expectations. Reserve pools also may be sold in primary markets in later years, diverted to secondary markets or disposed of in nonfood outlets.

Depending on how reserve pools are used ultimately, they may benefit consumers as well as producers. If reserve pools are used to remove production from the market during large crop years and then to supplement short supplies, they may create a net economic gain. On the other hand, if reserves are directed to secondary markets or nonfood uses, then the provision has the same effect as market allocation.

Periodic product destruction and diversion to nonfood uses associated with some marketing order reserve operations waste resources and represent a net social cost. But economic abandonment occurs in all fruit and vegetable crops. If reserve pools did not facilitate temporary storage, normal abandonment could be even larger.

Market Flow Regulation

Market flow regulation is the second form of quantity control authorized under marketing orders. With market flow control, even if all production is sold, producer returns may be increased by managing the amount sold each week to avoid low prices caused by seasonal gluts and high prices caused by seasonal shortages. Market flow regulations are used primarily in the citrus industry in the form of handler prorates and shipping holidays. Handler prorates specify the maximum quantity of a fruit or vegetable a handler may ship to the fresh market during a stated period of time, normally one week. A handler must hold excess supplies for later shipment or divert them to secondary markets.

While marketing order shipping limits are not always highly restrictive, use of prorates throughout most or all of a marketing season may force processing of fruit suitable for fresh domestic sale. Such intensive use can make prorates have some of the same effects as market allocation.

Shipping holidays prohibit commercial shipping during certain periods. Individual orders establish conditions under which shipping holidays may be declared, the maximum holiday length and the minimum period between holidays. Shipping holidays are a weak method of controlling market flow, generally set only around calendar holidays.

Neither shipping holidays nor prorates, when used for only part of the marketing season, appear to have substantially restricted seasonal supplies. However, they may smooth product flow over the season, potentially allowing more efficient use of marketing facilities.

Market flow regulations originally were intended to prevent temporary gluts in supply channels and the resulting low prices. There was a stronger rationale for their use when most produce was sold through consignment. In recent years, more produce has been sold direct to chain buyers and others, somewhat diminishing the reason for using this approach.

Market Facilitating Provisions

Standardizing packs and containers to promote uniformity is a widely used market-facilitating

activity. Specifications on containers and the arrangement of pack within containers prevent inefficiently large numbers of package variations. Such mandatory uniformity may improve marketing information and reduce handling costs and waste. Container costs may be lower where economies in manufacturing containers are passed on to handlers. However, cost-cutting packaging innovations may be stifled by order requirements if the orders are slow to adjust to new developments.

Some commodity producers raise funds for advertising promotion and research through assessments under marketing order authority. Such research may be directed at production problems, new variety development, yield improving cultural practices, post-harvest handling problems and ways to improve marketing efficiency. These funds permit longer-term research than that which individual firms could undertake profitably.

Assessments for advertising and promotion are relatively new to federal marketing orders. They are used to fund generic programs intended to increase demand for a commodity. This may help consumers make better informed decisions, but it may also merely raise overall marketing costs if producers of substitute commodities also advertise. Researchers have yet to determine the net effect of generic advertising and promotion.

The Effects of Marketing Orders

Fruit and vegetable marketing orders may be evaluated using a variety of criteria. Four explicit criteria have been applied in evaluating the effects of fruit and vegetable marketing orders:

- Do orders improve efficiency in marketing by encouraging greater output for the same use of resources or by improving pricing within the marketing system?
- How do orders affect the costs paid and the prices and incomes received by each participant in the market?
- Do marketing orders facilitate market operations or induce desirable changes in market structure?
- Do marketing order provisions eliminate unfair marketing practices?

Improving Efficiency

Given society's productive resources, if efficiency is defined in the broad sense of social welfare, fruit and vegetable orders contribute both positively and negatively to efficiency. Orders that establish minimum quality standards can increase efficiency by promoting quality control, thereby preventing rejected shipments and product deterioration. But efficiency may be reduced if standards preclude the sale of wholesome produce.

Quantity control provisions (producer allotments, market allocation and reserve pools) that limit price declines in years of large crops can dampen cycles in production and prevent associated cyclical disinvestment and reinvestment. Similarly, packing facilities can be utilized more efficiently if wide swings in volume can be avoided. Market flow provisions (prorates and shipping holidays) may also contribute to more efficient plant utilization. But seasonal and intraseasonal constraints on individual sales may penalize handlers by preventing exploitation of favorable sales opportunities. A particular handler structure may be "locked in" by order regulations. Quantity controls may also result in chronic surplus or deficit production with associated resource misallocation.

Market facilitating provisions, on the whole, appear to improve efficiency. Preventing package proliferation allows standardization of receiving facilities and reduces buyer confusion. Research assessments allow producers to jointly fund research to improve both production and marketing efficiency. The net effects of advertising and promotion have not been fully analyzed.

Redistributing Costs and Benefits

In addition to other effects, marketing order regulations influence the distribution of income among consumers, handlers and producers. Orders also alter the distribution of decision-making authority.

Some quantity regulations and some quality standards achieve their intended purpose of raising prices, at least in the short run. Producers thus obtain short-run total revenue gains at consumers' expense when demand conditions are favorable to such actions. However, prices raised higher than sustainable by underlying economic conditions may stimulate production, which eventually pushes price back toward the competitive level. Producers with allotments or with land, special skills or other assets especially suited for producing a given crop may gain in the long run as increased demand or restricted supply cause those assets to appreciate in value. Since handler income is at least partially tied to volume, handlers can suffer short-run losses in markets where volume is restricted, and enjoy gains where volume is increased. Market allocation provisions transfer benefits from consumers in the primary market to consumers in the secondary market. Quality standards transfer benefits from consumers who prefer lower quality produce to those who prefer higher quality.

All marketing order provisions limit certain choices available to either growers or handlers. The

industry advisory board, in conjunction with government, attains a greater role in the marketing decision system through monitoring and issuing marketing order regulations. The majority of producers under an order agree, through referendum, to limit their independence and to transfer some prescribed decisions to the administrative process of the marketing order structure. Though individuals maintain considerable influence over decision-making authority through the elective process, requirements for board composition and length of term may greatly reduce their prerogatives. While individuals give up some decision authority, the administrative committee attains more power than its members would have as individuals.

Handlers lose some individual decision-making ability under marketing orders. However, the orders do not specify in detail who must market what or where.

Facilitating Market Operation

Some features of fruit and vegetable marketing orders make markets work better by increasing the amount and quality of information available to market participants. Detailed shipping information is collected from handlers for order administration. Much of this information is made available publicly in the form of end-of-season statistical reviews. Quality control through marketing orders also represents a form of improved information. Buyers are more confident about the quality of purchases, and shippers of poor quality or immature produce are prevented from diminishing a product's image to the detriment of all growers and shippers.

On the other hand, some features of marketing orders can delay or prevent changes that would improve market operation. In particular, marketing quotas applied to handlers or producers tend to institutionalize the status quo.

Eliminating Unfair Marketing Practices

Marketing orders are initiated by producers, yet bind handlers to order terms. This ability of producers to influence handler behavior represents considerable countervailing power. To the extent monopsonistic power is present, marketing orders help hold it in check.

The order administration procedure itself guards against unfair marketing practices. In particular, data obtained by order administrative committees may make it possible to monitor potentially discriminatory or abusive behavior.

Finally, orders may specifically prohibit trade practices and methods of competition specified as unfair in a particular industry. They may also require price posting.

Costs of Marketing Orders

Monetary costs of marketing orders include handler assessments for order administration, grower funding of research and advertising, USDA administrative costs, and direct costs plus compliance costs of handlers and growers. Handler assessments and USDA costs are quite small in proportion to produce value.

In some cases, substantial direct costs of storage and other marketing activities may enter into the industry decision process on whether to use or continue marketing orders. Compliance costs are difficult to measure since they include the cost of paperwork added by regulation, in addition to direct costs. However, industry views support the conclusion that customary business records provide most of the information required for order administration.

The Key Issues

In summary, the effects of orders depend on both the types of provisions employed and the nature of markets for the commodities covered. To varying degrees, fruit and vegetable marketing orders may:

- maintain farm-level season-average returns above levels that would otherwise prevail.
- provide price floors in years of large supplies.
- reduce seasonal and intraseasonal price instability.
- provide quality assurance and consistent packaging to buyers.
- finance research and generic advertising and promotion programs.
- facilitate collecting and disseminating market information.

Public concerns about marketing orders relate both to the level of benefits, especially price and quality levels, and the manner in which the benefits are achieved. Many concerns are specific to certain provisions, primarily those involving quantity control. Other concerns involve perceived problems with order administration. Some legitimate concerns about marketing orders involve actual and potential costs and other problems. To varying degrees, orders may:

- contribute to food price inflation and penalize low-income consumers.
- cause inefficient resource allocation.
- reduce price competition among handlers.
- restrict growth and progressiveness.
- penalize foreign suppliers.
- allow inadequate public oversight.
- permit inequitable or undemocratic representation of interested parties.

Policy Options

Given these benefits and concerns, the key public policy question is whether the value of marketing orders exceeds the costs implied by concerns. Such a net assessment is impossible without applying considerable subjective judgment. However, it is possible to outline the likely effects of terminating the marketing order program, including development of voluntary and state-sponsored programs likely to replace federal order provisions. Certain changes within the existing program can be identified to alleviate concerns, and alternative federal programs are possible to achieve some of the same goals.

Terminate Order Provisions

Congress could remove authority for the fruit and vegetable orders by repealing the AMAA. Alternatively, the secretary of agriculture could suspend or terminate individual orders which do not accomplish the declared policy of the Act. This has been done in only one case, for hops in 1986. Since most commodities covered by marketing orders are perennials, the short-run and long-run effects of terminating orders may very well differ. While production would not drop immediately, in many cases prices would. In the longer-run, the opposite may occur. The net results would depend on the initial shock and adjustments over time as well as the amount of total production that is covered by an order.

Terminating *quantity controls* would remove constraints that limit total sales or the allocation of sales over time or among alternative markets. In situations where producer allotments had been restrictive, growers would likely increase production in the long run. Where market allocation had been restrictive, growers would likely decrease production in the long run due to narrowing price differentials among markets. Short-run grower returns would be expected to decrease and become more variable, at least until producers adjusted to revised conditions. Long-run resource allocation would respond to market signals, but effects on product prices, land values and consumers would depend on gains from improved allocation of resources, compared to losses from increased market instability.

Where marketing orders have encouraged over-investment, their termination could cause severe financial pressure on growers and handlers. Those possessing the most attractive balance sheets would likely survive. Where producer allotment marketing orders have led to under-investment, termination would lead to production expansion and lower prices, and eventually some less efficient allotment holders likely would be replaced. Termination of some quantity control programs would reinforce shifts toward fewer and larger firms.

Ending marketing orders that involve market allocation would redistribute consumers' incomes. Primary market prices would be lower and consumption higher, while secondary market prices would be higher. However, the effect on individual consumers would be small.

Lacking federal authority for industry-wide quantity controls, some producers likely would attempt to initiate similar programs under state legislation. However, their inability to regulate interstate commerce generally would limit their success. Major cooperatives might institute quantity control programs, but few possess a market share large enough to avoid problems associated with nonmembers receiveing benefits but not sharing program costs.

Private storage and futures markets might also substitute for some marketing order quantity controls. However, some commodities covered by orders are highly perishable, and few involve long enough seasons or high enough dollar volume to support futures markets.

Eliminating marketing order *quality controls* would permit handlers greater latitude with respect to size, grade and maturity composition of shipments. Consumers might occasionally be able to purchase less expensive, lower quality produce. But product quality would be more variable, overall produce image would likely diminish and spoilage losses could increase.

Without marketing order quality controls, handlers would have greater incentives to differentiate the quality of their products. Trade associations and cooperatives probably would attempt to implement quality standards in some cases. More state commissions likely would be instituted to promote quality improvement.

Elimination of *pack and container standardization* would have effects similar to elimination of quality controls. Handlers would have more flexibility, but buyers would be confronted with a broader and possibly more costly array of package sizes and contents. Private firms, trade associations and state-sponsored institutions would eventually play a more important role in promoting packaging consistency and standardization.

Without marketing order authority to fund industry-wide *generic advertising and promotion,* brand advertising by private firms might increase. And generic promotion through state marketing programs might also increase to offset some of the lost assessments. Growers also would likely seek state authority to fund *research* if federal authority were removed. But research by individual firms and voluntary organizations likely would not increase, again

because all industry members would benefit without sharing the costs.

Replace With Other Federal Programs

In addition to possible use of voluntary organizations and efforts to institute mandatory state programs, some existing federal programs might be strengthened and new programs initiated if marketing orders were terminated. These programs could be used to achieve some of the marketing order objectives deemed socially desirable.

Variations of *federal price support and stabilization programs* now used for major commodities might be employed for some fruits and vegetables. However, many fruits and vegetables covered by marketing orders are perishable, precluding use of long-term storage programs. Many commodities are small enough in volume that such programs likely would be costly compared to the crop value, at least relative to currently supported commodities. The diversity of products and marketing systems involved imply considerable complexity in tailoring individual programs.

In the absence of marketing orders, voluntary producer efforts to control volume would likely be frustrated by free riders. Federal legislation could authorize *marketing boards* or *exclusive agency bargaining*. However, marketing boards function similarly to marketing orders, and hence, would be subject to similar concerns. Exclusive agency bargaining would permit a single farmer bargaining association to serve as the sole bargaining agent for both members and nonmembers. Depending upon the latitude permitted in specifying negotiable terms, supply control powers of the bargaining agent could exceed those permitted under orders. Producer and handler independence also could be more restricted depending on specific program implementation.

Mandatory grading and labeling could be used to attain some of the desirable features of marketing order quality control and container standardization provisions without imposing minimum standards. This would eliminate the possible use of quality standards to control supply and allow market conditions to determine whether wholesome but lower quality produce would be available to consumers. Trading based on specified quality attributes would be facilitated, as more information would be available to buyers. Mandatory grading and labeling would require special federal or state legislation. Any additional handler costs would be borne ultimately by producers and consumers.

If marketing order authority were not available to fund research and promotion, individual commodity groups could seek *federal research and promotion acts* similar to those in place for several commodities. Or they could seek blanket legislation that would apply to all such "check off" programs. Compulsory programs prevent free riders in the funding of research and promotion that has industry-wide benefits. Voluntary and cooperative-sponsored efforts are feasible but unlikely to achieve full industry participation in cost-sharing.

Mandatory reporting of sales and prices could be instituted by law to obtain information comparable to that presently available through some marketing orders. Handlers likely would oppose such reporting and collection costs could be high.

Modify the Current Program

Another public policy strategy is one that would retain the current order program and its associated benefits with modifications to alleviate certain effects.

Concerns about potentially higher food prices, inefficient resource allocation, reduced price competition and restricted firm growth stem mainly from provisions regulating the timing or magnitude of handler shipments. Concern about inflation might be alleviated by *replacing the parity price goal,* which has been largely ineffective, with a new price objective, perhaps tied to the Consumer Price Index or some other measure. Or guidelines might be established to ensure that quantity control provisions are used only to prevent periodically depressed prices and not to consistently elevate price.

