1979

The political economy of milk price regulation in Montana.

William O. Bronson

The University of Montana

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THE POLITICAL ECONOMY OF MILK PRICE REGULATION
IN MONTANA

By
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B.A., University of Montana 1977
Presented in partial fulfillment of the requirements
for the degree of
Master of Public Administration
UNIVERSITY OF MONTANA
1979

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Date 9-6-79
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My interest in milk price regulation grew out of my work as Research Director for the Montana Republican Party in 1978. Part of this job involved the preparation of issue papers for legislative candidates. Since all milk control seemed to be a timely political topic, I developed a series of papers outlining the pros and cons of economic regulation of the dairy industry. Of all my work, this series generated the greatest interest among candidates and party officials. Apparently I had judged the salience of this issue rather well.

I faced the subject of milk control once again in 1979 when, as a lobbyist for the Associated Students of the University of Montana, I was asked to testify on behalf of two milk price deregulation bills that had been introduced in the Montana legislature. This exposure to the politics of the milk industry convinced me even more of its importance and the necessity of undertaking a detailed study of the subject.

This paper will be historical as well as evaluative in form. I intend to explore the philosophical and legal basis of milk price regulation. The reader will be treated
to an extensive analysis of the Montana Milk Control Board's activities of the last forty years. One crucial aspect of this analysis is an understanding of how the board has related to its clientele, the government, and the consumer. In addition, I will review the various attempts made in past years to substantially restructure the dairy industry through deregulation. New alternatives to existing law will be explored, with an eye on the potential reformers.

Some of the analysis contained in this paper is inconclusive. The complexities of milk control do not lend themselves to simple answers, as I shall demonstrate. The consequences of deregulation or alternative regulatory schemes, for example, are not always predictable. However, I have made a sincere effort to examine all the possible assumptions and options. In this way, future analysts will have a basis upon which to act responsibly.

I have relied heavily on the work of Charles Wolf, Jr., head of the Rand Corporation's Economics Department and director of the Rand Graduate Institute, in developing a method of critique. Dr. Wolf has postulated what he terms a "theory of non-market failure." Simply stated, Wolf believes that one cannot assume government to provide the perfect solutions for the asymmetry of the market system. He has proposed a typology of observable non-market failures, and presented it in such a form as to allow a policy analyst
to easily explore the consequences of public regulation.\(^1\)
I will explain this theory in more detail in the body of the paper.

Some aspects of milk control will not be dealt with in this paper. They are: (1) dairy sanitation laws; (2) the national "milk scandals" of the Nixon presidency; and (3) the recent literature attacking the necessity of milk as an item of human consumption. A good study of each of these subjects is by rights the subject of other professional papers. Their relationship to my topic is not so crucial as to make their examination mandatory.

I believe it is appropriate to lay my "ideological" cards on the table now. I do not conceive of any serious policy analysis as value free; to believe otherwise is, to put it mildly, an impossibility. A scholar always brings certain presuppositions into his work, and for this he should not apologize. This does not mean that one should deny all standards of balanced and objective observation. It is imperative to state all sides of a debate as fairly as possible, but this should not imply that one is necessarily unconcerned with the outcome of that debate. My standard is that used by the late C. Wright Mills in his sociological studies: "I have tried to be objective. I do not claim to be detached."\(^2\)
I subscribe to a school of thought which subjects the relationship between government regulation and the public welfare to great scrutiny. This school is common among academicians of the political left as well as the right. Public control of the industry's activities is often advocated by the industry and not the public. This raises a question of whether or not the ultimate benefits of regulation are designed with the public interest in mind. The consumer may often bear the brunt of unreasonable and costly administration. Another aspect of this question is whether or not a symbiotic relationship exists between the regulator and the enterprise, and what effect this relationship has on the public. These questions will be uppermost in my mind throughout the course of this paper.

I would be remiss if I did not acknowledge the assistance of various groups and individuals whom I have "milked" for information these past few months. Mr. Alfred Dougherty of Helena, who has observed the operation of the Montana dairy industry for over thirty years, cannot be thanked enough for his historical accounts. Mr. K. M. Kelly, Administrator of the Milk Control Division, Department of Business Regulation, has been kind in answering my numerous requests. Mr. Daniel Herbert, Chief Statistician for the Montana Crop and Livestock Reporting Service, has been equally helpful. I cannot leave mention of Mr. Jerome Cate,
Chief of the Antitrust Bureau, Department of Justice, for his kind assistance. The staff of the Montana Historical Society has graciously placed at my disposal several useful documents.

Various friends and acquaintances in the Montana legislature have provided useful insights. I especially recognize the comments of State Senator Bob Brown and State Representatives Ken Nortvedt, Jerry Metcalf, Bobbie Spilker and Mike Cooney. I also appreciate the comments of one individual who does not wish to be identified in this paper. I met this young gentleman in Helena during the legislative session. He has had connections with the dairy industry over the past few years, and his views were particularly helpful.

Finally, I extend my appreciation to my friends who have in many ways assisted with the development of this paper. All errors and omissions are entirely my responsibility.
NOTES

PREFACE


CHAPTER I

PURPOSE AND STRUCTURE OF THE MONTANA MILK CONTROL LAW

Milk: A Thoroughly Regulated Commodity

The production and distribution of milk has occupied the attention of economists and health experts for several years. Milk has been described as the most nutritionally balanced food item and therefore, a necessary article of human consumption. Since the early days of this century milk has been treated by government as a commodity greatly affected with the public interest.¹

Montana's first experience with dairy regulation came in 1911 when the legislature authorized the licensing and sanitary inspection of milk production. These sanitary laws have been modified and expanded through the years. Today, health regulations are a shared responsibility of the State Department of Livestock, Livestock Sanitary Board, Board of Health and Environmental Sciences, and local boards of health.² Economic regulation would not arrive until 1935. Before examining the development of these rules, it is important to understand the nature of the milk industry.

The Structure of the Dairy Industry

Montana’s dairy industry, like that of the entire nation, has been substantially transformed during the past
fifty years. In the 1930's it was made up of several producer-distributors and producers. The former raised their own cows, milked them, processed the raw milk into fluid or manufactured products, and distributed these to local consumers. The latter sold his raw milk to nearby independent distributors who processed the milk for resale. These distributors were rare during the early twentieth century as were the major retail supermarkets. Producer-distributors were the dominant type of operation.  

Following the 1930s came a period of increased specialization in the production and marketing of milk. Distributors came into their own and replaced most of the small producer-distributors. By the 1960s, small independent distributors known as jobbers appeared on the Montana scene. Jobbers purchased processed milk from large distributors and marketed it primarily in the small towns and rural areas; some jobbers can be found in big city markets. Many of the larger distributors have deemphasized direct home deliveries, leaving this task to locally owned grocery stores and interstate supermarket chains. This trend toward specialization has been common in many businesses in the United States. 

It is important to the subject of this paper to understand the pricing terminology used in the marketing of dairy products. **Producer prices** are those prices paid by
distributors or processors to producers for raw milk. Wholesale prices refer to the prices paid by retailers for processed milk sold in bulk or packaged form. Retail prices are the prices paid by consumers at the store or on home delivery. Wholesale and retail prices are often considered together and are then termed resale prices.

The Plight of the Montana Dairyman During the Depression

Montana dairy operators enjoyed prosperity until 1929. With the coming of the great depression, consumer purchasing power collapsed. Producer-distributors and distributors were thrust into an extremely competitive situation. They engaged in price cutting and giveaway programs to attract customers. Unmarketed surpluses of fluid milk were dumped in order to reduce the supply and force prices upward. Distributors passed their losses back to their producer-suppliers, thus putting several dairy farmers out of business. Some dairy operators attempted to reduce their costs by cutting down on production expenses, including the costs of complying with state sanitary codes. By the mid-1930s, public authorities were convinced that an abundant supply of healthful milk would soon become a rarity. K. M. Kelly, Administrator of the Milk Control Division, Department of Business Regulation, cites a typical example of the chaotic conditions:
In the late 1920s and early 1930s, we had about fifty-five dairies in Helena delivering milk to 12,000-15,000 people. Each dairy was cutting prices and giving away milk and cream to steal customers, with most of the losses passed back to the producers. Producers were being forced out of business and the milk supply was in jeopardy.6

Aggravating this situation was the fact that milk was and still is an extremely perishable commodity. It cannot be stored in any form for any great length of time. Also, dairy cows are on a fixed production cycle that cannot be regulated by price considerations. A cow will produce twice daily regardless of the shifts in producer and resale prices. Distributors are aware of this cycle and can place the producer in a precarious situation when it comes to bargaining for a price on raw milk. The producer has had little or no voice in this type of marketplace, especially when times were as rough as those of the depression.7

