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THE HIGH COST AND LOW RETURNS OF FARM MARKETING ORDERS

INTRODUCTION

Almost fifty years ago, in his classic novel, The Grapes of Wrath, John Steinbeck wrote angrily of waste in the California orange groves, where millions of pounds of fruit were destroyed to keep prices up, despite thousands of hungry people nearby. While Steinbeck was not referring to any particular government program, the federal government has administered a collection of programs since the early 1930s which ensure that millions of pounds of fresh fruits, vegetables, and other crops are similarly wasted every year.

Under these programs, known as marketing orders, producers are organized into cartels, which can direct the activities of each industry. Some of these cartels are relatively harmless, but others significantly limit the type and amount of food sold to the public. The result: both consumers and growers are harmed. Cartels are generally illegal under U.S. law, but those created by marketing orders are beyond the reach of the antitrust laws. In fact, the federal government actually enforces cartel decisions through fines for growers who do not comply.

Marketing orders are defended by some growers as necessary to ensure a stable supply of food to U.S. consumers and a reasonable income for growers. They are said to be an effective alternative to the costly government support programs for other crops. The evidence shows, however, that the orders offer few benefits to consumers. Many crops are marketed quite well without cartels. And on the few occasions that controls have been lifted, the unregulated market has provided an adequate and steady supply to consumers.

The cost to consumers of marketing orders is enormous. In the short run, Americans pay higher prices for food. Perhaps more important, the program costs the economy millions in wasteful

overproduction. This waste mainly takes the form of misallocation of resources and thus tends not to be noticed by the public. Oranges, for instance, are diverted from the fresh markets into processing markets, despite consumer preferences. At times, however, the waste is all too obvious. In 1981, for example, millions of oranges were left rotting in the sun because the orange cartel had blocked their sale.[1] Similarly, in 1983, some 20 million cartons of lemons were destroyed or abandoned as a result of orders from the cartel; more lemons were dumped that year than were sold to consumers.[2]

These programs can have bizarre results for U.S. trade. By limiting the supply of U.S. fresh lemons that can be sold in America, for example, the lemon cartel forces growers to sell millions of pounds of the fruit to other countries. To make up the difference, the U.S. must often import millions of pounds of lemons from European and South American countries.

Ironically, even the growers benefit little from these programs. Any increase in profits is soon eroded by new entrants to the industry.

During the last 15 years, numerous government agencies have criticized these wasteful and unnecessary marketing order programs. But Congress not only refuses to take action, it even impedes investigation of the value of the orders. In 1978, for example, in response to Federal Trade Commission criticism of marketing orders, Congress specifically prohibited the agency from studying the issue. In 1983, following criticism of the system by the Office of Management and Budget, that agency, too, was prohibited from looking into the effectiveness of the orders.

These programs conflict directly with the Reagan Administration's commitment to deregulation and promoting free markets to reduce costs to consumers. Not surprisingly, marketing orders were targeted for review by Vice President George Bush's Task Force on Regulatory Relief in 1981. Yet, although Secretary of Agriculture John Block can terminate marketing orders without congressional approval, the Administration did little to promote real reform during Reagan's first term. The major marketing orders survived with little or no change. In recent months, however, there have been signs that the Administration at last is beginning to address the problem seriously. This February, Secretary Block temporarily suspended the supply controls imposed under the navel orange marketing order. And in June,

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1. See Ann Crittenden, "Grower's Power in Marketing Under Attack," The New York Times, March 25, 1981, p. 1.

2. Doug Bandow, "Federal Marketing Orders: Good Food Rots While People Starve," Business and Society Review, Spring 1985, p. 41.

the Agriculture Department announced it would terminate the relatively minor marketing order for the hops industry.

This month, the Administration will have an opportunity to carry out more significant reforms. The navel orange industry has submitted to the Secretary of Agriculture its plans for controlling the supply of oranges during the upcoming crop season. The Secretary can show his commitment to deregulation, as well as give consumers a break, by rejecting the plan, thus terminating supply controls for that major crop.