Any tendency of marketing order quantity controls to misallocate resources could be lessened by *limiting their frequency and intensity* of use. Producer allotments could be increased regularly to reduce their lease or purchase values. Weekly prorates could be made less binding by restricting the number of weeks they are applied. Or the seasonal total of weekly prorates might be required to exceed total crop size to prevent their use as a market allocation device.

Such changes would increase periods of unrestricted competition and thus reduce the incentive for surplus or deficit production, alleviate resource misallocation tendencies and at least partially retain the benefits of stable markets. Administrative committees would thus need to consider their recommendations to USDA more carefully. Restrictions or proportional shares imposed under quantity control programs also might be required to be fully transferable to permit more aggressive or more efficient firms greater sales opportunities within a season. This would also promote more rapid inter-regional shifts in production.

Major concerns about order quality standards relate to effects on low-income consumers and foreign suppliers. One way to assure the availability of

wholesome but lower quality produce would be to *facilitate charitable contributions.* Current restrictions generally prevent charitable organizations from recovering their costs of distributing donated commodities. Relaxation of these restrictions would require monitoring to prevent "donations" from eroding normal commercial channels.

Alternatively, orders might be changed to *prohibit quality standards that exceed specified minimum levels.* This would restrict changes in standards that might control supply. However, it would not assure the availability of low-priced commodities to low-income consumers; availability would be contingent upon the profitability of sales. Since foreign suppliers of commodities covered by U.S. marketing orders face the same quality standards as domestic producers, such changes also would reduce restrictions on imports.

Concerns about order administration relate generally to public oversight, voting procedures and administrative committee representation. Presently, oversight responsibility is mainly with the Agricultural Marketing Service, USDA. This could be broadened by requiring *review of regulatory recommendations* within other USDA agencies and approval by the secretary of agriculture. This might increase public confidence in order decision-making, but at a cost of less timely decisions, which could be critical for highly perishable commodities. Alternatively, complete *administrative responsibility could be transferred to USDA.* This would increase public cost and diminish the self-help nature of orders.

Another alternative for strengthening public oversight would be for USDA to *specify performance criteria* which all marketing orders were required to meet. In 1986, in response to a GAO report, AMS created a task force to identify performance criteria for evaluating fruit and vegetable marketing order performance.

Increased industry involvement in order administration could be encouraged by requiring individual producer voting on major regulations -- an expensive and slow procedure. Periodic *referenda on continuation* of orders would assure that the orders not outlive their support. Prohibiting bloc voting by cooperatives would place cooperative and independent producers on more equal terms, allowing all individual growers to express their preference on order issues.

Many order administrative committees have added public or consumer representatives in recent years, as encouraged by AMS guidelines. However, others have fought this policy. *Requiring public representation* could increase the range of information upon which committee recommendations are made and help alleviate the concern that committees ignore the public interest.

Representation could be broadened by *limiting the terms of committee members.* This might promote more rapid adjustment to change in production and marketing practices.

Industry Support

No matter which set of options an individual or industry group prefers, support by a majority in the industry is necessary. Changes in marketing order regulations require public hearings and opportunities for written comments followed by a referendum. Thus, options that are to receive serious consideration must be well thought through and their impacts analyzed. Only with substantial industry support can marketing orders and their individual provisions be used to improve the marketing of fruits, vegetables and specialty crops.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socioeconomic level, race, color, sex, religion, handicap or national origin.

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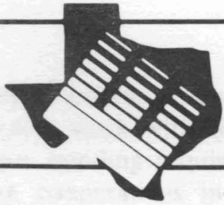

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Milk Marketing Orders

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A milk marketing order is a legal document embodying rules and regulations which govern the marketing and pricing of Grade A (fluid grade) milk. Virtually all Grade A milk and about 85 percent of total U.S. milk production fall under the regulation of either 43 federal orders or nine state orders.

Each order governs the pricing and marketing of raw milk in a specific geographic area ranging in size from several counties to several states. An order is initiated and terminated by a vote of the farmers affected by the order. Marketing orders are tailored to the marketing conditions they regulate; however, the basic design and functions of milk marketing orders are essentially the same. The four principal functions of milk marketing orders are classification, pricing, pooling and auditing.

Under federal marketing orders, milk purchased by a regulated processor is classified according to the type of product made from it, and a minimum price is established for each use class. Raw milk used to produce fluid or beverage milk products is identified as Class I and commands the highest minimum price. All other milk is identified and priced as Class II or Class III. Processors must pay at least the minimum prices for milk used in each class, but farmers receive a blend price based on a weighted average for the entire order area referred to as pooling. The blend price equals the total minimum payment required of all processors regulated under an order, divided by the total volume of raw milk delivered in the market area. Administrators of the order audit the monthly records of processors to make sure that the processors pay at least required minimum prices.

Rules and regulations set forth under milk marketing orders are complex. However, the following objectives have guided program administration:

- promote orderly marketing in fluid milk markets;
- stabilize milk prices and improve dairy farm income;
- supervise terms of trade in milk markets to achieve more bargaining equity between producers and milk processors; and
- assure consumers of adequate supplies of quality milk at reasonable prices.

The Current Program

Over time, the dairy industry has exhibited different levels of inequality in bargaining power between farmers and processors, as well as marketing problems associated with imperfect competition.

Dairy farmers' early efforts to enhance their competitive position by marketing milk cooperatively were only partially successful and were doomed by the Great Depression. The federal government and many states adopted legislation in the 1930s to increase farm incomes and maintain the productive capacity of dairying. The Agricultural Marketing Agreement Act of 1937, together with prior legislation, authorized the secretary of agriculture to issue milk marketing orders based on administrative hearings and producer referenda. A major objective of the act's dairy provisions is "to establish and maintain such orderly marketing conditions...as will provide in the interests of producers and consumers, an orderly flow of the supply to market...to avoid unreasonable fluctuations in supplies and prices." Moreover, the secretary is instructed to consider "economic conditions which affect market supply and demand for milk...[and] fix such prices as he finds will reflect such factors and insure a sufficient quan-

This is one of a series of articles on *Federal Agricultural Marketing Programs* developed by your state Extension Service as a component of the Land Grant University System in cooperation with the Texas Agricultural Extension Service, the Farm Foundation, and the National Public Policy Education Committee.

tity of pure and wholesome milk and be in the public interest."

The basic purposes and mechanisms underlying federal milk marketing orders have remained unchanged since 1937; however, specific provisions of orders have evolved in response to changes in dairy industry structure and market conditions.

The dairy industry is affected by a variety of regulations and policies. Besides federal and state milk marketing orders, the principals of these are 1) dairy price supports, 2) import restrictions on dairy products, 3) antitrust exemptions affecting agricultural cooperatives, 4) school lunch, special milk and other domestic and international food aid programs, and 5) health and product quality standards.

Dairy price support and milk marketing order programs are closely linked. The price support program influences all farm milk prices because the changes it causes in manufactured milk prices lead to corresponding changes in minimum federal order milk prices.

Although their major objectives are very similar, these two programs have evolved to serve different functions. Price supports are used primarily to affect farm prices, enhance farm income and influence aggregate supply. Compared to the macro-market orientation of the support program, marketing orders focus more on pricing equity among producers and processors; they also deal with problems of local and inter-regional trade. Marketing orders alone do not set overall milk price levels, but they do influence regional price differences.

During the 1980s, special programs to reduce surplus milk supplies have been used in conjunction with traditional price-oriented mechanisms of the support program. These special programs include the milk diversion program, which operated in 1984 and the first quarter of 1985, and the dairy termination program, a five-year program which began April 1, 1986.

Dairy import quotas are an important adjunct to the price support program. Import quotas make it feasible to support domestic dairy product prices at a level significantly higher than world prices. Without import restrictions, the U.S. government would be forced into the costly business of supporting world dairy product prices in order to maintain domestic prices.

The Capper-Volstead Act permits farmers to market their goods cooperatively and bargain collectively without challenge under the Sherman Act and other antitrust legislation. However, while permitting farmers to gain market power through a cooperative organization, the Capper-Volstead Act does not shield cooperatives from abuse of market power. In addition, dairy cooperatives are granted special privileges under the marketing order program. For example, cooperatives can vote as a unit for their members on producer referenda (bloc voting), which enhances their influence upon order provisions. They also are not usually required to pay federal order minimum blend prices to their members. Proprietary processors contend that this gives an unfair advantage to cooperatives that process and sell milk in competition with them.

Other programs also affect dairy markets and prices. For example, food aid and demand enhancement programs have helped reduce surpluses generated by the price support program, thereby facilitating price support objectives. On the other hand, changes in one program may be inhibited by the requirements of another. For example, proposals have been made to revise marketing order provisions governing the classification and pricing of reconstituted milk products, but the product identity standards for milk complicate such a revision. Some states do not accept reconstituted milk as a beverage milk product. Thus a change in federal orders that would encourage the use of reconstituted milk would run afoul of regulations which discourage or prohibit reconstituted milk.

What the Program Has Accomplished

Since the passage of the 1937 Agricultural Marketing Agreement Act, federal marketing orders have adapted to the changing needs and structure of the dairy industry. These adjustments frequently have been the subject of considerable controversy among various industry segments.

Improving Efficiency

Encouraging orderly, efficient marketing practices was an original objective of the federal order program and it remains a frequently cited justification for federal orders. Prior to widespread adoption of marketing orders, buyers often engaged in practices which enhanced their bargaining position relative to producers or improved their competitive position relative to other buyers, at the expense of efficiency. For example, buyers have been known to move milk unnecessarily long distances to discipline nearby producers. Federal orders align prices and establish rules that encourage production of fluid milk products from the nearest sources of raw milk.

Stable, secure markets are generally believed to be in the long-run best interests of all market participants. Without reliable markets, transaction costs and dairy product prices could rise. While marketing orders do not guarantee farmers a market, they do help provide a stable and orderly pricing system

which offers producers more security. Marketing orders work with the dairy price support program, state bonding requirements and strong milk marketing cooperatives in most regions to help provide secure markets for dairy farmers.

Information is a key ingredient in smoothly functioning markets. Without good market information, resource misallocation may occur. Federal orders generate market information and distribute it to producers, processors and the public. The system of announcing in advance minimum Class I and II prices also reduces uncertainty in milk markets.

While orders have promoted orderly marketing, they also may have discouraged some practices or adjustments that could lead to long-run improvements in the marketing system. Marketing orders have the flexibility to accommodate changes induced by improved technology or economic incentives. However, the inertia inherent with any bureaucracy may have slowed the adjustment process in regulated markets. For example, the market order system may now be impeding adoption of on-farm ultrafiltration technologies, multiple component pricing and reconstituted milk.

Reducing Unfair Trade Practices

Milk marketing orders have alleviated not only lost markets and low prices, but also the abusive effects suffered by dairy farmers from other unfair practices. Three examples include: nonpayment for milk delivered; inaccurate reports from handlers on the volume, butterfat content and utilization of milk; and the general lack of fairness inherent when the bargaining power of buyers and sellers is unequal.

The federal milk marketing order program helps ensure timely payment and protects farmers from handlers' failure to pay for milk. While federal milk marketing orders do not require handlers to post a cash bond or to pay in advance, they do specify partial and final payment dates each month. Farmers and farmer cooperatives are thus warned reasonably quickly if a handler finds it difficult to pay. In some orders, a schedule of charges on delinquent payments is specified. Yet full payment in the event of bankruptcy is not assured.

Transfers and payments for milk offer many opportunities for inaccurate reporting. Periodic audits of handler records by marketing order personnel ensure that milk marketing transactions are accurate and honest.

Redistributing Costs and Incomes

Federal order provisions make the distribution of market returns more equitable among producers by establishing a minimum blend price, and among processors by setting minimum class prices for raw milk. Other equity issues involve sharing costs and benefits of maintaining efficient markets.

Dairy farmer cooperatives perform several functions, such as negotiating prices and balancing milk supplies with demands, which also benefit nonmembers. Although part of the cost sometimes is charged to the cooperative's processors, the cost of providing these services may be borne disproportionately by cooperative members. Equity among producers is difficult to attain when all producers are not members of the same cooperative. Similarly, the costs of supply balancing and surplus disposal have not always been shared equitably between cooperatives and processors.

The Food Security Act of 1985 authorizes federal orders to collect money from those who do not bear marketwide service costs and remit it to cooperatives and proprietary firms which provide marketwide services. In the initial decision regarding this authorization, USDA decided not to implement a proposed system of marketwide service payments.

Orders benefit all sizes of dairy operations. If orders had not helped equalize bargaining power between producers and handlers, the exit of the smaller dairy farmer may have been hastened.

Pricing provisions also may have favored smaller handlers. Without minimum prices, the larger processor may have been able to procure milk supplies more cheaply.

Therefore, milk marketing orders distribute income among market participants in a different pattern than would exist without orders. This was a primary objective of the legislation. Nevertheless, it is reasonable to question whether the redistribution caused by marketing orders today could be improved significantly. This raises a difficult corollary question -- how does one decide what is a better, good or equitable distribution of economic benefits?

The answer to this question is difficult and varies depending upon one's values and market position. It is not surprising then that different observers and analysts of marketing orders have come to different conclusions regarding the distribution of benefits from marketing order regulation. Some contend that marketing orders raise farm prices to the benefit of farmers and the detriment of all others. Some argue that charging higher prices for raw milk used in fluid products (Class I) is an obvious case of classical price discrimination. This means that consumers of Class I products pay higher prices and subsidize producers and consumers of manufactured dairy products. No attempt is made here to be conclusive or to reconcile conflicting arguments, but some observations are offered.

First, economists have criticized orders because orders cause economic results that differ from what one would expect under perfect competition. The problem with such criticisms is the implication that perfect competition would exist if marketing orders were abolished. This would most surely not be the case -- large processors and large cooperatives would prevail. The norms of perfect competition provide many good targets for the administrators of marketing order policies, but marketing orders should be judged against the imperfect competition that would prevail in their absence.

Second, one must distinguish between faults in the system and faults in the administration of the system. For example, some would say that prices are too high because of federal orders. If that is true, it probably reflects more on the administration of the system than on the structure of the system.

Third, milk marketing orders have existed for almost half a century and orders may have become venerable because of their longevity. Marketing orders, as any other policy tool, may be good, but not because they are old. Because of their longevity, marketing orders and their specific provisions should be examined periodically and measured, as best they can, against a changing economic environment and changing technologies. Federal orders have not created equality; rather they have tried to create more equitable conditions than existed previously.

The Key Issues

Significant changes have occurred in the U.S. dairy industry during the last several decades. Federal milk orders appear to have adjusted to these changes, although important challenges remain to be addressed. Some of the key issues are new, others have faced us for some time. Most involve more than the federal milk marketing order system alone. Major issues are discussed below.