Attempts at Self-Regulation

In 1934, Montana dairymen availed themselves of the remedies offered by the National Industrial Recovery Act (NIRA). With support from the Dairy Division, Montana Department of Agriculture, the state was divided roughly along the Continental Divide into two marketing areas. All segments of the industry would voluntarily set and enforce a series of price codes within these zones. Regulations would be the responsibility of private enterprise with only modest government supervision.8
Self-regulation soon proved to be inadequate. By May of 1934, many voluntary agreements had broken down. Merchants in Kalispell, for example, found their sales of packaged milk falling under the high retail prices set by the code. They were soon selling milk at pre-1934 prices. When the NIRA was declared unconstitutional by the U.S. Supreme Court in late 1934, milk dealers decided to seek protection from state government. A well-organized, ad hoc lobby of producers and distributors attained this goal during the 1935 legislative session. Senate Bill 163, sponsored by State Senators Lars Angvick (R-Sheridan) and F. S. Karlberg, contained the elements of Montana's first milk control law. The condition of the milk industry was so chaotic as to convince nearly every legislator, regardless of party, of the need for regulation.9

Development of the Montana Milk Control Law: 1935-1979

SB 163 was passed as a temporary relief measure. A clause at the end of the bill stipulated that the legislature could repeal milk control when it determined that the existing public emergency was at an end. The powers of that clause were never exercised. In 1939, the legislature re-enacted most of the provisions of the 1935 act. These revisions are the basis of today's milk control law.10
Existing legislation lists a series of bold policy declarations. The legislature has determined in syllogistic fashion that (1) milk is necessary for human consumption; therefore, an adequate supply must be maintained; (2) the necessity of milk makes it a commodity affected by the public interest and potentially subject to government regulation; (3) unfair and uneconomic practices in the dairy industry pose a constant threat to the quality and availability of the milk supply; so (4) state supervision of production and marketing is necessary and proper to maintain the public interest. The "law of supply and demand" is deemed inadequate to meet that same task.¹¹

Regulation of the dairy industry has always been carried out by a State Board of Milk Control. The 1935 law provided for three commissioners—the Chairman of the Livestock Sanitary Board, the Chief of the Dairy Division, Montana Department of Agriculture, and a representative of the general public. The 1939 revisions provided for a five member board consisting of the Chairman of the Livestock Sanitary Board and one representative from each of the following groups: producers, producer-distributors, distributors, and consumers. A 1957 amendment eliminated producer-distributor membership and increased the number of members from the remaining three groups to two representatives apiece. A 1959 amendment totally revamped membership
patterns and provided for a five-member, all-consumer board. This structure remains intact today. Thus, supervision of the dairy industry was the province of its members for almost twenty years.\textsuperscript{12}

The chief function of the board has always been the provision of economic order through the fixing of minimum producer, wholesale, and retail prices. A use-classification system has been used since 1959 to rank and price all milk in the state. Class I or fluid milk is designed for drinking purposes. Class II comprises milk used in the manufacture of ice cream, sherbert, egg nog, sour cream, and related items. Class III includes products like butter and cheese as well as items not designated for human consumption; e.g., milk for livestock feed. Minimum producer prices are set for all classes of milk; resale price protection is extended to Class I products.\textsuperscript{13}

Procedures for developing minimum tariffs have changed substantially during the past forty years. Until 1971, lengthy public hearings were held on the cost of producing, processing, and distributing fluid milk and milk-based products. Prices would be established so as to insure the operation costs of producers and distributors and possibly provide them with a modest profit. This method was abandoned in 1971 and replaced by the use of flexible formulas. These formulas are to be devised so as to bring
about automatic adjustments in all minimum prices as are justified by changes in production, processing, and distribution costs. A public hearing is held to approve a suggested formula, but all price changes occur without hearings unless the board is petitioned to revise the formula.¹⁴

When establishing legal minimums, the Milk Control Board must follow fairly specific legislative criteria. Early legislation mandated minimum producer prices be set at least equal to one-half of the minimum retail price. Also, fixed prices had to take into account the purchasing power of the public. It is difficult to assess from available records just how serious the old milk boards implemented that provision. Today's law requires flexible formulas to be based upon such factors as milk prices in adjacent and neighboring states, consumer purchasing power, and indices of production and distribution costs. The old "fifty percent" section regarding producer prices was repealed by the 1959 legislature.¹⁵

Administrative procedures for implementing the milk control law have been constantly revised and updated since 1935. Originally, the board exercised its power only after a petition in support of regulation was submitted by a local association of producers and distributors. The board would hold a cost of production hearing, devise a marketing area, and fix minimum prices to be charged in that area. Sales
below minimum prices would be prohibited. The board was required to promote and foster these local associations under specific rules. The associations would become instrumentalities of the board in order to carry out the intent of the law. In 1959, the board was given authority to hold public hearings and establish prices on its own initiative. The 1975 legislature eliminated the requirement of promoting local dairy associations; this provision had become an anachronism after the organization of the State Department of Business Regulation. Thus, the law has progressed from a quasi-trade regulation measure to a more sophisticated scheme of independent government supervision.\(^{16}\)

In order to insure the propriety of price-fixing rules and orders, the board has possessed the power to subpoena books and records of all milk dealers. A uniform system of accounting for milk use by distributors has been required since 1959. Also, rules of fair trade have been provided for in law and board regulations. These rules prohibit such practices as rebates, kickbacks, extension of credit to retailers by distributors, and sales of milk below minimum prices. These activities circumvent the purpose of price-fixing and therefore, cannot be allowed.\(^{17}\)

Enforcement procedures have also been created. Milk distributors must be bonded in order to do business. All milk dealers except retailers must have a license in order
to do business. All milk dealers except retailers must have a license in order to traffic in milk. Licenses can be suspended or revoked for failure to comply with the law. In addition, the board may seek specific civil and criminal prosecution of violators; it may also seek remedies in equity, such as a court injunction to restrain a dealer from breaking the law. Sufficient procedural safeguards; i.e., due notice of and requirement of public hearing, have been provided by the legislature to insure fairness to all parties in the exercise of price regulation.  

Board activities are financed entirely through nominal license fees and assessments per hundredweight of milk sold by producers and distributors. The legislature previously fixed the amount of assessments; since 1975; the Department of Business Regulation has taken over this responsibility through the administrative hearings process. 

Up to 1959, price controls were exercised only in marketing areas designated by the board. These areas generally comprised only the territory immediately adjacent to cities and towns. Amendments have since extended price control to all areas of the state. The same producer and resale prices prevail in every area of the state, although many marketing areas are retained for administrative purposes.
The Board and Administrative Organization

The Milk Control Board is now attached to the Department of Business Regulation for administrative purposes. The Milk Control Division of the department serves as staff support for the board. It is headed by an administrator and employs approximately ten other individuals. (All employment figures are for Montana fiscal year 1979.) Employees are primarily involved in field audits of licensed milk dealers. The budget for the division in fiscal 1979 was $249,928; all of this was derived from license fees and dealer assessments.

The Montana Administrative Procedures Act (MAPA) is the guide for executive agencies and board when promulgating rules or orders designed to carry out the intent of legislation. Under MAPA, the Milk Control Board and the Department of Business Regulation have adopted a series of rules affecting the milk industry. Significant ones include (1) elaboration of reporting requirements for producers and distributors; (2) provision for restitution of underpayments by distributors to producers; (3) procedures for termination of supply contracts between producers and distributors; (4) unfair trade practices; (5) fee assessments; and (6) the indices and factors utilized in developing price formulas. Specific price orders are also adopted under MAPA rules. All rules and orders are published in the Administrative Rules of Montana.
The Modern Dairy Industry

The dairy industry has undergone significant changes since the 1930’s; indeed, these changes greatly influenced the development of the milk control law. Under a regulated economy, technological innovations have been striking. Milk now has an increased shelf life over that of thirty years ago. Modern refrigeration techniques can keep milk fresh in the dairy case for up to two weeks as opposed to the two day interval of years past. The productivity of the milk business has also advanced. Scientific breeding techniques have increased per-cow production levels although the cycle itself remains unchanged. Sophisticated handling virtually eliminates any contact of raw milk with the atmosphere. Refrigerated milk, whether raw or processed, can be shipped over great distances without much fear of spoilage; this was not possible during the 1930’s.23

Major technological changes have been costly. Capital investments by producers have been so significant as to make them even more subject to instability should prices prove unfavorable. Producers also face the consequences of modern inflation; i.e., increased food charges and heating bills. Departure from the dairy industry has continued on a steady basis since the depression. The number of processing-distribution operations fell 75 percent between 1961 and 1976, from ninety-three to twenty-three plants. The
national average decline during this same period was 70 percent. The number of producers has declined also. In 1959, there were roughly 825 producers in Montana; in 1975, there were 258. This decrease measured 69 percent. (Recently, the number of producers has risen to about 330, indicating some improvement in the health of the producer segment.) These declines will become important when the varied manifestations of price regulation are examined.