RATIONALE FOR A MARKETING ORDER SYSTEM

Marketing orders are one response to a general problem affecting agriculture: wide fluctuations in output, usually weather-related, lead to wide variations in the income of growers. Basically three methods can be used to temper these income swings:

1) Many farm products in America, such as wheat and corn, are subject to a system of federal price supports and subsidies. This approach means that all taxpayers, not just the consumers of particular products, pay the cost of supporting farmers' incomes; this can be enormous. From 1980 to 1984, for instance, farm programs cost the taxpayers almost $65 billion.[3]

2) Private mechanisms, including forward contracting, commodities futures, and options markets can also relieve the problems of agriculture. Using options, for instance, firm contracts for such products can be bought and sold months before the crop is harvested. As a result, wide variations in market prices need not lead to large fluctuations in farmer incomes. Essentially buyers and sellers self-insure their crops through the options market, with the risk, and the cost, spread among growers, distributors, and consumers. This approach has significant advantages over government programs. In the first place, it is an efficiency-driven market solution to the problem. It is in everyone's interest to minimize the risks involved. And second, it costs the general taxpayer nothing. All the cost is borne by the industry and its customers.[4]

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3. Office of Management and Budget, Budget of the U.S. Government: Historical Tables, Table 3.3. Cited in James L. Gattuso, "The 1985 Agricultural Bill: Still Time to Treat the Farm Crisis," Heritage Foundation Issue Bulletin No. 119, September 3, 1985.

4. Kandice Kahl, "Agricultural Options: An Alternative to Federal Farm Programs," Heritage Foundation Backgrounder No. 414, March 7, 1985.

3) Marketing orders attempt to even out the market by controlling the supply of the product. But in contrast to private mechanisms, decisions on supply in the marketing orders system are made only by the suppliers themselves. And as Adam Smith observed more than two centuries ago, when businessmen come together to regulate prices or supply, the consumers' interest is always secondary to their own.

STRUCTURE OF THE MARKETING ORDER SYSTEM

The marketing order system was first instituted in 1933 as a "temporary" response to the farm crisis of the 1930s. In fact, the current marketing order law, the Agricultural Marketing Agreement Act, dates back to 1937. Its two principal objectives are to keep growers' revenues high and to maintain orderly marketing conditions.

According to the law, growers' revenues are to be kept at "parity" levels, calculated by using an adjusted ten-year average of prices. The meaning of the "orderly marketing" objective is not so clear. The term has never been precisely defined. It has usually been interpreted, however, to mean a market in which there is little variation in price or supply. While the orderly marketing objective is said to be for the protection of consumers as well as producers, it has provided the rationale for holding prices above parity levels in many years.[5]

Types of Orders

Some 33 commodities are marketed under the 47 federal marketing orders currently in effect.[6] Each covers a specific crop in a defined region of the country. Although the largest U.S. crops, such as wheat and corn, are directly subsidized and not subject to orders, marketing orders apply to a wide variety of fruit, vegetable, and specialty crops, ranging from California oranges and kiwifruit to Virginia potatoes and Texas lettuce. These commodities include more than half of all the fruit and specialty crops and 15 percent of all

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5. General Accounting Office, The Rate of Marketing Orders in Establishing and Maintaining Orderly Marketing Conditions, Report of the Congress GAO/RCED-85-57, July 31, 1985, p. 3. In fact, the legislative history of the orderly marketing objective indicates that it can only be applied when prices are above parity, to keep them from falling below that level.

6. Ibid., p. 2, excluding dairy marketing orders.

the vegetables grown in the U.S. Crops covered by the orders were worth about $5.6 billion to growers in 1984.[7]

Marketing orders vary widely in type and scope. There are three major categories of programs--market support, quality control, and supply control. Market support programs require producers to pay a fee to their industry associations to provide promotional and advertising activities. Quality control provisions prohibit the marketing of products that do not meet certain size, taste, or freshness standards. Supply control provisions directly regulate the amount of food being sold to consumers.