Classified Pricing

One of the major criticisms of milk marketing orders relates to price discrimination -- charging different prices for an identical product based on how it is used. Classified pricing discriminates between markets but this should not automatically connote inequity. The original objective of classified pricing was to reward producers for the extra cost associated with Grade A milk production. Dispute now focuses on whether this extra cost exists or warrants special compensation. There is evidence that differences in size, management ability and other factors may make the average cost of Grade B production higher than for Grade A. Thus attention has returned to the price discrimination issue. The controversy was fueled by 1985 farm bill legislation, which considerably widened the price differential between Upper Midwest markets and distant markets to the south and east, which is discussed further in the next section.

Of particular concern has been the consumer cost of paying higher prices for milk used for fluid purposes. While some income is transferred from consumers to producers through classified pricing, the amount is debatable. The prices and type of price system that would exist in the absence of classified pricing is hard to predict. Elimination of classified pricing would not necessarily eliminate price discrimination between inelastic fluid milk markets and the more responsive manufactured product markets. Due to the difficulty of matching daily production levels with fluctuating processor needs, there probably would be more than one price paid to producers in most markets, with differences related to how milk is used. Extra milk not needed for fluid use on any given day likely would be priced at a lower, surplus value. In addition, if classified prices were eliminated from federal orders, the income gains from price discrimination might simply be transferred from producers to processors and retailers, who could discriminate among product markets. However, in the absence of classified pricing, market forces would have greater influence.

Distance and Geographic Differentials

Historically, federal orders priced Class I milk with an increasing price differential relative to distance from key basing points in the Upper Midwest, centering on Eau Claire, Wisconsin. The current rationale for the Class I differential in a particular area is primarily to reflect transportation costs. For years this differential was $0.15 per cwt. per 100 miles. This was less than the cost of transportation after energy prices increased in the 1970s. As a result, cooperatives, primarily in southern markets, negotiated premiums over federal milk order prices. These premiums tended to increase when milk supplies in the South required supplemental shipments from northern markets.

In 1984, during the milk diversion program, several southern markets experienced substantial milk shortages. As a result, these markets secured temporary increases in the Class I price to ease the problem of moving milk into these markets. Class I price increases were mandated for a two-year period by the 1985 farm bill for 33 specific federal order markets. Very small increases were granted in the Upper Midwest, with much larger increases in the South and East. Midwest dairy interests and legislators disputed the 1985 Food Security Act Class I price increase as

favoring producers in eastern and southern markets. Continuing controversy can be expected over both the appropriate level of the Class I differential and criteria for establishing the differential.

Over-Order Payments

Some argue that over-order payments are inconsistent with objectives of the milk marketing order program, and that order prices should be the effective prices. Others, including administrators of the order program, maintain the existence of over-order payments is compatible with the minimum price status of the orders' classified prices.

Cooperatives have argued that over-order payments are cost-justified and permit more timely response to changing market conditions than does the order mechanism. Research suggests that most over-order payments are explained by service cost factors and geographical price misalignment under federal orders. Over-order payments clearly were not the major cause of the current over-supply situation, since they account for only about a one percent increase in milk production between 1970 and 1980.

Market Service Charges and Payments

One of the incentives for over-order payments has been the so-called free-rider problem in which producers who are not members of cooperatives benefit from cooperative services but do not pay for those services. It likewise is asserted that processors who do not purchase milk from major cooperatives serving their market receive market supply balancing benefits but do not pay the costs. Some cooperatives have strongly advocated service charge provisions to deal with these issues.

While the free rider problem is very real, there is lack of agreement on an appropriate solution. As with many complex problems, there may be no perfectly equitable solution. The USDA traditionally took the position that authority for service charge provisions in marketing orders was unclear, that such provisions would put USDA in the business of public utility-type rate regulation, and that the free rider problem was being dealt with effectively by over-order payments.

Except for some nominal marketwide service charges in a few orders, USDA refused to consider the payments issue. However, the 1985 farm bill specifically authorizes marketwide service payments and mandates USDA to hold hearings on the issue. As indicated previously, the initial marketwide service charge proposal has been turned down. The major question is how to structure an equitable payment system where cooperatives and some proprietary processors perform varying degrees of balancing functions and related marketwide services.

Reconstituted Milk

New technologies have improved the quality of dried milk and milk concentrates. This makes it possible to produce a commercially acceptable beverage milk reconstituted from concentrated fluid or powdered milk. This could reduce the need to transport milk in its bulky form and permit storing milk from the heavy production season in the form of powder for use in the short season of the year. The potential cost difference of marketing fresh milk versus reconstituted milk is not agreed upon. However, there is no question that current federal order pricing provisions sharply restrict incentives to reconstitute milk.

Federal order pricing provisions could be revised to ease the economic penalty imposed on handlers for producing reconstituted beverage milk. Almost certainly, the effect of such change would be to reduce Class I differentials and increase relative prices for Midwest dairymen. Price benefits would accrue to consumers of fluid milk. Any substantial change in these order provisions, however, would likely diminish reliance on fresh milk to satisfy fluid consumption. Therefore, eliminating the price penalty on reconstituted milk could redistribute income among processors, producers and consumers and affect milk transportation patterns as well as costs.

Marketing Quotas

Surpluses frequently plague the dairy industry. Lower prices are not a politically popular means of controlling surpluses. Voluntary supply controls such as the milk diversion and dairy termination programs provide temporary relief but by themselves do not provide a long-run solution. Proposals to implement direct controls on production marketings are becoming more common.

Marketing controls could be instituted as part of federal orders by amending the Agricultural Marketing Agreements Act. In addition to authority for quotas, authority for orders would have to be mandated to provide national coverage of both Grade A and Grade B producers. The marketing order administrative structure could be used effectively to implement mandatory milk supply management provisions, although not all regions are currently covered by market orders. The cost of quotas would be borne by consumers and new milk producers who would be required to purchase marketing rights in one way or another. Windfall gains in asset values would accrue to dairymen in production at the time quotas are imposed. Government costs for dairy programs would decline.

Although the administrative structure of marketing orders offers an excellent tool for implementing and monitoring a mandatory supply control program, other agencies are possible and probably more likely. Voluntary programs initiated in 1984 and 1986 were administered by the Agricultural Stabilization and Conservation Service. Much data and assistance was required from market order administrators. One wonders if mandatory controls, or for that matter the entire dairy pricing programs could be more efficiently and effectively administered by a single USDA agency.

In any event, two things should be clear:

- Marketing orders could be adapted to mandatory supply controls, but such a program could be administered in various ways.
- Although there has been much grass roots discussion of mandatory supply controls, acceptance of such a program is by no means a foregone conclusion.

Coordination of Price Support Levels and Federal Order Prices

Sound practice calls for USDA to consider the combined effect of milk orders and price support levels in appraising the appropriateness of milk prices, given the close relationship between fluid and manufacturing milk markets. Establishing appropriate prices for the two programs may become more difficult during the next few years. Further widening between prices for fluid milk and milk used in manufacturing would intensify antagonisms between producers in manufacturing and fluid processing regions. Thus, careful coordination of the two milk pricing programs will be necessary to avoid this development and the equity issues it raises.

Should the Program be Modified?

The impact of federal orders on dairy marketing diminished during the 1970s. Changes in federal orders during that period were mainly of the housekeeping or fine-tuning variety. In the 1990s, federal order regulation could be changed to accommodate shifts in emphasis among purposes of regulation and changes in dairy marketing. This could mean either more regulation or less. The direction charted by the 1985 Farm Bill seems to point to further regulation and greater involvement by Congress in establishing regulatory parameters.

Five alternatives to current federal orders are presented below in increasing order of public intervention. Each alternative is briefly described, then the possible effects of each alternative on the current program are summarized for 12 objectives (see Table 1). These impacts should be interpreted as likely rather than unequivocal fact. The appraisals in Table 1 probably best point to directions of change; the magnitude of change is more difficult to ascertain.

Deregulate

All federal milk orders could be terminated. Prices and terms of trade would then be determined by negotiation between processors and producers or their cooperatives or by new institutional arrangements. Income would be redistributed among market participants with lower prices prevailing for fluid milk. Any verification of a trade would be left to the parties of the transaction. Equity in pricing milk to producers and processors would decline.

Deregulate Prices Only

Orders could be limited to the auditing of receipts and uses of milk. All prices would be established by negotiation between producers and processors, and orders could be a mechanism for reporting prices. A continuing flow of reliable public information would be a check on market inequities and potential abuses. This would be similar to the "marketing agreement" mechanisms which briefly preceded marketing orders during the 1930s.

Simplify Orders

Orders could be reformulated in a number of ways to simplify regulation. A variety of options could be used to improve geographic price alignment, reduce differences among order provisions, simplify pooling criteria and the like. The consequences of these alternatives may not be greatly different from current regulation, but there could be an increase in equity problems under order simplification.

Set Effective Prices

Steps could be taken to bring actual prices paid by processors and received by farmers closer to order prices. This might provide greater assurance that market prices were in the public interest. However, changing administered prices to fully account for market service costs or to reflect market conditions better would be difficult to do in a timely and precise manner. Both the cost of order administration and complexity of regulation would increase. If pricing procedures are altered only slightly, then the consequences of this alternative might not be much different from current regulation.

Reduce Equity Problems

Attempts to enhance equity could include pricing systems that account for the cost of maintaining and balancing market reserve supplies or that allocate

returns from Class I markets more uniformly. It is difficult to assess the consequences of changes designed to improve equity. Equity involves competing individual interests. As with attempts at administering effective prices, regulation which would cure all perceived equity problems may not be practical.

Table 1. Expected Impacts of Alternative Levels of Milk Regulation on Affected Groups and Policy Objectives

	Deregulate	Deregulate prices only	Simplify orders	Set effective prices	Reduce equity problems
			Impact*		
Producers					
Price and income level	-1	-1	0	+2	+2
Price and income stability	-1	-1	0	+1	+1
Market security	-2	-2	0	0	+1
Increased consumption	+1	+1	0	-2	-2
Equitable treatment	-2	-2	-1	0	+2
Promote family farm	-1	-1	0	0	0
Consumers					
Retail price stability	-1	-1	0	+1	+1
Adequate supply	0	0	0	0	0
Retail prices/manufactured	+1	+1	0	0	+1
Retail prices/fluid	-1	-1	0	+1	+1
General Public					
Out-of-treasury cost	-1	0	0	+1	0
Pricing efficiency	+1	+2	0	-1	-1
Technical efficiency	-2	-1	0	0	+1

* Impacts on objectives are represented as differences from present system of federal milk market orders as follows: +2 = moderate increase, +1 = small increase, 0 = no change, -1 = small decrease, and -2 = moderate decrease.

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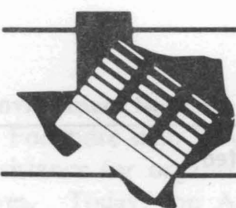

Texas Agricultural Extension Service

Agricultural Marketing and Bargaining Cooperatives

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Historically, cooperatives have been considered as institutions which could deal with family farm equity and survival issues in an increasingly industrialized agricultural setting. Cooperatives allow moderately sized farmer members to realize lower input costs and higher product prices enjoyed by large-scale farmers who frequently integrate on their own. In addition, added efficiencies, improved marketing and above normal profits may be gained to the benefit of cooperatives' members. Where proprietary agribusiness firms are already in a dominant market position through contract integration, bargaining associations may be formed to countervail the firm's dominance. This leaflet discusses alternative policy issues that evolve out of a cooperative's efforts to acquire market influence on behalf of its producer-members.

The Current Program

The Clayton Act states that nothing in antitrust law forbids existence and operation of agricultural and horticultural orgainzations instituted for "purposes of mutual help." Therefore, cooperative members are allowed to lawfully carry out legitimate marketing objectives as long as prices are not unduly enhanced. However, activities allowed under the exemption are not specified. The Capper-Volstead Act adds more guidance, allowing farmers to combine for "collectively processing, preparing for market, handling and marketing."

The courts have interpreted these functions broadly. One court defined "marketing" as *the aggregate of functions involved in transferring title and in moving goods from producer to consumer, including, among others, buying, selling, storing, transporting, standardizing, financing, risk bearing, and supplying market information.* Relying on the "plain meaning of the term," the court concluded that bargaining and price agreements were cooperative marketing activities exempt from the antitrust laws. Table 1 lists activities permitted or prohibited according to legal decisions involving cooperatives over the years.

USDA Enforcement of Capper-Volstead

The Capper-Volstead Act forbids cooperatives from unduly enhancing price. Since 1959, responsibility for enforcement of the undue enhancement provisions has generally been given to a committee of administrators from the U.S. Department of Agriculture. The committee makeup changes periodically, but generally the committee has consisted of the assistant secretary of economics, the general counsel and the assistant secretary for marketing and inspection services.

The USDA operates today much as in the past, acting on complaints concerning possible undue price enhancement. Complaints are referred to the committee, which authorizes analysis and makes recommendations to the secretary on further action. The committee delegates responsibility for analysis within the department. It is possible that personnel who promote cooperative activity may be involved in investigation, which has raised questions of conflict of interest.

If a basis is found for moving ahead on a complaint, further administrative procedures are set forth. However, the department has yet to bring a

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Table 1. **Cooperative activities permitted and prohibited under antitrust laws.**

Permitted	Prohibited
Processing	Picketing and harassment
Preparing for market	Boycotting
Handling	Coercing membership
Marketing	Unjustified price discrimination with the intent to eliminate competition
Bargaining and shipping	Engaging in "predatory" tactics
Fixing prices	Exercising monopoly power to stifle or smother competition by interfering with shipments, boycotting or exerting improper financial pressures
Acquiring monopoly power through growth and combination of agricultural cooperatives	Monopolizing or restraining trade to the extent that prices are unduly enhanced thereby
Forming marketing agencies in common, federations and other inter-cooperative arrangements and contracts, including mergers	Monopolizing or restraining trade through agreements with non-cooperative organizations
Acquiring, exchanging, interpreting, and disseminating crop, market, statistical, economic and similar information	Creating a joint venture or merging with a non-cooperative organization where the effect may be substantially to lessen competition or create a monopoly
	Permitting nonproducers or mere "contract integrators" to become members of a cooperative association

charge of undue price enhancement since the Capper-Volstead Act was passed. Eight cases have been subjected to inquiry, all since 1969.

Seven of the cases involved milk and were related to over-order payments. The other concerned potatoes for processing in Idaho. In each case, the examiner reviewed supply-demand conditions in the market affected and searched for prices that were out of line with those conditions. While conducting these investigations, the USDA never explicitly defined the term undue price enhancement; nor is the term defined in the law.

Enforcement of the Agricultural Fair Practices Act

The 1967 Agricultural Fair Practices Act (AFPA) prohibits handlers from discouraging producer membership in or contracts with a cooperative, and from discriminating between cooperative and noncooperative producers on trade terms. The secretary has delegated authority for enforcement to the Agricultural Marketing Service (AMS) administrator.

The AFPA's usefulness has been limited. Producers hesitate to complain of AFPA violations because of potential discrimination against them by buyers once their complaint becomes public. An Agricultural Cooperative Service (ACS) study found only 26 cases of producers seeking AFPA protection between 1968 and 1978. Of those, most were filed shortly after the act became effective. Only seven complaints resulted in favorable rulings to producers.