Summary

Concern over the quality and quantity of milk has led to it becoming the most regulated food commodity in the United States. The dairy industry has not been subjected to the same market conditions as has much of American business enterprise. Therefore, Montana dairymen and lawmakers have designed extensive regulations to insure a stabilized and sanitary system of producing and marketing milk. Wolf uses the term "internalities" to describe the standards which guide and evaluate public regulation. Internalities become a substitute for the workings of the price system.

Internalities do not necessarily prove effective in the course of public administration. The fact that many dairymen have departed the industry suggests the possibility of some improper or ineffective implementation of the milk control law. Subsequent chapters will probe this critical question in detail.
NOTES

CHAPTER I


4. Ibid., pp. 3-4.


8. Lanier, p. 81.


12 Chapter 189, Laws of Montana, 1935, p. 417;
Chapter 204, Laws of Montana, 1939, p. 516; Chapter 249,
Laws of Montana, 1957, p. 608; Chapter 192, Laws of Montana,


14 Chapter 189, Laws of Montana, 1935, pp. 417-19;
Chapter 204, Laws of Montana, 1939, pp. 526-27; 81-23-302

15 Chapter 204, Laws of Montana, 1939, pp. 526-27;

16 Chapter 189, Laws of Montana, 1935, pp. 417-19;
Chapter 192, Laws of Montana, 1959, pp. 417-418; Chapter 431,

17 81-23-103(1)-(2); 81-23-303; 81-23-401; 81-23-402,

18 81-23-104; 81-23-201; 81-23-202; 81-23-204;
81-23-301(2); 81-23-302(11); 81-23-405; 81-23-406,


21 Office of the Legislative Fiscal Analyst, Budget
Analysis, 1981 Biennium (Helena: Allied Printing,

22 Montana, Administrative Rules of Montana, Volume II,
Part III, Title 8, Subtitle 2, Chapter 12. Updated versions
of all rules and orders may be found in the Montana Adminis-
trative Register.

23 Interview with Al Dougherty, Helena, Montana,
22 June 1979; "Milk: Why Is the Price So High?," Consumer
Reports, January 1974, pp. 77, 80.

24 Interview with Al Dougherty, Helena, Montana,
22 June 1979; George Remington, "Milk Board curtails any
activities considered unfair," Missoulian, 23 June 1966,
p. 22; Ken Mortag, "What public outcry against milk control?,"
Great Falls Tribune, 5 March 1979, p. 6; Office of the
Legislative Auditor, Report, pp. 21-23, 77.

25 Charles Wolf, Jr., "A Theory of Non-market
Failures," The Public Interest, no. 55 (Spring 1979):121.
The Formative Years

The first Milk Control Board was organized in mid-1935 shortly after the governor's approval of SB 163. W. J. Butler, Chairman of the Livestock Sanitary Board, would head the new body. The membership was rounded off by the appointment of B. F. Thrailkill, representing the State Department of Agriculture, and G. A. Norris, representing the State Department of Agriculture, and G. A. Norris, representing the public. Norris was the former Chief of the State Dairy Division and was a creamery operator in Billings at the time of appointment. Thus, the first board had a great deal of expertise in dairying. Norris would also serve as the board's chief administrator when it was not in session.¹

Norris expressed the sentiments of the new board in a 1935 press release:

The main purpose and intent of the law is to eliminate that dangerous element of supply so numerous throughout the state known as the chiseler, and the price cutter, who have also been the uncontrolled and dangerous producer of this important and necessary food commodity, coming into competition with the reverse type, the legitimate milk producer, who carries a heavy investment in the required equipment necessary to the production of pure, wholesome, safe milk and cream from healthy dairy cows, and operating under a license and inspection
service of the Montana Livestock Board. . . . It is very apparent that the milk industry in the organized trade areas under milk control have taken on a new life . . . this is . . . to the advantage of these actively engaged in the business of producing and distributing milk, and . . . the consumer.

The board proceeded to enforce the law vigorously. Dairymens' associations were formed, petitions for regulation circulated, cost of production hearings held, and marketing areas and price orders established. Norris began cracking down on the dreaded "chiselers" and "bootleggers." In a celebrated case, the board successfully reprimanded the Helena Creamery for refusing to pay minimum prices to producers. U.S. Senator Burton K. Wheeler maneuvered behind the scenes to cancel Fort Harrison's supply contract with that distributor. Norris also pursued violations by reluctant Ravalli county distributors. These firms benefited from sympathetic local judges who would not convict them for violating minimum price orders. The Stevensville justice of the peace, for example, declared the entire milk control law unconstitutional in late 1935. Norris' persistence finally wore down the Bitterroot operators, and he secured their adherence to the law by 1936.

A "Constitutional Convention of the Fluid Milk Industry" was held under board auspices in Helena during the month of May, 1936. The convention, composed of producers and distributors, ratified a board-approved document which governed the operations of local dairymens' associations.
This action was another indication of the binding relationship between the industry and the regulator. Assistant Attorney General E. K. Matson reiterated the purpose of the milk control law when speaking to the assembled delegates:

The public has been misinformed to a certain extent and do not understand the bill, but there is something that can be attained, and I believe you people who are here can do your part in educating the public as to the purpose of the law... the major purpose is financial protection of the dairy industry. (Emphasis is Matson's.)

The first two years of board operation were often plagued by financial and enforcement problems. License fees and assessments mandated by the law were insufficient to cover most of the board's legitimate expenses. Enforcement powers of the board also needed some teeth. During the 1937 legislative session, the board and the milk dealers' associations sought additional revenues and powers. Their proposal, House Bill 170, received a comfortable margin of support in the House but died on the floor of the Senate. A number of senators partial to the bill were sick and therefore, absent during voting. The industry did take some comfort in the defeat of another bill, House Bill 21, which would have repealed the milk control law. (Interestingly, one of the strongest opponents of HB 170 was a Ravalli county legislator with a bright political future—Lee Metcalf.)
Another attempt to improve the law in 1939 was successful. Dairy lobbyists, with strong bipartisan support in the new legislature, secured the passage of House Bill 201. The new board was organized in May of that year. Norris was appointed its first executive secretary. With an indication of strong legislative backing, the new board began carrying out its duties as diligently as had its immediate predecessor.7

On some occasions during the 1930s and 1940s, it is apparent from the record of public hearings that consumer concerns and board/industry interests were conflicting. A public hearing held in Havre in November 1939 over proposed raises in minimum producer and resale prices stirred considerable discontent. Mrs. Charles Hanson, speaking for the Havre Parent-Teachers Association, expressed fears that the suggested price increase would not be in the pecuniary interest of the local citizens. A certain Mr. Lineberger attacked the proposals as being designed only for the benefit of area milkmen. The board was almost nonplussed by these presentations; the record indicates that they could not comprehend why these citizens would not accept the beneficence of the milk control law. Regardless of who was right or wrong in this controversy, it is clear that one perception of economic regulation was not always held in common. (An interesting sidenote: Mr. Lineberger's
testimony was described in an initial set of the minutes as "making a few other wild remarks." The minutes were later changed to indicate a more discreet presentation by the Havre citizen.8

A similar occurrence took place in Butte in the spring of 1942. One irate housewife took exception to the board's procedural rules. Notices of public hearings were printed by the newspapers in small type in the legal section. No one read these seemingly innocuous passages, or so the woman claimed. She criticized local dairymen for profiteering in wartime and seeking prices sure to cut the consumption of Butte citizens. The board was visibly annoyed by her comments. Again, perceptions had a tendency to diverge from one, common perspective.9

Despite these incidents, the board proceeded with the notion that their actions were definitely in the public interest. Distributors and producers worked together to insure the law's success. Production levels did stabilize, and violations were regularly prosecuted during the 1940s. The board's prices were subject to federal oversight by the Office of Price Administration during World War II. In 1944, Norris resigned the position of executive secretary for reasons of health. Allen Klemme, a former Bozeman area dairyman and deputy of the Milk Control Board, was chosen as Norris' successor.10
The 1957 Legislative Investigation

By the mid-1950s there were indications that the board's operations were coming into serious question from many quarters. Wolf suggests that agency functions approach a critical state when internalities bear no clear or reliable connection with the purposes that agency was designed to serve. An additional problem is the presence of "distributional inequities" in agency practice. These inequities are indexed on the power of the agency over its clientele and vice-versa. The following is an examination of improper internalities and identifiable distributional inequities.

Executive Secretary Klemme had noticed several misunderstandings about board prerogatives and activities. For example, the Wolf Point Chamber of Commerce had improperly assumed the authority to grant price increases to local dairymen in late 1944. Klemme also reported that many Bozeman area producers in 1947 had little or no idea about the milk board's existence. There was evidence to suggest that local distributors were keeping their producers in the dark in order to exploit a natural economic advantage.