Each of these provisions varies in scope and in effect:

Market support provisions. These are the least controversial of the marketing order programs. While they force growers to pay for activities that are financed voluntarily in other industries, the economic consequences of the provisions are small.

Quality control provisions. These controls are said to protect consumers from poor quality products. Yet the professional buyers who purchase fruit for retail markets can easily distinguish between good and bad produce and identify growers who deliver inferior goods. Furthermore, consumers are not slow to reject substandard produce.

The real harm of quality controls is that they are often used to control supply. By adjusting quality standards on an annual basis, many industry associations attempt to limit the supply of their product going to market in order to maximize their income. The Navel Orange Administrative Committee, for instance, which manages the marketing order for that crop, has often varied its size limitations for oranges from season to season, and sometimes during a season, to control the supply of that crop. The Committee often has stated candidly that its standards are calculated to increase growers' revenue rather than protect consumers.[8]

Supply control provisions. This most harmful form of marketing order provision directly controls the supply of products going to a market. Using it, the industry administrative committees can limit the amount of food sold to the public. Supply controls take a variety of forms. In some cases producers are assigned allotments; each year

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7. Ibid.

8. In 1970, for instance, the committee's annual report stated that "In years when specific sizes are produced in amounts that will depress returns, the control of sizes to be marketed also is exercised." Quoted in R. S. Radford, Federal Navel Orange Marketing Orders: A Report to the National Taxpayers Legal Fund, unpublished, April 17, 1979.

an industry association determines what share of that allotment each producer may sell to the public.[9] Other methods of supply control include market allocations, by which producers are told how much they may sell in certain specified markets, and reserve pools, in which supplies are set aside until prices improve.

The most controversial form of supply controls is known as prorate. Under this system, which is authorized by nine of the 47 marketing orders, industry committees meet each week during the crop season to determine how much fresh produce they will allow handlers to ship to U.S. markets during that week.[10] That total is then apportioned ("prorated") among handlers. Any excess must be diverted for processing, exported, or left to rot. In this way, the flow of goods to market is regulated so as to maximize grower returns and level off fluctuations in supply.

Prorate is rarely used for most crops and then only for limited periods during a season. But for three crops--California and Arizona navel oranges, Valencia oranges, and lemons--prorate has often extended throughout an entire season. In these cases, prorate controls not only limit the weekly flow to market during a season, they also limit the total supply of these fresh fruits in U.S. markets for the entire season.

Adoption and Enforcement of Marketing Orders

The marketing order restrictions faced by growers and handlers are the result of a long, cumbersome, and sometimes secretive process. Before an order is introduced, the Secretary of Agriculture must determine that it would promote the policies of the Agricultural Marketing Agreement Act. If he so determines, he drafts a proposed order, usually in consultation with industry members. A referendum of producers is then held, and if two-thirds (or, in some cases, three-fourths) vote to accept the order, it becomes law. An order can be terminated by the Secretary of Agriculture, however, should he find it no longer beneficial. Even this modest escape clause is now in danger. A provision in the omnibus farm bill recently passed by the House of Representatives would require another producer referendum before an order could be abolished.

The Secretary can amend any order. He does not need grower approval to make such amendments, although growers can vote to forego the regulation entirely rather than accept the amendments. In one

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9. This method is used in the spearmint oil, Florida celery, and until recently, the hops industries.

10. "Handlers" are middlemen who sort, pack, and ship commodities to market.

recent case, the Secretary allowed growers to accept or reject individual amendments, thus limiting his own power.

Once an order is established, regulations for enforcement must be adopted each crop season. Administrative committees, organized by the U.S. Department of Agriculture, meet before each crop season and draft regulations.[11] The meetings are not open to the public, and no record of the deliberations is released to the public. The committee members are selected by the producers; usually there are no consumer representatives. In many cases, one segment of the industry dominates the administrative committee.