Only one reported court case dealing extensively with alleged violations of AFPA has occurred. The court pointed out that the act was considerably weakened by inclusion of the so-called "escape clause." This clause declares that handler activity which might be a violation will not be considered as such if it is part of "normal dealing."

Government Support for Cooperatives

For more than 70 years USDA has provided direct assistance for organizing and strengthening cooperatives. Today, the ACS and the Extension Service (ES), acting through the land grant universities, provide cooperative research and information. Inside USDA, varying degrees of cooperative involvement also occur within the Economic Research Service, Commodity Credit Corporation, the Office of Transportation, Agricultural Marketing Service, Foreign Agriculture Service, Farmers Home Administration and Packers and Stockyards Administration. Outside USDA, federal agencies involved with cooperatives include the Farm Credit Administration, Internal Revenue Service, Department of Justice, Federal Trade Commission and the Small Business Administration.

The focal point of USDA's direct cooperative involvement is the ACS. Technical assistance to farmers' cooperatives has been a major thrust over the years. ACS frequently works closely with state Extension personnel on cooperative projects.

Land grant universities, with partial funding from the federal level, perform cooperative research and conduct Extension educational programs aimed at cooperatives. Most land grant research relating to cooperatives is supported by ACS. Direct assistance is provided to state Extension specialists by ACS and the federal Extension Service. From time-to-time special pilot projects have been established by ES to assist state specialists in developing educational materials.

What the Program Has Accomplished

It is difficult to separate the performance of government in regulating and facilitating cooperatives from performance of cooperatives themselves. Consequently, this assessment is limited and based primarily on deductive logic and economic theory.

Facilitating Market Operation

Cooperative marketing is an extension of the farm into subsequent marketing stages. Physical marketing practices and channels are not necessarily altered when cooperatives replace buyer-seller exchange, but vertical coordination is affected. Cooperative bargaining alters the structural interface between farmers and first handlers. Through collective action, sellers gain market power relative to buyers. In the "competitive yardstick" role, cooperatives form when private firms are inefficient or earn excess profits, or where performance information is obscure. Numerous examples can be cited in which cooperatives have performed the watchdog function by entry into handling or processing.

Marketing cooperatives increase the number of market outlets available to farmers and provide diversity in the type of outlets. The ability to pool assets lowers entry barriers at the first handler level. However, large cooperative stock purchases or other eligibility requirements can, in some cases, be barriers to entry into production. Historically, cooperatives have been an outlet for farms which are too small for benefits afforded large farms by private handlers. However, recently some cooperatives have been criticized for discriminating against smaller farms. But if cooperatives charge the same price for providing the same services to all members and the cost of serving large farms is less, the large farm is discriminated against.

Eliminating Unfair Marketing Practices

Cooperatives protect members from exploitation by private firms. A cooperative's nonprofit nature implies that above normal profits which would otherwise be earned by private firms are captured by the farmer-member. In most cases the cooperative goal of maximizing member returns can be shown theoretically to yield a higher output level at a lower price. However, cooperative behavior is not inherently pure. Cooperative margins are frequently retained within the business for years. In addition, cooperatives have at times also engaged in unfair or discriminatory practices. These instances have generally become the subject of litigation under antitrust laws with the most widely publicized examples involving milk.

Improving Efficiency

Vertical integration by cooperatives may improve coordinating efficiency. For example, cooperatives that represent a large share of production may be more efficient in performing assembly and surplus processing for a milk market. Where efficiency gains are divided between producers (in the form of higher prices or patronage refunds) and consumers (in the form of lower costs), market performance is improved.

More and more producers have turned marketing decisions over to their cooperative under a marketing agreement. Cooperatives are thereby frequently able to raise producer returns through superior marketing expertise. Such gains are often derived from better timing of marketing decisions or better choice of outlets.

Traditional economic justification for special treatment of cooperatives is that they capture profit margins of monopolistic firms and return the profits to their producer-patrons. The result is a more

competitive price. In practice, such benefits decrease if cooperatives retain net margins over a long period. In such a case, the present value to producers approaches zero and market performance is not changed materially.

Few cooperatives have accumulated sufficient market share and management expertise to administer prices through market power. In some cases marketing orders may provide support for accumulating such market power. This may be in the public interest since there is a history of low producer returns. The fact that Section 2 of the Capper-Volstead Act uses the term "undue" price enhancement infers that Congress intended for cooperatives to use market power, indicating that some price enhancement presumably was considered justified.

Redistributing Costs and Benefits

The primary, intended distributional effect of cooperative marketing and bargaining is to redistribute profits from the "middleman" to producers. If private firms possess substantial market power, cooperatives can increase output and reduce consumer prices. However, if they raise prices at the consumer's expense, adverse impacts on demand can be anticipated.

Distribution of decision-making authority is altered by cooperatives. Decisions are transferred from individual producers to boards of directors and management. But, by the same token, producers would have no control if they sold through private firms.

The Key Issues

As agriculture and marketing arrangements become more complex and diverse, questions increasingly arise as to the types of farmers, cooperatives and activities that are entitled to antitrust exemption. This issue pervades the public policy concerns that affect cooperatives.

What Is a Cooperative and Its Farmer Member?

The type of farmer and cooperative originally envisioned by the Capper-Volstead Act likely resembles, for example, traditional family dairy farmers who jointly organize to assemble and bargain for the price of their milk. In an increasingly industrialized and diverse agriculture, some farmers and cooperatives desiring Capper-Volstead exemption bear little resemblance to this original, relatively simple concept. Consequently, a host of questions arise as to the membership and organizational form of a cooperative. Most of these questions revolve around the cooperative's relationship to the proprietary agribusiness sector.

Who is the farmer in an integrated poultry industry structure? Is it the grower who works for a piece wage in return for his time and investment contributions? Or is it the integrator who owns the chickens, supplies most of the inputs, prescribes management practices and markets the end product? The courts have decided that it is the grower, except to the extent that integrators are actually involved in grower functions. Yet as proprietary agribusiness firms become increasingly involved in the full scope of farming activities, this issue grows in complexity.

One of the basic tenets of Capper-Volstead interpretation has been that cooperatives cannot combine with proprietary corporations to control markets. What about increasingly common joint ventures between cooperatives and corporations? The answer appears to hinge on the purpose and effect of the venture in terms of market control. Yet such relatively obscure criteria create the potential for formation of various structures of "quasi cooperatives" organized to obtain cooperative benefits. Such quasi-cooperative structures are fostered by court rulings that broadly interpret the Capper-Volstead term "marketing" to include price setting even if that is the sole cooperative function.

How Should Cooperatives Be Treated Under Antitrust Laws?

During the first 50 years following passage of Capper-Volstead, there were four major Supreme Court cases that narrowed the interpretation of permitted activities under Capper-Volstead Section 1. During this growth period within the cooperative sector, practices went largely unchallenged. In the early 1970s, a new, more critical attitude emerged as the Federal Trade Commission (FTC) and the Department of Justice (DOJ) challenged such common practices as full supply contracts, intercooperative mergers, federations, marketing agencies in common and bargaining. Cooperatives were accused of monopolization, and USDA was criticized for failing to actively enforce the undue price enhancement provisions of Section 2 of the Capper-Volstead Act.

The fundamental issues relating to cooperative antitrust are the nature of the Capper-Volstead monopolization exemption (Section 1) and the appropriate enforcement of Section 2. It has been argued that Capper-Volsted Section 1 is, in fact, less an exemption than an assurance of equal standing under the law -- combinations of farmers have the same antitrust status as combinations of corporate stockholders. However, a major exception to the "equal standing" principle lies in the area of mergers. Recent rulings suggest that exempt cooperatives may

combine to the extent of a monopoly or may fix prices among themselves, regardless of whether they are organized officially as a marketing agency in common. Such combinations surely would be challenged in the corporate sector. In summary, the following classes of cooperative activities may be defined:

- Predatory practices and restraint of trade are clearly and unequivocally outside the protection of Section 1.
- Bargaining, setting prices, use of marketing agencies in common, intercooperative mergers and use of membership contracts and agreements are exempt from antitrust laws.
- Cooperative mergers with non-cooperatives, limiting production, full supply contracts and cooperative monopolies fall into a gray area -- Section 1 exemption is contingent upon the absence of anticompetitive effects.

What Constitutes Undue Price Enhancement?

Proscription of undue price enhancement is unique to the cooperative form of business. An interpretation of the term is not available through the courts. Some standard is necessary to distinguish "due" from "undue." At a minimum, the Capper-Volstead Act was designed to create a balancing of market power between producers and proprietary marketing firms -- to raise prices to at least the competitive equilibrium in economic jargon. Was it designed to do more? Was it designed to give cooperatives more than countervailing power?

Clearly cooperatives were thought of as a potential substitute for farm program assistance in the form of price and income support or inventory management. Just as clearly, the Capper-Volstead exemption was not designed to foster consumer exploitation. The dividing line warrants clearer definition than currently exists. Continued growth, whether through intercooperative mergers, federations or joint ventures with non-cooperatives, will intensify public antitrust concerns regarding undue enhancement. If major issues relating to the secretary of agriculture's enforcement of Section 2 are not resolved, then all antitrust enforcement responsibility may be transferred to either the FTC or DOJ.

Should Further Incentives Be Given to Bargaining Cooperatives?

Under Capper-Volstead, farmers are permitted to bargain collectively as cooperative members on terms of trade for their products. The key issues revolve around rules that affect bargaining associations' ability to organize and to manage supplies to influence trade terms. Five issues appear to be most important:

- *Procedures for dealing with discrimination against farmers who participate in collective bargaining activity.* Farmers allege that handlers often discriminate against those who actively participate in bargaining, making it difficult to form effective associations. The Agricultural Fair Practices Act makes such discrimination illegal but has been ineffective.
- *Rules about the obligations of all growers in a designated group, whether members of an association or not, to participate in bargaining and the sharing of costs.* This is a free rider problem similar to the issue of an agency shop in union bargaining. Association members argue that as long as they incur costs for arriving at terms of trade, and nonmembers can benefit without joining, the effectiveness of the bargaining association is unfairly undermined.
- *Rules relating to open or closed membership and limits on quantity accepted by bargaining cooperatives.* Bargaining cooperatives might be in a position to achieve monopolistic trade terms if they could significantly influence total supply of a product. Cooperatives with open membership would not be in a position to control supply.
- *Rules about the obligation of processing cooperatives to bargain with bargaining cooperatives and share the costs.* Members of processing cooperatives frequently avoid the cost of bargaining while benefiting from price determinations provided by bargaining. Exemption from the obligation to bargain is claimed on the grounds that cooperative members cannot bargain with themselves. Many bargaining association members see this as an unfair free ride. Proprietary processors also consider it unfair -- when bargaining with cooperative processors who are exempt from the obligation, they face costs and obligations not imposed on their competition.
- *Rules determining the scope of the bargaining association.* A bargaining cooperative's effectiveness generally improves as its control over total supply of a commodity increases. Thus federal legislation is preferred to state legislation by those who seek regulatory assistance for cooperative bargaining.

How Much Public Support Should Be Provided Cooperatives?

Cooperation among farmers is not a naturally occurring phenomenon. The need for cooperation is frequently not recognized and preserved from generation to generation. Cooperative solutions to problems are not intuitively obvious to farmers whose expertise is in production rather than marketing.

The danger is ever present that a cooperative board of directors may be controlled or misguided by a manager who is more concerned about personal interests than members' interests.

Does the public sector have any special role in fostering and preserving an effective cooperative structure? The ACS is the focal point for cooperative research and education. Extension and the land grant university system represent important cooperating agencies in carrying out this mission. Proprietary firms consistently question public policies that single out cooperatives for special forms of assistance. Farmer and cooperative needs are frequently prevented from being openly discussed by managers and directors who favor status quo strategies.

Should Programs Be Modified?

In appraising the social desirability of cooperative policy alternatives relative to the status quo, our purpose is to identify alternatives and their potential consequences.

Specify Cooperative Qualification Standards

Section 1 of the Capper-Volstead Act specifies eligibility requirements for an agricultural marketing cooperative, but these requirements are not especially stringent. They place no restrictions on which producers may become members, what activities cooperatives can engage in or what arrangements cooperatives might pursue with non-cooperatives. USDA could develop specific qualification standards that prescribe rules of conduct in terms of generally accepted cooperative principles. Ideally, the rules would specify the department's position on such matters as acceptable farmer and grower membership characteristics; cooperative joint ventures, conglomeration and involvement in businesses that are only tangentially related to food marketing; representativeness of boards or directors; and membership control. USDA support and recognition for special treatment would be limited to cooperatives meeting the standards.

Transfer Enforcement Responsibility

An alternative suggested by the Commission to Review the Antitrust Laws and Procedures is to place Section 2 enforcement responsibility with the FTC or the DOJ, which would require a Capper-Volstead amendment. This would erase any possible conflict of interest inherent in USDA enforcement. However, enforcement by FTC or DOJ would likely be less than sympathetic to the producer interest. The legislative history of Capper-Volstead suggests that responsibility for Section 2 was placed in agriculture because Congress believed that a broad understanding of agricultural markets and cooperative principles was necessary to enforce it properly.

Expand USDA Surveillance

Another alternative involves expanded systematic enforcement of cooperative activities within USDA. An autonomous agency attached to the secretary's office and answerable only to him would help assure systematic and rigorous USDA enforcement of the Capper-Volstead Act. A full-time legal and economic staff would be needed to carry out this authority.

The agency's initial responsibility would be to develop guidelines for evidence of monopolization, restraint of trade and undue price enhancement. These could be written in conjunction with cooperative qualification standards. The agency's responsibilities would include monitoring cooperative activity for evidence of violations, determining when complaints should be served and preparing materials for subsequent administrative proceedings.

Establishing such an agency would serve notice that USDA is committed to retaining its enforcement authority and might increase public confidence both in the department and in cooperatives. Such an initiative would run counter to current deregulation initiatives, and some cooperatives would object to the added regulatory burden. However, most cooperatives, having little or no means of obtaining substantial market power, would be unaffected.

Increase Bargaining Support

Increased support for cooperative bargaining might be accomplished either by strengthening cooperative provisions, curbing unfair or discriminatory practices against farmer members or by exclusive agency bargaining. The Agricultural Fair Practices Act could be strengthened by:

- authorizing the secretary to investigate discrimination, on the submission of probable cause, and permitting a farmer or association to sue for civil damages resulting from discrimination.
- providing a procedure for accrediting farmer bargaining associations and requiring buyers to bargain in good faith with accredited associations.
- prohibiting a handler from offering more favorable terms of trade to a farmer, who is not a member of the accredited association, than are offered to the association.
- providing for binding arbitration in case of impasse between an accredited association and a handler.

Exclusive agency bargaining could be accomplished by:

- defining bargaining units.
- accrediting farmer associations.
- requiring good faith bargaining.
- requiring that an accredited association would have exclusive rights to represent all those in a defined bargaining unit, members and nonmembers alike.
- requiring open membership and democratic member control of associations.