The quality of milk board records was beginning to deteriorate in the late 1940s. The number of meetings and public hearings was becoming infrequent. By the mid-1950s,
an aggressive infancy had been superceded by mid-age senility.13

The Montana Dairy Producers' Association report to the board in 1955 indicated some serious reservations about the quality of regulation, although the association had no desire to abolish the law. They accused the board of lax enforcement and appeasement of violators. Cost studies were found to be inadequate and infrequent. The Montana Dairy Industries Association, a distributors' group, expressed some concerns of their own. Some of the group's members were concerned that executive sessions of the board were not closed to all industry officials. Supplementary evidence was supposedly introduced during these closed sessions, or so some distributors claimed. This evidence was not subject to critique during regular hearings. The board heard many of the same allegations during their 1956 meetings. Producers and distributors foresaw crisis arising during the coming legislative session.14

Their prediction turned out to be a self-fulfilling prophecy. Six bills were dropped into the hopper of the Senate Agriculture Committee in early 1957. All of the measures purported to make major changes in milk board composition, reporting requirements, and enforcement powers. A joint House-Senate Agriculture Committee hearing on all six proposals was held in February, mid-way through the
John C. Harrison, lobbyist for the Milk Producers' Association, attacked what he termed the limited reporting procedures authorized under the 1939 act. Detailed records of milk usage and wastage were not required or utilized extensively. Inadequate and insufficient records produced serious consequences for his employers:

We feel that more detailed record keeping and inspection is desirable in that in the existing law the producer never knows what becomes of his milk and, when he has a surplus, there is a feeling that the producers are not being paid for what they are delivering.16

Harrison also argued for strengthened civil penalties against violators of the milk control law.17

William Armstrong, President of the Milk Producers' Association, backed up the complaints of his constituents. The dairy industry had undergone tremendous changes since the 1930s, he argued. In the old days, there were many producer distributors, and it was only fair to include one of their group on the Milk Control Board. By 1957, only ten producer distributors were left in the state, as opposed to some sixty distributors and some 1000 bona fide producers. Armstrong's association felt that the board was now imbalanced in favor of the distributors. This imbalance was felt both in terms of numbers and in unfavorable board decisions. An expanded role for the producer was necessary to restore equality under the law.18
A Democrat legislator from Stillwater County alleged that minimum prices were not being set according to law. An easily missed section of the 1939 law declared that the minimum retail price could be set no more than twice established producer price. Yet in his home county, a producer received eight cents per quart of raw fluid milk sold. The retail price in his area was twenty-three cents. The producer was getting only about 35 percent of the legal retail price when he should have been getting 50 percent. These violations were claimed to be common in other marketing areas in the state.  

These criticisms were disputed by lobbyists for the Montana Dairy Industries Association. There was undoubtedly some contrast between their statements before this joint legislative committee and their reports to the board in 1955 and 1956. Strengthened reporting requirements were unnecessary and would be unworkable. Stan Halvorsen, the manager of Equity Co-op Supply of Kalispell—a processor and distributor—claimed that the present law was sufficient and needed no substantive changes. His testimony was corroborated by other witnesses including self-proclaimed "producers." Some legislators were perplexed by this apparent conflict between producers on the need for changes in the law. One gets the feeling from the testimony that these legislators were suspicious of the motives of producers who sided with the
Dairy Industries Association. A confused and apparently divided Senate Committee killed the bills during a regular meeting two days later.

Many people in the dairy industry were not optimistic about the future. Criticisms like those registered during the hearing would not subside. Failure to act might fan the flames of a strong effort to repeal the entire milk control law. Producers and even some distributors prevailed upon the legislative leadership to conduct a special investigation of the matter. House Speaker Eugene Mahoney (D-Thompson Falls) concurred with their request. On February 19, 1957, the House approved a motion by Rep. Fred Barrett (D-Chester) to appoint a special investigative committee with full subpoena powers. The speaker appointed two attorneys—Charles Cerovski (D-Lewiston) and B. W. Thomas (R-Chinook)—and three farmer-ranchers—Gordon McOmber (D-Fairfield,) Jake Frank (D-Park City) and Jerry Smeltzer (R-Baker)—to carry out the task.

During the next two weeks, the select committee interviewed thirty witnesses representing the industry and government. They also attended a milk board hearing then underway in Butte. In the waning days of the session, the committee reported their findings. Accompanying their report was a list of sixteen recommendations. The report was almost a journalist's dream.
The committee concluded that the milk control law was fine in intent but in need of major revisions. They concurred with several producers that representation on the board had been diluted and that equity had to be restored. The committee reserved its strongest criticism for the board's exercise of its price-fixing powers. The legislators discovered that few records were kept of public hearings. Written findings of fact and conclusions of law were generally unavailable. The legislators indicated that there was often insufficient evidence gathered during public hearings upon which to base board decisions. Inconsistent and contestable rulings were a frequent result of these discrepancies.24

Evidence also pointed to a near breakdown of board authority. Some prices were being set by producer-distributor agreements in open defiance of board orders. Board meetings were infrequent and review of existing price orders was rare. This was proving to be a financial disaster for some producers who had not received a price increase in ten years! The board was also found guilty of failing to enforce what was known as Attorney General's Opinion Number 18, which had been issued in 1949. This opinion required distributors who purchased milk in one marketing area and processed it for resale in another to pay the producers at least the minimum price prevailing in the area where the milk was
ultimately sold. Since inter-market purchases were becoming frequent, producers and the select committee reasoned that producers could be easily cheated without enforcement of the opinion. 

The committee also took note of dissension between producers and distributors. This situation had developed due to lax reporting requirements and the board's failure to inspect and validate distributor milk testing programs. The legislators agreed with many producers that some distributor reports were misrepresenting actual milk use. For example, it was alleged that distributors would label much of the producer's milk supply as "surplus milk," i.e., milk in amounts over and above the amount necessary to supply consumer demands. Surplus milk commanded a far lower price than regular or "base" milk. Yet, some of this surplus found its way into regular use and was sold to retailers or consumers at high prices. The middleman would pocket the profit from this unethical transaction. 

The services of Allen Klemme were found wanting. Klemme was deemed to be an incompetent hearing examiner and incapable of developing all the necessary evidence upon which to base adequate price orders. He was also found to be indecisive and inconsistent in handling other business of the board. Board members were chastised for not disciplining or firing Klemme. County attorneys were also criticized for
not cooperating in the prosecution of complaints as was their legal obligation. Political pressures on these officials was believed to be the source of their inaction.  

Finally, legislators took exception to the activities of Merlin Madsen, a Missoula distributor who had served on the board since 1949. Madsen was accused on controlling the action of the board, possibly to his own personal advantage. The complaint was made by producers and some of Madsen's competitors in the distribution and processing business. A cursory review of Milk Board minutes from 1949 to 1956 verifies this accusation. For example: on some occasions, Madsen was unwilling to pursue needed price changes for producers. His economic strength and personal persuasiveness was obviously very significant.

The legislators recommended the replacement of the old board members and executive secretary with new individuals. The new board was requested to establish concrete rules governing hearing procedures, review existing price orders, and develop adequate cost data and uniform standards for fixing prices. The board was also requested to meet on a monthly basis and issue its findings and conclusions in written form. Distributors were urged to file honest disposition reports with the board and producers. Testing procedures of distributors should also be inspected by the board for their degree of validity. An interim
committee was suggested as a forum for writing extensive amendments to the 1939 law.  

Rep. Cerovski and the other committee members proposed a temporary reform package—HB 481—as a sign of good faith on the part of the legislature. The bill would alter the disposition of seats on the board to insure equality of representation by the various groups. Two producers, two distributors, and two consumers would be appointed to the new board which would continue under the chairmanship of the head of the Livestock Sanitary Board. A requirement to hold meetings every sixty days was agreed to, as was a clause urging the board to maintain policy of nondiscrimination in the implementation of the milk control law. HB 481 passed with little opposition.