Since the Secretary of Agriculture must approve any regulations proposed by the committees, in theory he can prevent abuses. In reality, his approval is routinely granted--as the Secretary tends to defer to the "expertise" of the committees. In addition, while federal law requires that the public be given notice and an opportunity to comment before most regulations are adopted, Secretaries of Agriculture long have maintained that such procedures are not required for these regulations. Regulations adopted may be challenged in court--but only by industry members, not by consumers.

EFFECTS OF MARKETING ORDERS ON CONSUMERS

Proponents of the marketing order system argue that it benefits consumers and growers alike. Consumers, it is said, are protected from unreasonable fluctuations in price and supply as the orders ensure orderly marketing. Growers in the regulated industries are said to obtain better and more predictable prices and stable markets. But these benefits are illusory.

Supply and Price Fluctuations

Regulations to create orderly marketing are often justified by the supposedly unique economics of agriculture. Farmers cannot control the amount of crops they produce, the argument goes, and total output can vary widely from one year to the next--meaning wide fluctuations in prices and earnings. Further, the bulk of many crops ripens all at once, meaning that farmers bring large quantities of the crop to market at the same time. Without regulation, it is argued, there would be periodic gluts and shortages.

This would suggest that all agricultural products need regulation. Yet growers of many crops, similar to those now under

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11. For crops under "prorate" controls, the committees also must propose, and the Secretary approve, specific prorates each week during the crop season.

marketing orders, operate well in a market free of government regulation. Growers of pistachios, macadamia nuts, and pecans, for example, produce crops freely, while walnut, filbert, and almond growers are regulated. Sweet cherries are uncontrolled, while tart cherries are subject to marketing orders. Even more puzzling, oranges grown in California are under strict supply controls, while those grown in Florida and Texas, with slightly different physical characteristics, are under no supply controls at all.

There is no evidence that the uncontrolled industries are any more unstable or disorderly than those regulated by orders. A 1982 study by the Office of Management and Budget, for instance, compared the variability of prices from year to year for crops under marketing orders with those free of orders. The study found that the prices of regulated crops actually varied more than those not under regulation--the opposite of that predicted by the marketing order lobby.[12]

Similarly, a 1981 U.S. Department of Agriculture study found that the price of crops marketed under the most restrictive orders varied just as much as those under less restrictive controls.[13] Further, according to the OMB study, week-to-week fluctuations within a single season are not any less for marketing order crops. Comparing regulated California oranges with unregulated oranges and grapefruit from Texas, the OMB analysts found no difference in price fluctuations, indicating the orders had no effect.[14]

Another way to judge whether supply controls actually help stabilize prices or supply is to compare a crop during a period of control with the same crop when it was not controlled. On at least two occasions, the prorate provisions of the navel orange marketing order have been suspended temporarily. On each occasion the market continued to function in a smooth and orderly fashion with no extreme fluctuations in prices or disruptions in supply. The first termination occurred in 1953. A later Agriculture Department report

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12. Unpublished Office of Management and Budget Memorandum from Michael McConnell, et al. to Christopher DeMuth, et al., February 18, 1982, p. 17.

13. Edward V. Jesse and Aaron C. Johnson, Jr., Effectiveness of Federal Marketing Orders for Fruits and Vegetables, USDA Agricultural Economic Report No. 471, June 1981.