Such arrangements are most applicable to contract situations where the farmer does not own the product that is being produced, such as in poultry. In such situations the farmer is inherently in a vulnerable economic position with little or no ability to influence trade terms.

Expand Research and Education Support

One of the keys to agriculture's success has been the environment within which farmers and agribusiness firms compete. As farm and cooperative enterprises expand, they should be able to internally support a larger research and educational program. Yet studies consistently indicate that cooperatives lag behind the corporate sector in support for research. The need for education in the cooperative system is much greater than in corporate agriculture.

If public research and education on cooperatives were eliminated, the strongest cooperatives would likely survive and continue to prosper. Cooperatives that face major adjustment problems would find survival more difficult without public sector assistance to provide direction for change. Fewer new cooperatives would be formed.

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Texas Agricultural Extension Service

Trade Practice Regulation

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Over the years, the U.S. Department of Agriculture (USDA) has been assigned responsibility for several laws which regulate trade practices in markets for farm products. This paper analyzes three types of trade practices regulated by seven laws (Table 1). Most of these laws were enacted in the 1920s and 1930s.

Antitrust and Unfair Trade Practice Regulation

Four laws were designed specifically to deal with potential antitrust problems in agricultural markets:

- Packers and Stockyards Act (P&S)
- Commodity Futures Trading Commission Act (CFTC)
- Capper-Volstead Act (C-V)
- Federal Seed Act (FSA).

The Packers and Stockyards Act was enacted in response to a concentration of economic power in livestock markets that developed in the late 1800s. Meat packers -- referred to as "beef trusts" -- divided markets, allocated purchases among competitors and conspired to set prices in both the livestock and wholesale meat trade. Title II of the P&S prohibits discriminatory, collusive or monopolistic practices by meat packers when the effect harms a person, restrains trade, manipulates price or creates a monopoly. Title III regulates stockyards by authorizing the licensing of marketing agents and dealers as

Table 1. Statutory intent of the major agricultural trade practice laws.

Intent	P&S[1]	PACA[2]	C-V[3]	AFPA[4]	CFTC[5]	USWA[6]	FSA[7]
Reduce concentrations of power, collusive behavior and eliminate unfair practices.	✔	✔	✔		✔		✔
Increase producer bargaining power.			✔	✔			
Assure prompt and full payment for products marketed.	✔	✔				✔	

[1]Packers and Stockyards Act (P&S)
[2]Perishable Agricultural Commodities Act (PACA)
[3]Capper-Volstead Act (C-V)
[4]Agricultural Fair Practices Act (AFPA)
[5]Commodity Futures Trading Commission Act (CFTC)
[6]U.S. Warehousing Act (USWA)
[7]Federal Seed Act (FSA)

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well as establishing rules that foster more competitive market conditions and fair trade practices. The Packers and Stockyards Act gives the secretary of agriculture the power to regulate poultry markets in addition to livestock markets.

The Commodity Futures Trading Commission Act was designed to curb such anti-competitive behaviors in the futures market as market squeezes, corners and manipulations. Initially, the authority for futures market regulation rested with the secretary of agriculture, but in 1974, CFTC was made an independent regulatory agency. This move partially reflected the inherent conflict between futures trading in agricultural commodities and the traditional role of USDA in supporting farm prices and helping expand markets for farm products. In addition, the types of items traded in the futures market have expanded to also include nonagricultural transactions.

The Capper-Volstead Act provides a public protection against undue price enhancement by cooperatives. This restricts the potential ability of dominant cooperatives to control enough of the supply of a commodity to raise prices above a competitive market price. Section 1 of the C-V Act gives farmers and their cooperatives virtually unlimited right to join together in cooperatives or associations.

The Federal Seed Act imposes truth-in-labeling regulations on seed moving in interstate commerce. It requires that labels contain certain facts about the seed, forbids false advertising of seed and sets standards for imported and certified seed.

Bargaining Power for Farmers

If farmers received the same or similar organizational rights as labor, processors would be required to bargain in good faith with bargaining organizations that represent agricultural producers. As contracts between processors and growers have been used more, producers have become more interested in rules to encourage good faith bargaining. The main laws affecting producer bargaining are those affecting farmers' rights to organize cooperatives.

The Capper-Volstead Act gave marketing cooperatives the right to organize even to the extent of creating a monopoly. However, the act does not allow cooperatives to use illegal competitive tactics, such as predatory practices and collusion with non-cooperative companies, nor to unduly enhance prices.

The Agricultural Fair Practices Act (AFPA) was intended to prevent discrimination against producers by buyers or members of cooperatives and bargaining organizations. Discriminatory practices include paying producers different prices for the same products, charging different fees for services or using different methods of determining product quality.

Prompt and Full-Pay Provisions

A persistent problem in farm product markets has been failure by marketing firms to pay producers promptly. In addition, producers frequently have had little or no assurance that they would be paid in full because of the poor financial condition of buyers. Under bankruptcy law, a farmer who sells produce to a buyer and does not receive full payment is treated as an unsecured creditor. The producer and other unsecured creditors must share what assets remain after the claims of secured creditors are settled. Three laws deal with the prompt and full-pay problem in quite different ways -- the Perishable Agricultural Commodities Act, the U.S. Warehouse Act and the Packers and Stockyards Act.

The Perishable Agricultural Commodities Act (PACA) made possible long-distance marketing of fresh fruits and vegetables by providing a central system for arbitration of disputes about the quality of perishable products. PACA basically establishes a code of conduct making it unlawful for a merchant, dealer or broker to use unfair, discriminatory or deceptive practices; reject delivery or fail to deliver in accordance with the terms of a contract; destroy products received; or make false or misleading statements about a transaction. While this may sound like an antitrust-unfair practices law, the most typical case under PACA involves failure to pay promptly because of disputes about product quality.

The U.S. Warehousing Act's (USWA) jurisdiction is limited to warehouses licensed under the USWA or approved for storage of Commodity Credit Corporation owned or "loaned" commodities. Warehouse receipts issued under the USWA are uniform, dependable and acceptable in financial circles for loans. Surveillance, through unannounced comprehensive warehouse examinations, is used to enforce the USWA. The act provides an assurance of prompt and full payment for agricultural commodities in storage but does not regulate merchandising operations of buyers.

The Packers and Stockyards Act includes several provisions to assure prompt and full payment. It requires payment by check or electronic funds transfer within 24 hours of purchase; it grants USDA the power to revoke licenses; and it creates a trust that, in effect, gives livestock producers priority over secured and unsecured creditors of the buyer in the event of bankruptcy. This approach is also used in fruits and vegetables and has been suggested for grain and cotton.

The Current Programs

The current regulatory emphasis under each of the seven laws reflects the evolution of regulatory

activity, the industry structure and its problems.

Antitrust and Unfair Trade Practice Regulation

USDA's regulatory thrust in enforcing the Packers and Stockyards Act has consisted largely of responding to charges by complaintants. In fact, it would appear that P&S antitrust surveillance and enforcement activities are largely dormant with few resources devoted to this function at a time when structure issues are very important. Antitrust enforcement focuses mostly on unfair trade practice regulation, commercial bribery and discriminatory advertising.

Considerable question exists regarding the viability of the P&S antitrust enforcement program. While major changes have occurred in the structure of the livestock, meat and poultry industries, P&S administrators have done little but study these changes. Efforts to regulate the broiler industry were stifled by legal questions regarding USDA authority under P&S to regulate anything but "live" poultry markets. Recent trends of acquisitions, consolidations and integration of beef, pork, and sheep slaughter capacity deserves careful analysis by P&S. At a minimum, P&S should be in a position to provide concise information on structural developments and their economic implications.

The focus of CFTC regulation is establishment of markets and trading rules, and enforcement of those rules. Nearly 50 percent of its resources are devoted to these activities. On the other hand, only 7 percent of its resources are devoted to a surveillance unit, which monitors day-to-day performance for manipulation, corners, squeezes and other violations. In effect, the surveillance function is the policeman on the beat for CFTC. It appears a reexamination of priorities regarding the relative importance of surveillance is in order.

While the USDA has investigated allegations of undue price enhancement by cooperatives, it has not found any violations in more than 60 years. However, because USDA has never explicitly defined undue enhancement, it may not have known what it was looking for. Alternatively, there may never have been undue enhancement or the USDA may have been protecting cooperative interests. While a monitoring unit has been proposed to handle Capper-Volstead enforcement responsibilities within USDA, it has never been established.

Emphasis in the FSA program is placed upon complementing whatever seed inspection programs exist at the state level. USDA appears to hesitate in prosecuting "main line" seed companies for violations of the Federal Seed Act. It has been recommended by the Agricultural Marketing Service that the Federal Seed Act be repealed, but no action has been taken.

Bargaining Power For Farmers

The Agricultural Fair Practices Act, while enacted with good intentions, became so watered down in the legislative process that it is largely an inactive and ineffective piece of legislation. Changes proposed to improve the law have not received serious consideration by either USDA or Congress.

Without question, the most important source of bargaining strength for farmers lies in the Capper-Volstead Act. Through court interpretation, Capper-Volstead has given cooperatives virtually unlimited authority to merge -- even to the extent of monopoly influence, as long as the monopoly is not accomplished by predatory means. If cooperatives develop monopoly power and substantially raise prices, they can be challenged by the secretary of agriculture; however, there has never been such a challenge.

Prompt and Full Pay

The key to assurance of prompt and full pay under PACA is the immediate arbitration process and the threat of license revocation for nonpayment. Bonding requirements for firms are generally limited to those with a history of slow pay. This has not provided adequate protection in the event of insolvency. As a result, legislation similar to the protection accorded livestock producers has been proposed for producers of perishable agricultural products.

The U.S. Warehousing Act regulates approximately 54 percent of commercial cotton storage capacity (70 percent of output) and 43 percent of grain storage capacity (30 percent of output). Only commodities in storage are covered by the USWA. Enforcement activities consist primarily of periodic unannounced audits.

Most bankrupt grain and cotton operations have failed because of the effects of speculation and inadequate hedging on their merchandising operation. Farmers receive no prompt and full pay protection for "cash" sales to merchants of storable commodities. Thus, increasingly popular "call" or "delayed pricing" contracts are not regulated. Such contracts are an extension of unsecured credit by the farmer-producer. No action has been taken to extend successful prompt and full pay regulation used in livestock and fruits and vegetables to grain.

Provisions in the Packers and Stockyards Act which changed claim priorities in the event of bankruptcy have become increasingly important in protecting livestock producers against losses. Claims in fruits and vegetables have greatly exceeded expectations with good results.

What the Programs Have Accomplished

The accomplishments of marketing regulation appear to have waned as industry structure, technology and market procedures have changed. An exception is the new protection of prompt and full pay programs created under the Packers and Stockyards Act and the Perishable Agricultural Commodities Act.

Antitrust and Unfair Trade Practice Regulation

The Packers and Stockyards Act played an important role in eliminating unfair trade practices and thereby ensuring more competitive markets for livestock during a period dominated by central livestock markets. The result was more efficient market operation and a redistribution of benefits toward farmers. P&S has not dealt as effectively with more recent developments, such as packer concentration, vertical integration, pricing problems in wholesale markets or increased concentration of procurement in live cattle markets (particularly outside of major production areas). It has become a sterile agency in terms of structure regulation.

The regulatory scope of the Commodity Futures Trading Commission has broadened considerably as futures markets expand to encompass more agricultural and nonagricultural commodities. As a result, the Commission has facilitated the ability of both buyers and sellers to hedge an ever larger number of commodities. Unfair practices and market abuses have been reduced. Yet, questions remain about market manipulation by major market intermediaries because of their size, market position and superior market information. Little attention has been given to these issues.

Capper-Volstead regulation of undue price enhancement has been essentially nonexistent. Prosecution has been left mostly to the Antitrust Division of the Department of Justice and the Federal Trade Commission. Substantial evidence exists that the secretary of agriculture has not carried out Capper-Volstead enforcement responsibilities.

The Federal Seed Act has provided a broader base for more uniform regulation of the quality and identity of seeds. However, regulation is spotty and tends to avoid conflict with major seed suppliers. Such a strategy reduces the effectiveness of regulation in states where agriculture is less important and provides a lower level of protection to home gardeners. The need for this regulation is in doubt.

Producer Bargaining Power

For commodities such as milk, processed fruits and processed vegetables, the Capper-Volstead Act (in conjunction with marketing orders) has substantially helped farmers gain more marketing power. Similar benefits have not occurred for contract growers as a result of the Agricultural Fair Practices Act. AFPA cases are now nonexistent, mainly because of adverse legal decisions.

Prompt and Full Payment

The U.S. Warehousing Act offers little protection because it lacks full commodity coverage. Its coverage of warehouse capacity is limited and its coverage of commodities is restricted to those actually in storage. Thus, it omits protection for merchandising activities. As a result, grain and cotton producers tend to look to new forms of protection, like that afforded by the P&S and PACA. Provisions for storable commodity produce (grain) have been added to the bankruptcy act to provide priority for farmer-sellers if the elevator goes bankrupt.

The Key Issues

This performance assessment raises the following key issues:

- Is it possible for the USDA to effectively carry out antitrust regulatory functions? The USDA record on P&S Title II and C-V undue enhancement is not good. Questions exist regarding USDA's resolve to enforce regulations, in part because of conflicts of interest between regulatory programs and other departmental programs and activities. The legislative history of commodity exchange regulation clearly shows that Congress recognized this conflict of interest in futures regulation by creating an independent agency. Could steps be undertaken to assure greater independence within USDA?
- Should USDA have a uniform, comprehensive prompt and full payment policy? The prompt and full payment provisions of Packers and Stockyards and PACA appear to be working reasonably well. The Warehousing Act represents a different problem because of its exclusion of commodity merchandising operations.
- What changes are needed in regulations to deal with contractual arrangements? Neither Packers and Stockyards, Perishable Commodities, Fair Practices nor the Warehousing Act deal effectively with contract agriculture.
- Should regulatory programs be made more self-financing and more self-enforcing? The question is particularly relevant to Packers and Stockyards, Title III (stockyards), the Warehousing Act, Seed Act, Futures Trading Commission and possibly Capper-Volstead.

Should the Programs be Modified?

Intensify Antitrust and Unfair Trade Practice Enforcement

Intensifying antitrust and unfair trade practice enforcement implies changes in the Packers and Stockyards, Capper-Volstead and Fair Practices Acts, and the Commodity Futures Trading Commission.

For Packers and Stockyards, intensification would require a substantial shift and augmentation of resources to Title II enforcement. In addition, an evaluation is needed of why grade and weight sales methods have failed to capture a significant market share. Grade and yield sales of hogs have been hampered by the multiplicity of incomparable private grades and a variety of methods for calculating the carcass price. In Denmark, a combination of electronic scale and backfat measurement are used uniformly to measure leanness, with payments made accordingly. It is questionable whether such actions would stabilize or reduce strong industry trends toward a concentrated-integrated livestock marketing system. Intensified enforcement and pricing system changes could help maintain an open, competitive market for farm products and thus aid the survival of small-scale farmer-feeders.