A Crisis Unresolved

The Milk Control Board was not out of the newspapers at the end of the 1957 legislature. When the old board members refused to resign as the select committee had recommended, Governor J. Hugo Aronson summarily fired them. Their replacements were installed immediately. Aronson carefully chose the new board members so as to restore confidence in the administration of the law. The new board soon requested the resignation of Allen Klemme; he was replaced by T. P. McNulty, a cooperative extension agent from the Great Falls area.
The reconstituted board proceeded to restore integrity and equity in the regulatory process. However, the next few months would prove to be a trying experience. The board voted by a split decision not to enforce the attorney general's Opinion Number 18. This action disturbed producers affected by intermarket purchases. Also, the years of lax enforcement and inconsistent administration could not be removed overnight. Many legal challenges to board decisions were filed by consumers and producers throughout 1958.32

Two major court cases decided in 1958 were not especially helpful in developing momentum. In *Heimbichner v. Montana Milk Control Board*, the Montana Supreme Court ruled in favor of James Heimbichner, a dairy producer who claimed that an October, 1957, price order violated the express provisions of the Milk Control Act. The minimum retail price in Heimbichner's marketing areas was twenty-four cents per quart. However, the board had approved a special minimum retail price of ninety-two cents for a multiple package of four quarts; the average price of a quart in this package was twenty-three cents. Heimbichner received eleven and one-half cents per quart of raw milk sold, or one-half of the price of a single quart of milk sold in the multiple package. While this seems to agree with the "fifty percent provision" of the law, Heimbichner argued—and the court agreed—that the relevant retail price
was the single quart sale price. Heimbichner was entitled to a reimbursement of one-half cent per quart sold under the invalid price order. 32

The Heimbichner decision was mild in comparison to the March, 1958, decision of Butte District Judge John McClernan. Upon the arguments of a Bozeman milk distributor, Judge McClernan ruled the wholesale and retail price-fixing powers of the board unconstitutional. The decision was to have confusing ramification over the course of the next two years. 34

By November, 1958, board members were operating under a legal and administrative quandry. A special public hearing that month indicated that dairymen, the state Chamber of Commerce, labor and womens' groups all favored retention of the milk control law, but these groups were undecided as to how to correct the deficiencies. Shortly before this hearing, representatives from both producer and distributor associations began a series of joint meetings in order to draw up a workable solution. There was a mildly optimistic mood among dairymen and concerned citizens as the 1959 legislative session was about to open. 35

Summary

Despite opposition from some reluctant dairymen and consumers, the Montana Milk Control Board was determined to bring what it saw as economic justice and stability to an
industry plagued by chaotic conditions. From this writer's personal acquaintance with many early producers and distributors in the Great Falls and Havre areas, it is safe to conclude that their intentions were extremely honorable.

The board regressed from a period of sincere, positive vitality in the late 1930s and early 1940s to one of laxity and inequity by the 1950s. Many distributors were exploiting their natural economic advantage over producers. Loopholes in the 1939 law prevented aggrieved parties from correcting injustices. The board had become lax in rectifying deficiencies—in part due to strong influence on their direction by certain distributors. This is not to suggest that all producers were honest or that all distributors were scalawags. Some of the animosity between segments of the dairy industry was grounded more in unfounded suspicion than in real exploitation.

Distributional inequities and inadequate interna-
lities were the rule of operation for the board by 1957. A new board flush with integrity was not enough to combat the complex problems that had arisen over the years. Pragmatic dairymen knew they would have to clean up their own house or face the extinction of the milk control law.
CHAPTER III

1 Minutes of the Montana Milk Control Board, Volume 1, pp. 1-2.


4 Minutes of the Montana Milk Control Board, Volume 1, pp. 194-198.

5 Ibid., p. 195.


7 Minutes of the Montana Milk Control Board, Volume 1, p. 228; Volume 2, pp. 1-7; Montana House, Journal, 1939, p. 405; Montana Senate, Journal, 1939, p. 419.

8 Minutes of the Montana Milk Control Board, Volume 2, p. 35.

9 Ibid., p. 156.

10 Ibid., pp. 167, 208.


12 Minutes of the Montana Milk Control Board, Volume 2, p. 216.

13 Personal observation of the author based on extensive review of board minutes.


16. Ibid.

17. Ibid.

18. Ibid.


20. Ibid., testimony of Alfred Dougherty and Stan Halvorson.


24. Ibid., pp. 606-7.


27. Ibid., pp. 606-5; Interview with K. M. Kelly, Helena, MT, 22 June 1979.


CHAPTER III

CONFRONTATION AND DEVELOPMENT: 1959-1971

The 1959 Amendments: A Crisis Averted

After long and hard bargaining, representatives of the Dairy Producers' Association and the Dairy Industries Association prepared a compromise reform of the milk control law for the 1959 legislature. The House Agriculture Committee sponsored it as House Bill 27. The bill seemed to answer most of the producers' major complaints. Uniform and detailed reporting requirements would be instituted by the board on a reasonable basis. The provision for bonding of distributors would give the dairy farmer a legal method of recovery in the event of violations. Local advisory boards would give both segments of the industry a chance to participate in the determination of equitable prices. The board could now act on establishment of marketing areas and prices without the need for petitions by local dairy associations.¹

Bringing the entire state under milk control was another feature of the bill strongly supported by producers. Bob Ellis, Secretary-treasurer of the Helena Milk Producers'
Association, perceived this as providing the end to unfair trade practices in the industry. The competitive pressures from unregulated areas of the state would cease, and order could return to the industry.²

The all-consumer board was perhaps the most striking innovation contained in HB 27. Many dairymen had a hard time swallowing this change, but finally accepted it as a viable alternative. Consumers with no interest in the milk industry might well be the best arbiters between the conflicting claims of producers and distributors. Their presence would also give at least the impression that the consumer's interest was being observed.³

There was some recorded opposition to HB 27. Gene Picotte, a Helena attorney and former legislator, attacked the proposal during hearings as a "dictator bill;" its strict reporting requirements would unjustly drive small dairymen out of business. The extension of pricing authority was considered inappropriate and destructive of competition. He predicted that the bill would be declared unconstitutional and that its consequences would haunt the legislature in coming years.⁴ Picotte's first prediction would eventually be disproven; his second one, however, could be accepted on its face value.

Mrs. Harold Wright, speaking for the executive committee of the Montana Womens' Federation, opposed the bill
as giving too much authority to individuals without expertise in dairying. Her position was supported by a few independent producers and distributors present at the same hearing. Legislators were admittedly baffled by her testimony, since other members of the federation had offered their advice during drafting of the bill and found the proposed amendments acceptable.\(^5\)

The disagreement within the women's group did not stop the legislature from enacting HB 27. It passed the House 44-20 and the Senate 35-18. The opposition did take on some interesting characteristics. Entire legislative delegations from Sheridan, Wibaux, Gallatin, Broadwater, Meagher and Powder River Counties voted against the measure. All but one of the Park County delegates was opposed. Few urban legislators voted against the measure. The favorable urban vote might be explained by the provision for an all-consumer board. Conversely, this might explain the strong negative vote by some rural legislators.\(^6\) (Gallatin County comprises one of the larger milksheds in the state.)

The new board immediately began the task of implementing the amendments. They revised their fair trade rules and state marketing areas. Public hearings, cost surveys and field investigations proceeded vigorously into the 1960s. Increased revenues from revised license fees subsidized the board's heavy agenda. The board again experienced the vitality of its early years.\(^7\)
The Milk Board and the Courts

The early 1960's witnessed some of the board's most important dealings with the Montana judicial system. The impact of some of the more critical cases will be discussed below.

Judge McClerman's unfavorable 1958 ruling would rear itself in two cases. The Montana Supreme Court rejected a restraining order based on that decision in Milk Board v. District Court, decided in 1960. The court, by a 4-1 vote quashed a restraining order issued by District Judge Philip Duncan of Dillon. Duncan's order was issued after two Beaverhead County consumers asserted the validity of McClerman's decision. Duncan also ruled that board decisions affecting the Beaverhead County area were not founded upon factual evidence, and that the local advisory board appointed in accord with the 1959 amendments was unfamiliar with local economic conditions. The Supreme Court accepted the board's argument that the issue of constitutionality had become moot by virtue of the 1959 amendments and that public hearings were held in accord with the law. No direct ruling on constitutionality was made, however.8

In Milk Board v. Maier, issued in late 1961, the Supreme Court again rejected a claim of unconstitutionality filed by a former Butte dairy operator who was delinquent in paying his license fees and assessments. The McClerman
decision was again rejected as moot without a direct statement as to the milk law's constitutionality. The justices did uphold the power of civil suit granted to the board under the law.\(^9\)

Both the District Court and Maier decisions focused on constitutionality only as a secondary issue. The Milk Control Board was definitely interested in asserting the constitutionality of its price-fixing powers as the prime issue in a case.\(^10\) It would soon have that opportunity. Jack Rehbert, owner of a Billings dairy farm, provided the direct challenge of the law that its proponents and opponents had sought for years. Rehberg began selling milk in the Billings area in 1962 for less than the legal minimum price. A board injunction to restrain Rehberg's activities was denied by District Court Judge Charles Sande in early 1962. The board immediately appealed the matter to the State Supreme Court.\(^11\)

Rehberg's defense focused on the very heart of the law. His attorneys challenged the price-fixing powers as they were a denial of the right of contract under the U.S. and Montana constitutions. They also claimed that the law constituted an unconstitutional delegation of legislative powers, since the Montana legislature had never established a formal policy to fix prices. Neither had the legislature prescribed
standards and guides when delegating those powers. The Rehberg defense relied heavily on two recently decided southern cases, *Harris v. Duncan* and *Gwynette v. Meyers*, which declared that milk was not affected with a public interest and therefore, not a proper concern of government.¹²

The Supreme Court rejected the defense’s arguments without much fanfare. The right contract was not absolute, the court declared. It was subordinate to "reasonable restraint and regulation by the state in the exercise of its sovereign prerogative—police power."¹³ The justices were unwilling to question the economic wisdom of the legislature when enacting price-fixing laws; this was not within the purview of the judicial system. The Montana court adopted the rule of the U.S. Supreme Court in *Nebbia v. New York* that the court’s interest lay only in whether the law in question was unreasonable, arbitrary, and capricious in its execution. Chief Justice James T. Harrison, speaking for the majority, found no evidence of inequitable administration of the milk control law.¹⁴

The court also determined that the legislature had provided sufficient standards to guide the board in its activities. In no way was the board exercising overbroad administrative discretion. The decision was warmly greeted by the board and the industry as the culmination of years of unanswered questions. (The court ruled in favor of the
board on a 3-2 vote. Justice Hugh Adair and Stanley Doyle gave no reasons for their dissents.)\textsuperscript{15}

Attorneys may dispute the point, but it can be argued that the 1959 amendments may have preserved the law's constitutionality. The earlier 1935 and 1939 laws smacked of industry-oriented trade regulation and may have been unacceptable in light of the \textit{Schecter} decision. It should be remembered that under the 1939 law, the board acted only upon the petition of the industry; the 1959 amendments gave the board the primary power to exercise price-fixing.