14. OMB Study, op. cit., p. 1.

found that the absence of regulation led to lower prices, but cited no evidence of any chaotic marketing conditions.[15] It has been estimated that the variation in prices increased by only 1.2 percent.[16]

The second termination occurred early this year. On January 29, Secretary Block, citing unusually high prices for navel oranges, suspended all prorate controls on the crop. Despite claims by the Navel Orange Administrative Committee and the major growers' cooperatives that the market would fall into turmoil, there was no chaos. Shipments of fresh oranges to market fluctuated in much the same manner as they had during the previous crop year. In a newly released study of the 1985 suspension, the Agriculture Department found little change in variability, and concluded that "the market system performed as well, if not better, after the prorate suspension."[17]

Thus, the markets for noncontrolled crops not only have been no more disorderly than those subject to control, but even the controlled markets do not degenerate into chaos when suddenly left to a free market. The reason is that growers and handlers know that, if a glut begins to develop during the season, they can get higher prices by holding back their crops a few weeks until the crop is more scarce. So the supply of fruit to consumers is kept stable without federal regulation.

While marketing orders apparently have been ineffective in stabilizing prices and supply, there are other, market-based mechanisms that could reduce fluctuations. Long-term contracts, futures markets, agricultural options, and long-term storage could all be used to protect growers and buyers from price and thus income fluctuations, without controls, cartels, and inflated prices to consumers.

Higher Prices and Waste

Marketing orders fail to provide any real benefits to consumers. Even worse, they hurt consumers. The most obvious burden is the increased prices paid by consumers for fresh oranges, lemons, and

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15. U.S. Department of Agriculture, Farmers Cooperative Service, "Price Impacts of Federal Market Order Programs: Report of the Interagency Task Force, Special Report #12, 1975, cited in Radford, op. cit., p. 24.

16. Radford, op. cit., p. 24.

17. U.S. Department of Agriculture, Economic Research Service, Economic Implications of the 1984/5 California Arizona Orange Shipment Prorate Suspension, unpublished, September 13, 1985, p. 9.

other controlled products in any particular year. During this year's navel orange season, for instance, the retail price of oranges dropped measurably after the prorate controls were suspended.[18] This is consistent with a recent study exploring the effect of a termination of supply controls on California and Arizona navel oranges, which found that producer prices would decrease from 12 to 20 percent if marketing orders were lifted.[19]

A second undesirable effect of supply controls is waste. Prorate controls limit the total amount of fresh fruit that can be sold by restricting the share of output that can be sent to the fresh fruit market. Example: a lemon prorate may allow a lemon grower to market as fresh fruit only one out of every four lemons picked. A grower thus can earn the right to sell an additional lemon by growing four more--but the other three must be exported, sent to processing plants, or simply left to rot. The result is that consumers pay for the production of much more food than they use. Without supply controls, the USDA estimates, 20 to 30 percent fewer acres would be needed to produce the California and Arizona oranges currently reaching the market.[20] The cost of these wasted resources is substantial. One economist has estimated that in the navel orange industry in California and Arizona, over $72 million per year is wasted due to marketing order supply controls.[21]

Reduced Innovation

The third way in which the consumer is harmed by supply controls is through the loss of competition and a decrease in innovation in the controlled industries. There is little incentive under the present system for growers to improve or promote their product, since they are

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18. Based on a February 25, 1985, survey by California Citrus Mutual, an industry association, printed in Mutual Market Memo. See also a letter from George H. Lombardi, Sequoia Orange Company, to James Handley, Agricultural Marketing Service, U.S. Department of Agriculture, March 12, 1985.

19. Agribusiness Associates, Inc., Economic Analysis of Volume Controls: California-Arizona Navel Orange Marketing Order, unpublished draft, p. 107. As described below, in the long run the decrease in consumer prices would be smaller, as production in the affected industries decreased.

20. Peter K. Thor and Edward V. Jesse, Economic Effects of Terminating Federal Marketing Orders for California-Arizona Oranges, U.S. Department of Agriculture, Economic Research Service, Technical Bulletin No. 1664, November 1981, p. 40.