More intensive enforcement of Capper-Volstead would require defining the concept of undue price enhancement, assigning enforcement responsibilities to a regulatory agency such as the Agricultrual Marketing Service and maintaining the economic expertise needed to analyze possible undue enhancement cases. The greatest benefit would accrue to cooperatives who regularly serve the public interest, consumers and agribusiness firms.

The Agricultural Fair Practices Act would need strengthening to make it an effective policy tool for curbing unfair and discriminatory practices against farmers and their cooperatives. This would expand the authority of USDA to conduct investigations and prosecute violations. It would also clarify the intent of the Fair Practices Act.

The Commodity Futures Trading Commission needs to increase its resource commitment to surveillance activities. Its concern for industry conduct and performance would expand beyond simply intensifying trade practice detection and enforcement activity. It could, in addition, investigate structural problems and advise the Department of Justice on antitrust action that might be taken to develop more competitive structures and patterns of conduct.

Remove Antitrust Regulatory Responsibilities from USDA

To overcome possible USDA inhibitions about enforcing antitrust and unfair trade practice laws, this responsibility could be removed from the USDA entirely. This presumably would involve transferring the job to another agencey, such as the Federal Trade Commission or the Department of Justice. Regarding Packers and Stockyards, the statute just might be repealed. Regulation of livestock, poultry and meat markets would then fall exclusively under general antitrust laws. This would clarify, for example, who has responsibility for monitoring competitive conditions in the meat industry. On the other hand, USDA clearly has the greatest expertise on the structure and operations of the livestock and poultry industries.

Broaden Prompt and Full Pay Coverage

A number of alternatives exist for dealing with the prompt and full pay issue.

- All buyers could be required to provide the seller with a cashiers check, certified check or electronic funds transfer upon delivery. If unable to provide assured payment, the buyer would at once give the seller solvency information. This alternative would not protect producers who have products in storage or those who sell on contract. Farmers whose products are covered by warehouse receipts generally do not have problems securing return of goods. Farmers who sell on delayed pricing contracts can secure themselves by taking a Purchase Money Security Interest in the product sold under these contracts.
- A federal or state assured payment program could be established to cover financial losses resulting from bankruptcy. Such insurance could be mandatory, or voluntary where producers who desire it could pay a premium. If mandatory, it could be financed by merchant license fees, by a checkoff from the producers' price or by the government.
- Producers could be given preferential treatment in bankruptcy proceedings. This procedure has been effectively used in Packers and Stockyards and PACA cases. However, it could undermine bankruptcy laws. It also could lead to higher interest rates on marketing firm loans, the cost of which likely would be passed on to farmers.
- The Warehousing Act could be strengthened to provide review and protection for merchandising and all storage activities. States could also be encouraged to adopt comparable procedures.

Extend Regulation to Contract Agriculture

Current market regulations did not envision an agriculture that involved significant contract trading. The exception is the Agricultural Fair Practices Act, which has been demonstrably ineffective. Major

areas where contract coverage is questionable include Packers and Stockyards in livestock and poultry, the Perishable Commodities Act in fruits and vegetables, and the Warehousing Act in grains and cotton. If regulation of contract agriculture is determined to be unwarranted, at least contracting buyers could be required to clearly advise producers of their legal status. Such an advisory should include the nature of the transaction; each party's rights, duties and obligations under the contract; and a signature indicating producer understanding. To avoid arrangements becoming laboriously legalistic, USDA could be charged with developing acceptable model statements.

Self-Financing and Self-Regulation

Concerns about the cost of government programs and the increasing number of large-scale farmers raise the possibility of farmers and marketing firms either paying for the cost of regulation or regulating themselves. Self-financing through user fees is being adopted more frequently for service programs. In the case of regulatory programs, user fees increase the risk that those who pay the cost of regulation will have undue influence on the nature and extent of regulation. Self-regulation has the greatest potential when it is in the collective interest of the industry. It does not work well when conflicts of interest are involved (farmer bargaining power) between buyers and sellers. Of the four general areas examined, self-regulation probably has the most potential for truth in trading. Self-regulation of antitrust would clearly not work.

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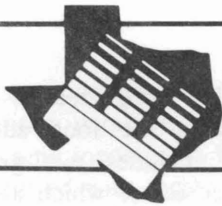

Texas Agricultural Extension Service

Assessment of Food Safety Programs and Federal Policy Options

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Safe food supplies are desired by consumers, producers and food processors. Safe means the absence of risk or hazard. Absolute safety is probably too costly to achieve in most areas of our lives. Rather, there is a cost-benefit trade-off between safety and some acceptable level of risk.

Determination of "safe" food does not necessarily imply zero risk but rather a personal and societal judgement about the level of acceptable risk. The basic economic problem in food safety is one of balance between acceptable risk in our food supply, in terms of health consequences, and cost.

The health hazard or safety of a particular food item is expensive and nearly impossible for an individual to determine. The major reasons for government intervention in the area of food safety are the high costs of individual consumer information, destroyed products and health care due to morbidity and mortality resulting from ingestion of unsafe food. Government regulations and agencies, rather than individual consumers, must determine, measure and monitor food supplies for level of hazard or safety.

Current Food Safety Legislation and Programs

The intent of major food safety legislation generally is to regulate food processing to prevent adulteration, protect public health, prevent degradation of food products over time and promote truthful labeling and information about food product ingredients. Thousands of specific regulations have been issued to accomplish the broad legislative intent. Some of the initial legislation was passed early in this century.

Early Legislation

In 1906 Congress passed the Pure Food Act and in 1907 the Meat Inspection Act, both as a response in part to publication of Upton Sinclair's *The Jungle.* The book detailed unsanitary conditions in the nation's major meatpacking houses.

Though these early laws represented a policy breakthrough, they were weak compared to current food and drug laws. For example, drug provisions were restricted to prohibitions against misbranding (specifically false and misleading claims). In disputes, the burden of proof was on the government, not food manufacturers using the drug or those producing the drug.

Federal Food, Drug and Cosmetic Act (FFDCA)

In 1938, the current foundation of food safety legislation was passed in the form of the Federal Food, Drug and Cosmetic Act. The Act contains provisions relating to food and animal feed and to human and animal drugs. It also defines adulteration and conditions of contamination of food by other substances. According to Section 402 of the Federal Food, Drug and Cosmetic Act as ammended, food is adulterated if it contains substances potentially injurious to health; any added poisonous or deleterious substance; any unprocessed agricultural commodity with unsafe pesticide residues; or any filthy, putrid or decomposed substances. In addition, the legislation covers any food prepared, packed or held under unsanitary conditions; the product of a diseased animal or one that died other than by slaughter; unsafe packaging materials; radiation; and confectionery products.

The Act prohibits adulterated or misbranded products in interstate commerce. It provides the Food and Drug Administration (FDA) with power to

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inspect products and establishments to monitor compliance with the law. Among other powers, FDA has authority to establish tolerance levels for contaminants and to mandate safety testing prior to licensing a product for distribution by company. FDA may require a product's withdrawal from the market if evidence indicates lack of safety. If violators are found, FDA can take various actions, ranging from warnings, product recall and publicity to recommendations to the Justice Department for legal action. State laws regulating food products in intrastate commerce are often not as rigorous.

Important amendments have expanded food safety law over the years. The cumulative body of food safety laws are: the Food, Drug and Cosmetic Act (FDCA), Meat Inspection Act, Poultry Products Inspection Act and the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA). These laws contain provisions concerning eight categories of food substances: 1) food additives, 2) color additives, 3) animal feed and drug additives, 4) pesticide residues, 5) food substances generally recognized as safe (GRAS), 6) prior sanctioned substances, 7) naturally occurring substances, and 8) environmental contaminants.

Along with the eight categories of food substances, the law prescribes five safety standards. Safety standards define when a substance should be prohibited and rules for licensing.

In 1958, 1960, 1962 and 1967, important amendments expanded the original Food, Drug and Cosmetic Act. Several of these amendments have important implications for food safety.

The 1958 Food Additives Amendment

The 1958 amendment requires that any substance added to food must be proven safe by the manufacturer. This law, in terms of food additives, is similar to the Food, Drug and Cosmetic Act for prescription drugs. It shifts the burden of proof of safety from government to private industry. In a sense, the amendment legitimizes the role of chemical technology in producing and processing food. Included are intended additives, natural and synthetic additives and elements of packaging which may become part of food.

Exemptions from 1958 Amendment

The 1958 amendment also defines exemptions. Not included under the definition of food additives are substances which accidentally enter or become part of the food supply. Accidental additives include environmental contaminants and some cleaning solutions. These may be permitted in food, despite classification as poisonous or deleterious substances, if occurrence is below specified tolerance levels.

Those substances "generally recognized as safe" (GRAS) are also exempt from the food additive amendment. The category includes two groups. Some fall under a grandfather clause which accords GRAS status to substances commonly used in food before January 1, 1958. GRAS substances not grandfathered require expert evaluation of scientific records for confirmation of safety.

Pesticide chemicals which contaminate unprocessed agricultural products, primarily fresh fruits and vegetables, do not conform to the food additive amendment. They are exempted under the general adulteration portion of the Act unless they occur in quantities above tolerances set by the Environmental Protection Agency.

The Delaney Clause

A clause added to the 1958 Food Additive Amendment states that no additive is safe if found to induce cancer when ingested by man or animal, or if found, after appropriate tests, to induce cancer in man or animal. This simple clause is known as the Delaney Amendment. Ironically, the controversy surrounding this clause exceeds its actual use. It rarely has been applied in food safety decisions although the influence of Delaney is considerable. Even if the Delaney clause were eliminated, it appears enforcement would not change materially.

A 1960 Color Additives Amendment contained a second statement of the Delaney Clause, pertaining to substances added to food to enhance color. Another amendment passed in 1962 also required that drugs be proven effective as well as safe. In addition to evidence of safety and efficacy, the law requires manufacturers to submit descriptions of manufacturing, processing and packaging procedures; proposed labeling; and proposed tolerance to FDA.

The section on animal drugs states that a drug inducing cancer but intended for use in animals may be approved under the condition of use specified. Also, the drug cannot adversely affect the animal for which it is intended and no residue of such drug may be found in any edible portion of such animals after slaughter.

Agency Structure

Agencies that administer federal programs for food safety include the:

- Food and Drug Administration of the Department of Health and Human Services
- U.S. Department of Agriculture
- Federal Trade Commission (FTC)
- Departments of Commerce and Interior
- Environmental Protection Agency (EPA)

In addition to these agencies, the Department of

Defense assumes responsibility for food safety for all military personnel. Even the State Department may become involved in food safey issues. This recently occurred with regard to DES and meat exports from the United States.

The U.S. Department of Agriculture has primary responsibility for inspection of red meats, poultry and egg products. The Environmental Protection Agency and FDA share responsibility for the inspection of fresh fruits and vegetables. The EPA sets standards on pesticide tolerance for fresh fruits and vegetables while FDA actually enforces the tolerances established by EPA.

What the Programs Have Accomplished

Food safety laws and regulations in the United States have achieved remarkable success in removing the "immediate" health risk from ingestion of food. Consumers may choose from a wide variety of food and be reasonably sure their next meal will not pose any serious threat to their health. Unfortunately, the effects of continually ingesting some foods, which contain substances at current legal levels, over long periods of time are still uncertain. From this standpoint, the food safety programs have been effective in reassuring consumers who, for the most part, feel they are protected. There are some, however, who feel skeptical about the level of protection.

Facilitating Marketing

Food safety programs regulate food additives and provide for inspection and enforcement. This assures all consumers that food meets or exceeds some level of safety. This assurance allows potential buyers, when making their purchase decisions, to concentrate on other product attributes such as nutritional value, appearance or convenience.

Food safey programs also sustain a lower-cost food distribution channel by alleviating wholesalers and retailers of the fear of reprisals for the sale of harmful products. Safety regulations also reduce information costs, allowing exchange of items without the necessity of buyers personally inspecting and testing individual products.

Redistributing Costs and Benefits

The costs and benefits of food safety regulations do not fall evenly on all consumers and business firms. However, it is difficult to determine the precise impacts on various income classes of consumers and sizes of business firms. For example, the 1967 Wholesome Meat Act imposed federal standards, which were higher than existing standards in most states, on all meat processing firms. It is believed this caused small-scale firms to suffer relatively more than large-scale firms because of higher compliance costs. Several small-scale firms are believed to have been forced out of business because of these increased compliance costs.

The cost of food safety programs to consumers is imprecise at best. If expenditures for inspection and enforcement are paid from general tax revenue, the costs are distributed in the same manner as the tax burden. However, not all the costs are borne directly by taxpayers; some costs are borne by food firms which pass them on to consumers in the form of higher prices for products. On balance, the distribution of costs probably falls more heavily on lower-income consumers than upon the more wealthy.

Another cost is the removal of food deemed unsafe for human consumption. By removing such products, safety programs prohibit consumers from trading off safety against price, assuming such food would be offered at lower prices. This diminished availability may, in the long-run, raise average food prices and have relatively more impact on low-income consumers. In this instance, benefits have to be weighed against costs.

Government regulation may require some food processors, especially smaller volume ones, to maintain a higher level of food safety in their products than they would without regulation. This forces them into a narrower market segment, raising their costs without expanding demand for food. Large manufacturers typically exceed legally mandated safety levels. Processors probably experience significant economies of size in complying with regulation. Thus, when safety levels are imposed or increased over time, small volume processors are adversely affected more than large ones, which may lead to fewer but larger firms. This tends to concentrate processing over time within a few large companies.

The Key Issues

Evaluation of current food safety programs and procedures raises three key policy issues:

- framework for governmental decisions.
- definition of "safe" and public health.
- agency coordination and policy implementation.

Framework for Governmental Decisions

Some observers and analysts argue that food safety policy be based on risk/benefit assessment. This would involve judgemental decision-making about the trade-off between estimated hazard potential and the possible benefit of a particular food substance.

Scientists could theoretically measure risks associated with many different additives and contaminants. These risks are usually stated as some percent chance of one additional disease occurrence per 1,000

persons from use of particular substance. However, the translation of this risk into a cost, or value in the case of risk avoidance, either to society or to individuals, lacks precision.

Additional difficulty with the risk/benefit framework is encountered with valuing of human life. Lives and risks to life are not traded in conventional markets. No observations of various consumers' willingness to pay to avoid risk can be made. Thus, if risk/benefit calculations attempt to incorporate the value of human life, subjective judgments are necessary.

The core issue is whether or not an explicit accounting of positive and negative aspects of food additives should be attempted, given the acknowledged imprecision and subjectivity of such calculations. Some argue it is the only rational policy framework for decisions. Others argue that because the calculations would be imprecise and subjective, a decision framework should not depend on such methods.

Definition of "Safe" and Public Health

A legislative definition of safe has been an issue virtually since passage of the 1958 Delaney Amendment. The definition of safe is essentially a policy question and must be decided in the political arena.