The milk board did not fare well in two other cases. In another 1961 case, \textit{Milk Board v. Community Creamery}, the Supreme Court ruled that a 1957 board order still in effect setting minimum prices for milk furnished to Missoula schools was illegal. The 1939 law upon which the order was based did not mention the authorized fixing of prices on sales to public schools. The court also declared that alleged violations of fair trade rules in the Missoula area were unfounded, since the board had not adopted specific rules implementing the suggested statutory prohibitions. The court believed that the milk statute was not self-executing; it needed an affirmative response on the part of the board. (The 1959 law did bring schools under the jurisdiction of the board. A price order based on the law would be acceptable to the courts.)\textsuperscript{16}
Another district court decision rendered in 1960 in Gallatin County required a special price hearing and order for a unique form of marketing—on-the-farm sales. The court ruled that the Gallatin farmer in question supervised a dairy operation that had not been considered in statute.\(^{17}\) The trial judge, in making his findings, made one interesting observation about the potential distributional inequities inherent in government regulation:

>This milk control act, that started as a shield for the embattled and poverty stricken dairy farmer, may well end as a sword to destroy his economic freedom.\(^{18}\)

The truth of that statement would not just be measured by the problems of the past, it would be an accurate prophecy of the future.

**Producer and Distributor Under the 1959 Amendments**

The 1959 compromise did not end the frequent animosity between segments of the Montana dairy industry. Two incidents that occurred during the 1960s bear out this observation.

The record of a price hearing held in Missoula in the fall of 1960 indicated that dairymen were not of one opinion on the subject of regulation. Local producers asserted the need for strong supervision by the board. The economics of the modern milk business was such that a producer was now more than ever left at the mercy of his distributor. Without continuous and aggressive supervision
by the state, exploitation was the inevitable outcome. Accusations of unfair treatment of producers, abuse in the definition of base and surplus milk, and pure extortion were numerous. Some distributors were allegedly preventing dairy farmers from joining the producers' association by threatening to cancel their contracts.19

Distributors denied many of these claims as well as the cost survey data submitted by area producers supporting the need for an increased producer price. The level of suspicion among the hearing participants was high even if all the claims and counterclaims lacked validity.20

Another example of inter-industry antagonism surfaced in a 1965 legislative debate over including manufacturing or Class II milk under minimum price protection of the law. This omission in the 1959 amendments was regarded as controversial from the start. During Senate Agriculture committee hearings on a bill to correct this problem, producers accused processors and distributors of cheating on their milk usage reports. They claimed that processors would purchase milk ostensibly for manufacturing purposes at the uncontrolled price but bottle it for fluid purposes and pocket a hefty profit. Producers also blasted some distributors for "hushing up" their producers with fears of contract cancellation.21
Milk distributors were outraged at these statements and pointed to the economic consequences of including Class II milk under price-fixing provisions. Higher producer prices for manufactured products would attract competition from out of the state. These same high prices might also discourage production of Grade A fluid milk. Despite this testimony, the legislature gave overwhelming approval to the bill. Lobbyists for the distributors got the upper hand, however, when Governor Tim Babcock vetoed the bill as unworkable and costly to administer. The producers' lobby had lost much of its clout when John Harrison left their employ to take a Supreme Court seat in 1960. However, the bill was reintroduced in 1967 and eventually enacted into law.22

During the early 1960s, accusations were made that T. P. McNulty, the board's executive secretary, was to some extent a "captive" of the distributor's viewpoint, although he was not believed to be weak and indecisive like his predecessor. McNulty left his position in 1964 with praise from his employers. His successors generally have been regarded as stronger administrators and sympathetic with the producer's plight.23

The persistence of distributional inequities—whether perceived or real—was a common trait of the modern dairy industry. These difficulties would influence the development
of milk price regulation well into the 1970s.

The 1966 Price-Fixing Scandal

A series of federal indictments handed down in late 1966 awakened some Montanans to the economic realities of the modern dairy industry. Their repercussions would continue for the next few years.

The indictments concerned attempts by the Montana Food Distributors' Association (MFDA) an organization of retail food stores, and several milk processor-distributors to conspire illegally to fix prices on fluid and manufactured milk items. In 1965 and 1966, the MFDA was unsuccessful in convincing the Milk Control Board to raise minimum retail prices on certain milk products. The group then went to various Montana milk distributors and asked them to quote a suggested retail price for their products. Ideally, the new suggested price would be higher than the existing minimum retail price. According to the MFDA president, distributors were sympathetic with the situation of retailers. They feared that retailers would suffer financially without some kind of price increase. They feared that without an increase, retail stores might start their own processing plants and go into direct competition with the distributors. Safeway Stores had already begun an integrated operation of this type.24
The situation was decidedly more complex than the newspapers initially reported. Sources within the industry accused the MFDA of pushing the distributors into quoting suggested retail prices. MFDA members purportedly threatened them into raising their home delivery prices so as not to compete unfavorably with the retailers. Distributors who refused to comply with the arrangement would be denied shelf space in the retail stores to sell milk products. It must be remembered that nothing prevented individual retailers or distributors from raising their prices above the prescribed minimums. If one did and a competitor did not, however, the former would probably lose customers to the latter. To receive the benefits of the price increase, all parties in the industry had to be involved.25

The federal government cried foul to this scheme in late 1966. A Billings federal court acted on a U.S. Department of Justice complaint of illegal price-fixing in the industry. MFDA and Beatrice Foods were charged with wrongfully manipulating the fluid milk market. Eight distributors—Beatrice Foods, Gallatin Co-op Creamery, Equity Supply Co., Wilcoxon's, Best, Gate City, Medo-Land, and Phillips—were accused of fixing prices of various non-fluid milk products. All of the above-listed firms except Gate City, Wilcoxon's, and Phillips, and the MFDA, pleaded no contest to the indictments in 1967. In other words, they
did not necessarily agree with the Justice Department that they had sinned, but they would agree to sin no more! The MFDA, its president, and the three milk distributors were eventually found guilty and fined.26

The propriety of several milk distribution and retail outlets would be in serious question during coming years. The consequences of the 1966 incident will be discussed in Chapter VI.

1971 Amendments

Montana dairymen were able to come together again in 1971 to obtain some common goals. The major concern of industry spokesmen was the means by which prices were set. Cost of production surveys were coming into serious question:

To ascertain what prices will bring a "reasonable" return on investment to the producers and the dealers of a particular market, the Milk Control Board held public and private hearings to collect cost data. To many this seemed like a logical approach; i.e., accumulated cost data can be analyzed and a certain markup percentage applied to gain the desired selling price that will result in a reasonable return to the producer or dealer. . . . However, accurate and reliable cost data were inconsistent. The seriously plausible statement that milk prices can be established on the basis of calculated costs, is a fallacy.27

The other consequence of this pricing system was that prices for one year were based on cost data collected from the previous year. The present administrator of the Milk Control Division examines the result:
The dairy industry was always playing catchup. . . . By the time the farmer was getting the increase in price under the old method, some of them were broke.28

The flexible formula plan, which brought about automatic changes in minimum prices as were mandated in indices of production, distribution, and retailing costs, was believed to be the proper alternative. Established formulas would signal cost adjustments as the economy changed. The producer and distributor would be guaranteed an immediate change without the need for long and complex hearings.29

As indicated in Chapter II, the milk industry also sought to cover jobbers and prevent unfair extension of credit to retailers. A $500 civil penalty option was also added to the law as an alternative to suspension or revocation of a dealer's license. Spokesmen for the milk lobby argued that a civil penalty was necessary because the board was often afraid to revoke a license for fear of decreasing the available milk supply in an area.30