21. Dr. Sheldon Kimmel of the U.S. Department of Justice, cited in Antitrust Division, U.S. Department of Justice, Exceptions to Recommended Decision, In Re: Proposed Amendment to Marketing Agreements and Orders 907 and 908, USDA Docket No. AO-245-A8, AO-250-A6, May 29, 1984, p. 15.

bound by the restrictive orders. In the lemon industry, for instance, a process has been developed by which the shelf life of lemons can be drastically increased by wrapping each individual fruit in a tight plastic cover. Known as "shrink wrap," this process will keep lemons fresh for up to six months. Due to supply controls in the lemon industry, however, lemon handlers have been unable to take advantage of this breakthrough. Under the lemon prorate system, the sale of a fresh lemon, whether shrink wrapped or not, is counted against a handler's quota. Thus, a grower who spends the time and money necessary to shrink wrap lemons is not rewarded for his effort, and consumers are deprived of the benefits of this technological innovation.

EFFECTS ON GROWERS

Marketing order cartels also fail to benefit their own members. Growers in these controlled industries are not making much more money, and some are making less, than if their markets were free. This year's suspension of the navel orange prorate, for instance, seems to have had little impact on growers' incomes. This was one of the industry's most profitable years and, according to the Department of Agriculture, grower income was about the same as it would have been under regulation.[22] This may have been because growers were able to sell many more fresh oranges than supply controls would have allowed.

Regardless of any short-run income effect, growers do not benefit in the long run from marketing orders. To the extent that supply controls keep returns in an industry higher than they would be otherwise, more growers are attracted to that industry. Thus, any temporary increase in industry revenue does not benefit individual growers since that revenue must be split among more growers.[23]

Certain growers are directly and substantially harmed by these programs. While advocates of marketing orders often speak of growers consenting to mutually beneficial regulations, the orders actually favor some growers at the expense of others. For many crops, for example, the largest growers' cooperative selects up to half of the voting members of the industry's administrative committee. Thus, one organization often effectively controls the administration of a marketing order.

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22. Economic Research Service, op. cit., September 13, 1985, p. ii.

23. See A Review of Federal Marketing Orders for Fruits, Vegetables, and Specialty Crops, U.S. Department of Agriculture, Agricultural Marketing Service, Agricultural Economic Report No. 477, November 1981, p. 55. This, of course, applies only with controls such as prorate, where entry into an industry is not controlled.

CONCLUSION

Marketing orders are of no benefit to consumers, and of only limited benefit to growers. They should be abolished, either by Congress, or administratively by the termination of individual marketing orders by the Department of Agriculture.

At the very least, Congress should cease impeding study of the issue. The laws barring the Federal Trade Commission and the Office of Management and Budget from studying marketing orders make no sense. In addition, Congress should reject efforts to restrict Agriculture Department review of the programs. Legislation passed by the House of Representatives, as part of the 1985 farm bill, would prevent the USDA from terminating marketing orders without the approval of the growers. This would entrench the cartels even further.

The Department of Agriculture should take advantage of its current authority and suspend or terminate the supply control provisions of the most egregious orders. Short of this, there are many other reforms the Department could carry out to decrease the harm caused by these programs. It could:

o exempt from supply controls the citrus fruit preserved with shrink wrap technology;

o reject proposed supply controls whenever prices for the season are expected to be above parity levels;

o establish a clear method by which the effectiveness of marketing orders can be judged;

o allow more nonindustry members on administrative committees so that consumer interests can be represented;

o limit the representation of large cooperatives on administrative committees so as to reduce their ability to dominate the affairs of their competitors;

o require prorate controls to allow open marketing of crops during some minimum amount of time during the season.

o encourage the development of futures and options markets, and forward contracting as an alternative to regulation.

Lastly, the Department of Agriculture should exercise its full powers to amend marketing orders. It should not, as it has in the past, allow producers simply to choose which part of a regulation they

will agree to. By giving producers such a veto power over reform, the Department abdicates its responsibility to protect consumers.

The marketing order system is harmful both to consumers and producers. The Reagan Administration has the power to stop this harm, either through outright termination of the orders or by reform. By exercising its full powers in this area, the Administration can show it is serious about deregulating markets to benefit American consumers.

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