The current Delaney Clause presumes that additives which prove to be carcinogenic in laboratory animals are not safe for human consumption. Tolerance or permissible levels of some additives would be permitted in the food supply if a legal restriction such as Delaney were absent. This would represent a significant shift in the current definition of safe. Some suggest changes in wording that would ban a substance when it is shown to be carcinogenic to humans, not just animals.

Agency Coordination and Policy Implementation

The current regulatory agency structure can lead to different treatment of identical risks and inconsistency in food additive classification -- both within agencies and across agencies. Some argue that agency responsibility should be changed sufficiently to produce simplified and uniform treatment of substances that have identical risks.

FDA and USDA coordination is a related issue. The problem is mostly one of improving the consistency of regulations affecting processors and manufacturers, regardless of which federal agency has authority. Differing regulatory philosophies can vary from cooperation to policing. Increased coordination may accomplish more effective and efficient policy implementation.

Should Legislation and Programs Be Modified?

The issues raised suggest some broad alternatives to current food safety programs. The suggested alternatives, in no particular order, are:

- greater reliance on market forces to provide safe food supplies.
- extend coverage of the Delaney clause.
- shift legal and regulatory framework to acceptable risk.

Greater Reliance on the Market

This alternative abandons the Delaney Clause and allows market forces to operate more fully in the provision of various levels of food safety to consumers.

Some argue that the private sector could provide consumer information about the risks and relative safety of various products. No particular level of risk would be banned from the market by legislative or regulatory edict. Presumably, different levels of food safety would be available and consumers would be free to choose among them, given adequate information to do so.

Providing safety information to the consumer presents some difficulties, however. Would information originate from food product suppliers or independent sources? Could consumers believe information compiled by suppliers? Because of the suppliers' financial interest in their products, close inspection of their product information would be required. This could increase government regulation or the time consumers spend sifting through information.

Alternatively, an independent testing service, either public or private, could determine a product's risks to health or safety and supply this information to consumers. While such information might have more credibility, it also would require a system of sampling, testing and publication of results. The problem with this approach is that quality and safety of food products fluctuate greatly from item to item or even from day to day in production. The amount of information necessary would be vast. Meat, milk, fruits and vegetables sold by a single processor may come from hundreds of producers. The consumer is unlikely to find information about the average risk of a product very helpful.

A significant disadvantage in these situations is the burden placed on the consumer to process the information that is presented. Data about risks to health and safety are often difficult to understand without advanced training and experience in subjects such as toxicology, epidemiology and statistical inference. Even if such information were put in "layman's

language," it is doubtful that consumers could understand the health implications of their consumption. In addition to understanding the information, processing the information would be a considerable task. Weekly food purchases for a typical family include scores of items. Each item would need to be checked to verify that it presented an acceptable level of risk. The time and cost required to process the available information means many consumers would not regularly use the information. This could cause more frequent occurrence of adverse health effects, even deaths, with their attendant costs to individuals and society.

Individual consumers generally do not consider societal impacts of food risks. For example, certain types of food contamination may have unnoticeable effects for several years or generations, but then cause a seeming explosion of genetic disorders or other problems in the population. This "time bomb" effect would be difficult for most consumers to factor into price and other quality characteristics of a product. Also, the individual's preferences for incurring such risk may place a significant burden on society at a future time. It can be argued that decisions about acceptable food risks should be made only from a society-wide perspective, and resolved through the scientific and political decision process.

The advantage of this alternative is that it attempts to minimize public sector costs for food safety and maximize consumer choice. Private costs of processor compliance with government regulation could be reduced under this alternative. Individual consumer costs with regard to food safety would increase. Retail food prices, on the average, may be less if processor or distributor cost-savings from "deregulation" were passed on to consumers and if "less safe" but lower cost food were supplied at retail. Government or private firm costs of evaluating safety, monitoring food manufacturing and distribution, and disseminating information may not be reduced much from the current situation.

Extension of Delaney-Type Coverage

A second alternative to current food safety programs is to extend Delaney-type coverage to a wider range of health concerns, such as heart disease or high blood pressure, and broaden the extent of publicly funded information on food safety. A cornerstone of this alternative would be a total ban on additives suspected of carcinogenicity in man or animal. No risk/benefit framework would be part of this food safety policy.

The Delaney alternative would include increased public funding for toxicological and basic biological research. In addition, budgets for FDA, USDA and other agencies currently possessing regulatory responsibility would be increased. These agencies would bolster their monitoring activities and provide additional food safety information and regulation for consumers. Whatever regulations necessary would be implemented to move the available food supply as close as possible to zero risk in terms of public health consequences, both present and future, regardless of cost.

The costs of this alternative could be much higher than current food safety programs. The objective of this alternative would be to come as close as possible to providing the nation with food at zero risk. The burden of processing information and monitoring supplies would be placed mainly on government. Implementation would be through FDA, USDA and other appropriate agencies. Individual consumer costs for processing information likely would be less but public cost via taxes would be greater. Also, food prices would rise to the extent that processors and distributors pass on higher compliance costs to consumers.

Acceptable Risk Framework

The performance of the system now in place must be given high marks for effectiveness. Fine tuning current laws and agencies seems more appropriate than restarting implementation of food safety policy. This alternative would entail an *acceptable risk* framework for food safety decisions rather than a *zero risk* framework. Some food safety decisions already are made on the basis of risk/benefit calculations, but these are not really systematic and explicit.

This alternative would explicitly mandate a systematic risk/benefit approach to food safety regulations and policy decisions. This approach recognizes that most food safety decisions involve some risk to at least some people. There is no option that gives a truly zero level of risk. Shifting to the risk/benefit approach would keep consumers and governmental decision-makers aware of the risk involved. It would change the decision from "Is the product safe?" to "What is the acceptable level of risk and to whom?" Keeping the decision explicit would permit more realistic thinking about the risks and a constant realization that efforts should be made to reduce risks.

Current food safety laws and regulations would still hold except for the Delaney-zero risk objective. Established regulatory responsibilities would remain virtually unchanged. Mechanisms for this approach already exist within FDA and USDA, so actual implementation of this alternative would be simplified.

This framework is far from perfect. Particular cases would require judgements, especially where the

hazards and benefits cannot yet be measured in common terms. As previously mentioned, a significant unresolved issue is the appropriate method for evaluating risk to human life and health. Nor do we have the methodology to assess risk in all cases. The extent to which public and private costs of an alternative would be increased, as compared to the current system, is unknown.

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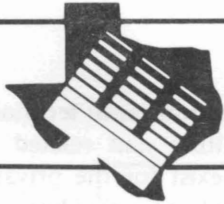

Texas Agricultural Extension Service

Agricultural Marketing Programs: Issues, Options and Strategies For Change

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Most of the federal agricultural marketing programs discussed in these leaflets were initiated in the first half of the 20th century. Since then, agriculture has changed tremendously and is moving rapidly toward an industrialized system like that of the rest of the economy. Strategies for updating and changing agricultural marketing programs are needed.

Economic changes have created more specialization and interdependence among participants in agricultural markets. This industrialization of agriculture has led to demands for new forms of coordination. For example, many trading arrangements have shifted from the spot market to the contract market, thus increasing interest in bargaining. Products purchased from farmers by contract must meet quality factors specified by buyers, who frequently modify official grades and standards. Consumers often desire that even more stringent standards be placed on food safety; that the composition of highly processed foods be identified; and that explicit nutrition information be provided.

As structural change occurs, support for marketing policy initiatives also changes. Large, complex corporations in the industrialized marketing system are less open to public scrutiny and more secretive about their operations. This is partly because these firms have more at stake. Because they have advanced information systems, they have fewer requirements for public information and therefore, are less concerned about cooperating to make public information systems accurate. Thus, the clientele makeup for marketing programs may gradually shift from large, commercial entities to less influencial market participants and the general public.

Adjustments in marketing programs are being made continuously in response to changing market structure, new market mechanisms and new demands on the food and fiber system. However, as demonstrated in this series of articles, these changes are just the tip of the industrialization iceberg. We need to prepare for even more radical change in the future. It is hoped these articles will foster thought about the evolving marketing system, how federal marketing programs must adjust and how desired changes may be sought.

The Key Issues

The authors have evaluated how well existing federal agricultural marketing programs meet four criteria identified by Breimyer.

- Does a program *facilitate market operations* or induce desirable changes in market structure?
- Does a program *eliminate unfair marketing practices* in order to protect weaker participants in the marketing system from abuse or exploitation?
- Does the program *improve technical* or *pricing efficiency* in marketing?
- Does the program *redistribute costs and benefits* borne by and received by market participants in an acceptable manner?

Using these criteria, the evaluations have identified a number of key issues associated with each program area (see Tables 1 and 2). While the programs cover a broad spectrum of marketing activities, the key issues are surprisingly similar in several programs.

For nearly two-thirds of the programs, questions have been raised about whether the program operates

This is one of a series of articles on *Federal Agricultural Marketing Programs* developed by your state Extension Service as a component of the Land Grant University System in cooperation with the Texas Agricultural Extension Service, the Farm Foundation, and the National Public Policy Education Committee.

in the public interest. This reflects increasing public concern about the industrialization of agriculture, public expectations regarding performance of the food system and conflicts between the public interest and special interests within agriculture. Public interest questions are, therefore, deeply rooted in several contemporary concerns regarding marketing programs -- perhaps the most deeply rooted of any of the key issues. Interest groups outside of agriculture are becoming more important constituents of marketing programs. Special interests within agriculture are *relatively* less important and *they sense it.*

Much of the concern about marketing programs and the public interest has arisen from doubt that the U.S. Department of Agriculture (USDA) is committed to regulating in the public interest. This question was raised about both regulatory programs and service programs such as advertising and promotion. The question reflects the fact that USDA is charged with regulating the very same industry that gives it political support. The origin of the issue lies in public expectations, conflicts of interest, the special interest nature of the political process and the reality that the secretary of agriculture is more responsible to the president than to agricultural clientele interests.

The private sector's ability to perform government functions was raised as a key issue for two-thirds of the programs. With structural and technological change occurring in agriculture and related industries, increased possibilities exist for the private sector to perform services such as providing market information, grading and advertising. In addition, questions arose about whether the evolution of larger cooperatives makes marketing orders unnecessary for some commodities and markets. The answers to these questions are not clear -- that is what makes them a public policy issue.

The need for mandatory compliance was identified as a priority concern in four service programs. For a number of commodities, marketing orders are used to gather information, require minimum grade standards, and fund. Refund provisions in some research and advertising checkoff programs remain controversial. Bargaining cooperatives would like a mandatory, good faith bargaining requirement for agriculture comparable to that for organized labor. Once again the root cause of these issues is largely one of structural change and reaction to competitive forces. For example, milk producers established the national milk promotion program to meet the competition of highly advertised products such as Coke, Maxwell House or Parkay. Conflicts of interest become apparent when firms decline to voluntarily provide information or allow their products to be graded.

Table 1. Key marketing policy issues by marketing program.

	Marketing Program								
Key Issue	Price reporting	Grading	Advertising	Fruit and vegetable marketing orders	Milk marketing orders	Cooperatives and bargaining	Trade practice regulation	Food safety	Number of programs
Is the program operating in the public interest?		✔		✔	✔	✔		✔	5
Is there a USDA commitment to regulate in the public interest?			✔	✔	✔	✔	✔	✔	6
Could the private sector perform this function?	✔	✔	✔	✔	✔				5
Should the program be mandatory?	✔	✔	✔			✔			4
Are costs greater than benefits?			✔	✔	✔			✔	4
What would be the consequences of deregulation or discontinuation?	✔			✔	✔		✔		4
Should the program be self-financing?	✔	✔					✔		3
Number of key issues	4	4	4	5	5	3	3	3	

Table 2. Contemporary concerns giving rise to the key issues.

Key Issue	Contemporary Concerns					Number of concerns
	Structural change	Trend toward deregulation	Public expectations	Conflicts of interest	Political process	
Is the program operating in the public interest?	✔		✔	✔	✔	4
Is there a USDA commitment to regulate in the public interest?			✔	✔	✔	3
Could the private sector perform this function?	✔		✔	✔		3
Should the program be mandatory?	✔			✔		2
Are costs greater than benefits?			✔	✔		2
What would be the consequences of deregulation or discontinuation?	✔	✔	✔			3
Should the program be self-financing?		✔			✔	2
Is the program outdated?	✔	✔				2
Number of key issues	5	3	5	5	3	

Cost-benefit comparisons are becoming more important for half the programs. While most people would be willing to admit some benefits from marketing orders, many suspect that offsetting consumer costs are higher. Many also recognize that advertising programs may expand demand, but possibly at the expense of consumption of other commodities. In food safety, the question is whether cost-benefit analysis has any role. Public expectations and conflicts of interest play a key part in making program cost-benefit analysis a viable issue. Yet, difficulty exists in quantifying benefits where public goods are involved.

The consequences of deregulation are receiving increased attention. Public interest advocates see deregulation as a means of removing what they believe are adverse impacts of programs such as marketing orders. Those who are regulated question how they would fare in a free market environment, particularly where regulations have helped shape the current industry structure and marketing system. For example, where marketing orders have helped maintain the number of producers, marked adjustment would occur if the orders were discontinued.

Self-financing is viewed as an alternative to deregulation because it reduces direct costs to taxpayers. While self-financing makes sense for service programs, it may adversely affect regulatory programs. For instance, if the Packers and Stockyards Act or meat inspection regulations were fully self-financing, would the integrity of the system be sacrificed? Would regulators be captives of the meat packers and auction markets?

It is argued some programs simply are outdated -- they no longer have a role in the public sector. These range from programs such as price reporting, in which the private sector might readily become more involved, to Packers and Stockyards regulation, where the industry has changed so radically that some current forms of regulation may no longer be needed, and to the Federal Seed Act which either needs to be strengthened or eliminated.

Table 3. Marketing policy alternatives by program area.

Marketing Policy Alternative	Marketing Program								Number of programs
	Price reporting	Grading	Advertising	Fruit and vegetable marketing orders	Milk marketing orders	Cooperatives and bargaining	Trade practice regulation	Food safety	
Regular program review and modernization	✔	✔	✔	✔	✔	✔	✔	✔	8
Deregulate or discontinue	✔			✔	✔		✔	✔	5
Increase supervision and enforcement			✔	✔	✔	✔	✔		5
Provide more services	✔	✔				✔	✔		4
Self finance	✔						✔	✔	3
Transfer function						✔	✔		2
Make mandatory	✔	✔							2
Apply risk/benefit criteria								✔	1

Policy Options

The policy options mirror the issues. They range from a return to an unimpeded market (deregulation) to even higher levels of control. Within this range, eight distinct policy options were identified and applied to different programs by the authors (Table 3).

Agricultural markets are changing so rapidly that continuous program review, evaluation and modernization is necessary just to keep pace. *Regular program review and modernization* was a policy alternative discussed for every program analyzed. In each program, the basis for this policy was relatively unique. Regarding market information there is a call for contract reporting, utilization of modern information technology and reporting of quantity in addition to price information. As for marketing orders, there is a need to provide greater recognition of the public interest as well as better adjustment to changes in the basic structure of industries involved. In the trade practice regulation area, there is a need to modernize the Packers and Stockyards Act and expand producer protection against marketing firm insolvency.