The amendments were easily approved in the House and Senate. A few conservative, rural Republicans and liberal Butte Democrats comprised the bulk of the opposition. The industry did not succeed in passing a companion bill designed to clarify and expand the definition of unfair trade practices. Some distributors and small retailers believed the bill would put them at an unfair advantage with their large competitors. The House Agriculture Committee agreed with

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them, and the bill died in committee.\textsuperscript{31}

A single formula to set all prices was set up by the board in 1972 with the assistance of a New York consulting firm. The formula utilized eighteen indices of economic performances including prices received by farmers for their produce, prices of hay for feed, U.S. and Montana employment rates, and personal income estimates. If one of the indices registered an increase, it could have an inflating or deflating effect on the formula depending on what it measured. The same was true if the indices registered a decrease. The final price adjustment would be up or down depending on the net change in all indices.\textsuperscript{32}

Federal wage-price controls implemented in 1971 did not help the formula pricing scheme. As feed costs skyrocketed in 1972, the formula indicated a substantial boost in prices for producers. (Feed costs were not covered by federal price controls.) However, the total increase in producer prices as justified by the formula was denied by the federal Cost of Living Council, since the increase would also affect distributor prices in such a way as to put the amount of the increase over government guidelines. The board again asked for federal approval to okay a price increase, with the stipulation that only producers would receive the increase. A distributor challenged this decision in district court, alleging that any increase should be
shared across the board. The judge agreed with the distributor and quashed the board proposal.  

The milk board solved this dilemma in 1973 by splitting the formula into two parts—one for producers, the other for the rest of the industry. Price increases to producers could now be registered when they alone were justifiable. The eventual removal of federal price controls also spared the formula approach much anguish.  

Summary  
The Montana dairy industry came together in 1959 and 1971 to alter the milk control law substantially in their mutual interests. The years in between, though, were often marked with suspicion, accusation, and general ill will among dairymen. Yet, equity was continually built into the relationship by the legislature and the board. Tight reporting, full price protection, and sophisticated pricing techniques were proposed and implemented to assist the producer. Although some of these changes were opposed by some distributors, others worked to further the health of the entire industry.  
The Milk Control Board was entering a new era by the 1970s. Favorable court decisions strengthened its resolve; unfavorable decisions performed a check on its errors and oversights. The board and the industry's credibility would soon come into question again, as a period of economic and administrative problems loomed on the horizon.
NOTES

CHAPTER IV

1 Montana Senate, Minutes of the Senate Agriculture Committee, February 6, 1959, n.p.
2 Ibid.
3 Interview with Al Dougherty, Helena, Montana, 22 June 1979.
4 Montana Senate, Minutes, February 6, 1959, n.p.
5 Ibid.
9 Montana Milk Control Board v. Martin Maier, 140 Mont 38 (1962).
10 "Board gives notice it wants decision," The Daily Missoulian, 19 April 1960, p. 12.
12 Ibid., at 152-153.
13 Ibid., at 153.
14 Ibid., at 158-159.
15 Ibid., at 161-164.

17 Montana Milk Control Board v. Boylan District Court, 18th Judicial District, Gallatin County, File No. 14, 207.

18 Ibid.

19 Briggs, Legal Barriers, pp. 119-120, 128-130.

20 Briggs, Legal Barriers, pp. 119-120.

21 Minutes of the Montana Milk Control Board, Volume 5, p. 131; Montana Senate, Minutes of the Senate Agriculture Committee, 1965, n.p.


23 Two sources connected with the dairy industry make this accusation with some substance. They have asked not to be identified in this paper.

24 George Remington, "Effort made for 'decent markup'," Missoulian, 3 June 1966, p. 28.

25 Ibid.


29 Ibid.


34 Ibid., p. 12.
CHAPTER IV

THE FRUSTRATIONS OF CONSUMERISM: 1973-1979

A "Consumer" Board

The mere presence of five consumers on the Montana Milk Control Board does not by itself make for public representation. If one appoints a majority of conscientious individuals who will adhere to those provisions of the law requiring a balanced decision on behalf of the industry and the public, then one has a consumer board in operation. The events of the past few years indicate that Montana's board has shown a marked consumer preference. This preference has yet to be transformed into meaningful action, however.¹

In early 1976, the board decided to grant producer price increases without making similar adjustments in wholesale or retail prices. The board reasoned that the latter's minimum prices were more than sufficient to insure their profitability. Individual distributors or retailers were always free to raise their prices above the minimums if their costs and consumer demand indicated such an action was necessary. This plan was praised by the Montana Consumer Affairs Council; some distributors were not too pleased.

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the board decision. Ed McHugh, operator of Clover Leaf Dairy in Helena, indicated that many distributors were afraid to raise prices for fear that some firms would keep prices at the minimum and steal customers. A concerted effort by all dairies to raise prices in unison could be construed as price fixing; this would bring on the wrath of the Federal Trade Commission and the Justice Department, as was the case in 1966.²

The case was settled in October in favor of the distributors. Judge Peter Meloy ruled that the board's decision was illegal by virtue of their failure to give proper notice of the hearing where they made the decision and omission in not publishing the proposed rule in the Montana Administrative Register.³ This setback would not constrain the board in future activities.

A March 1978 proposal to lower the minimum retail price by six cents per half-gallon met distributor opposition again. The milk control division administrator insisted that the reduction would affect only 10 percent of the statewide distributor sales volume; the remaining 90 percent of their volume was wholesale and the proposed reduction in wholesale charges was but two cents. The minimum price could always be exceeded if need be. For example: a distributor with rural deliveries could raise the price for those runs to make up for the decreases in city sales.

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Distributors were skeptical. They produced expert testimony claiming that many of the processors would operate at substantial losses should the board proposal become effective. They again raised fears of cut-throat competition by the major supermarket chains. The board decision was overturned on a legal technicality later that year. The milk division administrator commented rather pointedly that "it is interesting to note that the board has never been challenged on an increase in milk rates, only on a decrease in prices."^5

A final example of consumer interest on the part of the board has not yet come to fruition. In January 1979, the board unanimously adopted a motion to alter the pricing formula. The proposed change would consolidate three of the formula indices into one index, and raise the interval upon which increases in prices are based. The consolidation and interval adjustments would make the formula less volatile; i.e., price increase would be less frequent. In addition to those changes, the permissible minimum retail markup would be reduced. The net change from all three adjustments would amount to about a six cent reduction per half-gallon of milk.6

Distributors have once again announced their intention to fight the proposal, citing arguments used in 1976 and 1978. The board has taken the position that the public interest would be better served by competition at the retail
level. They fear that non-price competition; i.e., engaging in unfair trade practices, is presently taking place as an inefficient substitute for real price competition. A public hearing on the board plan has been delayed twice since mid-April as industry and board representatives prepare testimony to support their positions. Questions of law and economics will again become entangled, and the probable outcome is anyone's best guess. The record of the last three years is not a signal of optimism.

Consumer Frustration

Although consumer complaints against selective price increases appear throughout the history of the Milk Control Board, the reported public criticism of the past few years has been intense. Low income groups did stage a short-lived boycott of milk in the early 1970s over a planned increase. In recent months, consumer advocates have sharply questioned the need for further regulation of at least retail prices. Three opinion surveys tend to support that view.

A statewide telephone survey conducted in March 1979, by Frank Magid Associates of Iowa for the Lee Newspapers found 54 percent of the respondents opposed to legal price controls. 34 percent were in favor of continuing the present system. A survey of the six major college campuses by the Montana Student Lobby in January 1979 revealed similar totals: 47 percent were in favor of abolishing milk price
controls and 32 percent were opposed. The results were remarkably consistent between campuses; the exception was Northern Montana College, where a clear majority were opposed to decontrol. A final survey conducted in December 1978 by pollsters for a Great Falls radio station revealed that 90 percent of the local citizens were in favor of eliminating the Milk Control Board. Personal knowledge about the board was minimal, but respondents were clearly frustrated over the price of milk in their area.9

A recent chorus of newspaper editorials has also joined in demanding change. An excerpt from a Great Falls Tribune commentary is illustrative:

The milk industry primarily distributors seems to view the pricing formula as a one-way street that allows prices to increase forever, but never drop back more than a penney. That's nice for them, but the formula has to be able to reverse itself. Otherwise, it turns into a joke.

The joke is on the people of Montana, forced by state regulations to pay an unwarranted premium price for the elixir of cows.10

As might be expected, distributors and other dairy-men do not take kindly to what professor Ed McHugh terms a despicable "kill job" on the milk industry.11 Their concerns and agonies about the press and the public will be reviewed again in subsequent chapters.
Summary

Consumer dissatisfaction with the Milk Control Board has been evident over the past forty years, although recently the frustration has reached a feverish pitch. The modern inflationary spiral spurred on since the Vietnam War has no doubt helped generate this concern. Attacks made directly on the board's intentions are misguided, however, since the board recently demonstrated a strong consumer bias. This is not to suggest that board members are opposed to the milk industry. Rather, they are motivated toward securing a meaningful balance of factors in their decisions. For this they should be commended.