Deregulation or discontinuance of a program was identified as an option for more than half of the programs. This does not constitute an endorsement for such a strategy. In each case, this option can realistically be viewed as an extreme measure. However, if for some reason none of the other options are pursued, deregulation or discontinuance could become quite viable.

The need to *increase supervision and enforcement* of existing laws was also identified as an option for more than half of the programs. The public wants assurance that its interest is being reflected in marketing program administration. Operating programs in the public interest does not mean they would be operated to the detriment of producers. In fact, even-handed administration of marketing orders, advertising, trade practice regulation and cooperatives may well be crucial to the continuation of these programs.

The signal for marketing programs is not always one of cutting back. A substantial clientele would have government *provide more services* in areas such as price reporting, grading, trade practice regulation and cooperatives. However, many of the opportunities for increased marketing services are associated with potential conflicts of interest which, combined with budget constraints, have kept services from being initiated.

Many marketing programs, such as grading and marketing orders, are already *self-financing*. Others are regulatory in nature and would raise conflict of interest questions if they were made self-financing. Yet, there is continuing interest from some quarters in expanding the requirement for fees from

beneficiaries of government programs.

Questions about the USDA's ability to administer regulatory marketing programs have resulted in suggestions to *transfer functions* to another agency. The Packers and Stockyard Act and the Capper-Volstead undue enhancement regulations have been the primary targets of such suggestions, though the USDA has the greatest expertise to administer these programs. Nevertheless, programs have been transferred from USDA when lack of rigorous enforcement was suspected. An example is the creation of the Commodity Futures Trading Commission from the Commodity Exchange Authority, a USDA agency.

Despite the trend toward deregulation, arguments were made for *making two programs mandatory*. In an industrialized agriculture, the pricing system may function better with mandatory price reporting. Likewise, the use of official grades possibly should be mandatory, with uniform nomenclature.

The use of cost benefit analysis has become increasingly common as a tool in making public policy decisions. A variation of this procedure is the official use of *risk-benefit analysis* in making food safety decisions. This policy option may be a practical alternative to controversial Delaney-type zero tolerance approaches.

Changing Agricultural Marketing Programs

As agriculture becomes more industrialized, its need for marketing programs does not diminish. The need may be for a different type of program and may involve a different clientele, but it still exists. The problem is one of determining future needs, and following strategies to achieve necessary program changes. The ability to meet that challenge will determine the scope of future agricultural marketing programs.

Needed and desired program changes will not occur spontaneously. People must, and probably will, organize to seek these changes. What strategies might or can they take?

Sources of Agency Discretion

Marketing programs are products of a legislative struggle marked by deadlines, lack of detailed industry knowledge, uncertainty, competing interests and recognition of the need for administrative flexibility. As a result, the program mandates enacted by Congress are not self-executing nor explicitly directive. Operating objectives, implementation and how to balance various interests are subject to interpretation by agency administrators.

For example, Section 202a of the Packers and Stockyards Act declares that it is unlawful for meat packers to "engage in any unfair, unjustly discriminatory or deceptive practice or device." The meaning of "unfair," "deceptive" and similar terms is open to agency interpretation. Similarly, Section 2(2)(a) of the Agricultural Marketing Agreement Act requires the secretary of agriculture to "protect the interest of the consumer," while Section 2(1) charges the secretary with establishing parity prices for farmers. While the Act clearly requires a balancing of conflicting interests, the relative emphases are left open to the administrative process to determine.

The greater the number of objectives, the more conflicts with which an agency must deal. However, a broad agency mandate may not be matched adequately with appropriated resources. As a result, an agency must exercise discretion in ranking objectives and allocating attention to the most pressing problems.

The characteristic vagueness and broadness of program mandates, as well as the limited resources available for carrying them out, create three important sources of discretion for agencies:

- Agencies have discretion in interpreting program objectives and how statutory provisions apply in different cases.
- They have discretion in balancing competing interests.
- They have discretion in allocating effort.

The type and degree of discretion given to administrative agencies differ among marketing programs.

Programs designed to facilitate competitive, market-oriented agriculture include public price reporting, food and agricultural commodity grading and advertising. Changes in these programs can increase direct costs to taxpayers or market participants, depending on how the changes are financed. Thus, agency discretion is limited. If new services or program initiatives are sought, the agreement of those who would pay must be sought. However, these agencies can determine the effectiveness of their program services and impose some indirect costs on private parties, depending on how the agencies set standards.

Public interest protection programs include trade practice regulation and food safety programs. These programs can create indirect costs and benefits for certain classes of individuals. For example, trade practice and food safety regulations may cause higher production costs or foregone profit opportunities for some parties while giving other parties the benefits of new market opportunities, increased income, lower prices or increased product quality. Since such regulatory programs can redistribute wealth, the statutory language of their authorizing mandates is susceptible to negotiation during the legislative process. Consequently, the provisions of these mandates are often

broad and ambiguous, calling for substantial agency discretion.

Where the authorizing statute allows substantial agency discretion, agencies may change program emphases by issuing new regulations, adjudicating cases and redesigning program activities. As a result, the amount and distribution of indirect costs and benefits of these programs are likely to be the subject of struggle between affected industry segments as well as between different levels within the marketing system. For example, the stringency of marketing order regulations has variable effects on producers facing different production costs. It also affects benefits to producers relative to costs imposed on consumers.

It is important to understand the sources of agency discretion in order to determine how an agency's interpretation of its mandate may be changed. However, it is also important to realize that agency discretion is limited. Statutory language enacted by Congress determines what an agency must, may or may not do. Any change sought in an agency's interpretation of its mandate must be within these bounds. If the change exceeds these bounds, the appropriate avenue for seeking change in a marketing program is legislative or judicial.

Interest Groups

When programs and the agencies that implement them are created, external interests in the programs also are created. Some of these interests receive net benefits from a program while others incur net costs. Of course, the way an agency interprets its mandate affects the size and distribution of program benefits and costs. So any change sought in interpretation will also change those benefits and costs, and thus determine external support for and opposition to the program change.

Different patterns of support and opposition may occur for different programs and different issues within programs. The differences depend on the amount of benefits or costs that various parties expect from programs and the costs of organizing support for, or opposition to, policy changes among those parties. For example, if the parties that receive the benefits of a program are numerous and diverse, the benefits received by any one individual within the group may be relatively small. Furthermore, the larger the group receiving benefits, the more difficult it is for the group to organize support or opposition to policy changes. Members of a large group have an incentive to "ride free," hoping to receive a share of the benefits while letting others bear the burden of organizing. The interests of individuals within the group are likely to be heterogenous, leading to disagreements about what changes should be sought.

In contrast, if the group receiving program benefits is relatively small, the gains to individuals within the group are less diluted by the size of the group. Having more to gain, individuals in the group are less likely to "free ride." The interests of individuals in the group also are more likely to be similar. Consequently, organizing support for, or opposition to, policy changes is easier in smaller groups, and individuals are likely to commit greater resources to organization efforts.

The same principles apply to parties who bear the program costs. The larger the group, the smaller the proportion of total cost that is borne by any given individual. There is less incentive to organize and the costs of organizing are greater than those experienced by smaller, more concentrated groups.

Table 4 summarizes the differences that can occur in the external political structure surrounding different programs and issues. The table predicts the type of support and opposition that can be expected, depending on the way program costs and benefits are perceived by affected parties.

Each of these structures can be illustrated by different marketing programs. For example, the benefits of most market-facilitating programs are directed at a relatively well-defined group of agricultural interests, while the costs of these programs are spread out over a large number of taxpayers or passed through the marketing system indirectly to consumers. Thus, there is generally weak opposition to market-facilitating programs, but strong support for them.

Regulations which impose costs on, or obtain benefits for, a segment of the food industry do not uniformly affect agricultural interests. Relatively few firms might benefit. Other groups, which are also concentrated, see the benefits to the first segment as a cost to them. However, as in the case of bargaining legislation, change will occur slowly in the face of struggle between opposing, concentrated interests.

In contrast, some programs, such as those in food safety, provide indirect benefits diffused among many consumers and producers. Indirect costs, on the other hand, are imposed on a concentrated, smaller group of marketing participants. Increasing those benefits and costs results in weakly organized support and strongly organized opposition.

Although concentrated interests are more effective in marshaling support for or opposition to policy changes, weak groups still have an impact on policy choices. There are several strategies that groups with fewer political resources and less organized support can use to increase their effectiveness. They can conserve resources by standardizing responses to

Table 4. Reaction to program change, depending on perception of program costs and benefits.

Benefits \ Costs	Diffuse	Concentrated
Diffuse	isolated conflicts	strong opposition, weak support
Concentrated	weak opposition, strong support	opposing interests

objections from opposing groups. They can also raise objections which are costly for the other side to rebut or they can appeal to the press, which may "subsidize" the cost of lobbying for them. Furthermore, because the marginal impact of lobbying declines as lobbying activity increases, the political support within government for strong groups will likely peak or grow slowly.

Two important implications follow from this discussion of interest groups. First, different programs and issues evoke different patterns of support and opposition and therefore, require different strategies for seeking change. Second, the benefits received by some groups are limited by the opposition of other groups. The greater this opposition, the greater the limitation on gains. To effectively seek change within programs, the structure of external political pressures surrounding a program must be understood and anticipated. These structures not only include members of privately organized groups, but other agencies and bodies of government as well. Representatives of groups which stand to lose from program changes will try to thwart attempted changes. Groups who stand to gain must be made aware of the opportunity. The strength of these groups and the tactics they use determine how easy or difficult it may be to change the way an agency interprets its mandate.

Internal Characteristics of Agencies

Agency actions do not always perfectly mirror external interest group pressures, due to special characteristics of the decision-making mechanism employed in interpreting the agency mandate. Thus, the effectiveness of groups seeking program changes also depends on the rules which govern agency decisionmaking. Three basic types of decision mechanisms can be used, either individually or in some combination -- bargaining, voting and hierarchy.

Bargaining processes. These are typified by open forum debates, such as public comment procedures and hearings, where all affected parties provide input to program decisions. The final decision of the agency must be based on evidence produced in the forum. Participation in such forums may be expensive, incurring costs for travel and information collection. Consequently, it is difficult for unorganized, diffuse parties to participate or to be as effective as more organized groups. Interested individuals may participate, but their views are not likely to carry much weight unless they can demonstrate that their views represent those of a larger group -- often an expensive task.

When bargaining is the primary decision process, the outcome reflects the existing distribution of resources among market participants and the implied distributional consequences of the decision outlined in Table 4. The most organized groups are most influential but they do not necessarily achieve all their goals because the agency's mandate may require a balancing of interests. In other words, the winners' gains are limited by the opposition and the losers' losses are less than they would be if the agency favored only one group.

Voting mechanism. Agencies or programs which have elected officials, or officials appointed on the basis of representation, employ a form of voting mechanism. Direct voting by constituents in referenda also occurs in some programs such as marketing orders and advertising and promotion programs. Voting mechanisms assign decision-making authority in the form of nontransferable voting rights. Thus, most market-related resources are not relevant except insofar as lobbying influences voters. In this case, diffuse groups may prevail because they are larger than concentrated groups and because the cost of voting is less than the cost of organizing for bargaining. However, the extent to which they prevail depends on whether the cost of voting is less than the gain that individuals expect to receive. Then there is still the problem of informing voters of their potential gain. Furthermore, voting outcomes will depend on the type of ballot proposals presented to voters. These must be designed carefully, taking into account

heterogeneity of interests and the problem of meeting majority levels required for adoption.

Hierarchy system. The third type of decision mechanism is characterized by policy decisions in which public preferences may be overruled by other decision-making criteria. For example, the extent of economic impact or the health consequences of policy change may be the decision-making criteria required by a program mandate. In this case, objective or expert evidence provided in hearings may overrule the preferences of groups even if the groups are concentrated and well organized. Under the hierarchy decision process, expert knowledge and formal position within the agency administering the program are the basis of decision authority. In its pure form, preferences of authorities and experts are substituted for preferences of private sector participants. However, as with bargaining mechanisms, influence is not equally distributed among decision-making participants. Groups which can develop expert information relevant to an agency's decision-making criteria may have greater influence than those which can not.

Most programs involve more than one of the three decision mechanisms, so each must be considered in determining how to seek change in an agency's interpretation of its mandate. Different types of resources are important in the different decision-making processes. Groups who seek change must possess those resources.

Strategies for Change

Formulating a strategy for change requires finding a receptive route and anticipating the source and strength of resistance.

Step 1. Examine whether the change that is sought is consistent with the existing mandate of the program or whether new authorization by Congress is necessary. An agency's discretion is limited by its authorizing act and other related statutes, such as the Administrative Procedures Act, so these must be examined. For example, expending effort to improve price reports or to evaluate the effectiveness of advertising is certainly in line with existing mandates to provide market-facilitating programs. Similarly, reexamining both the grades and standards programs and the approaches used under marketing orders is feasible. On the other hand, changing the orientation of food safety laws to require the "acceptable risk" criterion would call for congressional action, as would the elimination of programs, or their reorganization and consolidation.

Step 2. Examine the area of discretion involved and who would stand to gain or lose from proposed changes. If highly organized and influential groups will benefit, they must be informed, mobilized and involved. If those who will benefit are unorganized and diffuse, possibilities for coalition building among existing groups and their allies in government should be examined. Forming such coalitions requires careful documentation of changes in program costs and benefits and strategies for obtaining the changes. Potential opposition must be gauged as well. If opposition will likely be strong, tactics for overcoming the opposition must be developed.

Step 3. Develop an understanding of the decision processes of an agency. While bargaining is likely to be involved, special voting rules or expert criteria used by the agency must be examined. For example, agencies may be required to assess the economic or environmental impact of proposals for change. Similarly, some proposals may require new appropriations which must be estimated and justified. Approval of congressional oversight, authorization and appropriations committees should also be assessed and sought if programmatic changes will entail new costs or shifts in objectives. The agency administering the program may not be the only potential ally in government. Other agencies which are likely to be affected by change should also be consulted. Sometimes they can turn out to be more influential in obtaining a change than the administering agency itself.

Motivating enough interest and creating optimism about change among affected parties and within government is a major task. Overcoming program inertia, providing capable lobbying efforts and getting the attention of decisionmakers is a continual challenge. Federal marketing programs have a long history; they have administrative precedents which shaped the current program; and they have many vested interests. It is important for those who seek specific changes to thoroughly understand a program's purpose, history and participants. Only then can they work effectively to achieve change.

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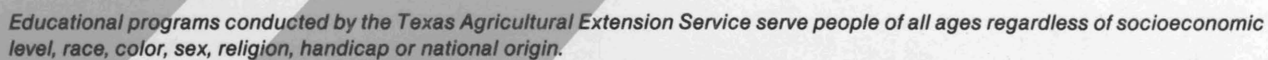

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