The perceptions of many consumers are clearly aligned against the existing regulatory system. There is on their part an intuitive realization of the distributional inequities and improper internalities that plague non-market operations. The next chapter will explore still another non-market failure of the Montana Milk Control Board.
NOTES

CHAPTER V

1 Interview with K. M. Kelly, Helena, Montana, 22 June 1979.


3 "Meloy: Milk Board acted improperly," Great Falls Tribune, 1 October 1976, p. 23.

4 Garry Moes, "Some milk ventures would go 'belly up' if price is cut 6 cents," Great Falls Tribune, 14 July 1978, p. 5.


6 Montana, Montana Administrative Register no. 6 (1979): 284-85; Garry Moes, "Court challenge of milk price proposal said to be considered," Great Falls Tribune, 18 April 1979, p. 38; Minutes of the Montana Milk Control Board, Volume 6, p. 12.


9 "Legislators, constituents play same songs, but same tunes," Great Falls Tribune, 5 March 1979, p. 4; Montana Student Lobby Survey Results (rough copy in author's possession); KMON, "Phase II—The Surveys," December 1978.


CHAPTER V

AN ECONOMIC CRITIQUE OF REGULATION

The Presence of Derived Externalities

Wolf suggests that government regulation to offset market failures may promote "unanticipated side effects, often in an area remote from that which the public policy was intended to operate."\(^1\) These effects are called derived externalities. Even when these externalities become apparent, they are not always understood or corrected.\(^2\) This chapter will survey derived externalities in the operation of the Milk Control Board.

Distribution Efficiency

A generally accepted measure of the efficiency of distributing commodities is the distributor's gross margin (DGM). In the case of the milk industry, the DGM is the difference between what distributors pay producers for milk and the retail price. An examination of DGMs in Montana reveals some interesting statistics.

In 1976, Montana's milk DGM was considerably higher than those of adjacent states like Washington, Wyoming, and the Dakotas. Montana's DGM even exceeded California's
average level by 47 percent. Leaving DGMs aside for the moment and looking at net profit margins (profit as a percentage of a firm's net equity,) one will find that the national average was about 8 percent in the dairy industry by July 31, 1978; Montana's average was approximately 18 percent. Some processors do operate at considerably lower margins, but this average is startling.\(^3\)

The Milk Control Division has claimed in the past that transportation costs in Montana account for much of the high DGM. The Montana Legislative Auditor has taken exception to this assertion:

Such reasoning is valid for some distribution points in the state, such as along the Highline and other rural areas. Since some milk must be transported, we would expect higher prices in these areas. However, the majority of milk in Montana is consumed in urban areas, where processing plants are nearby. Consequently, transportation costs should not account for much of the difference in DGMs . . . In the adjacent states . . . all of which are similar to Montana in terms of population distribution problems, DGMs are generally lower. . . . It is difficult to accept the premise that the difference in DGMs between Montana and other states is accounted for entirely by transportation costs.\(^4\)

Montana's high DGM is more likely explained by the methods of distributing milk. Home delivery—a far more costly service than buying milk at the store—is still utilized more in Montana than in most states. This would account for some of the high cost of distribution. Also, Montana's price-fixing statute does not allow for various discount delivery methods such as dock delivery. The only
exception is on the "on-the-farm sale" which is limited in use. A University of Illinois study suggests that states like Montana which have strict and uniform resale price controls will be slow to adopt cost-saving innovations in distribution.⁵ Even the Milk Board has recognized the possible inefficiencies behind high margins:

It appears that since distributors are not allowed to compete on the basis of price, they must compete on the basis of cost-increasing service and containers. The public interest would be better served if the pricing system provided incentive for cost-reducing innovation.⁶

Ironically, one of the legislature's express policy declarations is "to make the distribution of milk between the producer and consumer as direct as can be efficiently and economically done."⁷

"Minimum" Pricing

Economic theory suggests that prices are usually determined in a free market by the balance of supply and demand. Should an artificial force like government price-fixing intervene, the normal market outcomes could be destabilized. If, for example, a government agency sets a legal minimum price below the price that would prevail under normal market conditions, the effect is inconsequential if there is no stipulation that one can charge higher than the minimum price. Consumers will be willing to pay a higher price for the commodity in question and suppliers will insure sufficient quantities of that commodity at that price.
On the other hand, should the government set a mandatory minimum price above the market price, one will see suppliers providing more of a commodity, but consumer demand will not match that supply. As unnecessary surplus will result. There is a net loss to society in financial terms, since consumers will be paying higher than normal prices for the commodity, and suppliers will be bearing an increased cost for maintaining the surplus.

The above situation may be occurring in Montana with respect to minimum retail prices. The reader will remember that in many instances, processors were individually unwilling to raise wholesale prices above the minimum for fear of losing customers. Thus, minimum wholesale prices are relatively uniform; i.e., they are in effect maximum prices. An inspection of grocery stores and supermarkets in any Montana community will reveal that retail prices do not vary. (This author knows of only one exception; see footnote.) A minimum retail price higher than the market price is not about to be raised any further. A retailer would be committing economic suicide in such a case. 8

When fixed prices exceed market prices, economic theory suggests another problem; violations of the controls can be expected as suppliers attempt to "beat down" the effective price in order to increase sales. Montana's prescriptions against unfair trade practices should
theoretically solve this problem. However, Montana dairymen have not always been known for their strict adherence to the law. Board records and a report of the legislative auditor reveal several instances of violations. These include: (1) selling milk and providing a milk dispenser; (2) inability to sell milk to certain retail outlets because the competition owns the refrigeration equipment; (3) loss of milk accounts because of failure to grant requested kickbacks on the minimum price; and (4) providing "freebies" like ice cream in order to obtain milk accounts.\(^9\)

The Milk Control Division has successfully prosecuted many violations in recent years and has fined several businesses.\(^{10}\) Non-price competition will still continue, though, so long as the offender is willing to take the risk of being caught. The potential benefits from violation and the relatively small resources of the division make this risk minimal. The board has taken note of this problem during the past three years; this explains part of their rationale behind changing the formula to induce competition at the retail level.\(^{11}\)

**Potential for Competitive Pricing**

The milk control law does not apply to federal installations located in the state. Hence, a miniscule free market in milk exists on these facilities. The Malmstrom Air Base post exchange price for milk was recently reported
to be seventy-seven cents a half-gallon; during the same period, the civilian price was $1.07 a half-gallon. The same discrepancies can be found between wholesale prices paid at federal facilities and in controlled markets. The Legislative Auditor has claimed that distributors use far more efficient delivery methods when supplying the U.S. government; e.g., dock delivery is used rather than stocking of shelves. The incentive for finding efficient distribution methods lies in the fact that distributors must bid to supply the federal government. 12

This evidence of potential competition suggests that retail and perhaps wholesale prices could be lower in Montana but for the presence of price controls. The wholesale price may not be much lower, as will be explained in Chapter VI. The legislative auditor suggested in 1976 that controls may have set the retail price six to twelve cents higher than the probable market price. 13 This paper will assess the merits of this contention later, as well as the reasons why distributors dispute this argument.

Milk Consumption and the Elasticity of Demand

Elasticity of demand refers to the measure of responsiveness of consumer demand to changes in a commodity price. In mathematical terms, the dividing point of elasticity is minus one (-1). Negativity is due to the inverse relationship between price and quantity; i.e., if price goes up, the
quantity purchased goes down and vice versa. The closer elasticity of demand for a commodity approaches zero, demand is said to be inelastic. In other words, consumers will tolerate great increases in price before decreasing consumption. Conversely, as elasticity approaches minus one and beyond, demand is elastic. Consumers will adjust consumption patterns for even the smallest change in price. This tool can help one better understand the relationship between price changes and consumption of milk in Montana.

A cursory review of Montana milk prices and sales relationships reveals that in some periods, the theoretical inverse relationship between price and demand does hold up. A sample period is illustrated in Table 1 on page 69. Retail price-fixing can put a dent into consumption patterns, something the law was not designed to promote.

An elasticity study conducted by Montana State University places short-run elasticity at -.32 and long-run elasticity at -2.66. Thus, a 10 percent increase in price is associated with a 3 percent decrease in demand, in the short-run; in the long-run, the same increase will decrease consumption 27 percent. Short-run is defined as the quarter of the year when a price change occurs. The long-run represents changes after three to four years. It is implicit in the MSU model that consumers will not shift their consumption patterns overnight. The long-run is thus the real
TABLE 1

MONTANA MILK PRICE AND SALES RELATIONSHIPS:
1972-1975

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Average Price per half-gallon in 1967</th>
<th>Increase or Decrease in Price</th>
<th>Packages Increase or Decrease of Class I in Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>1972</td>
<td>$0.503</td>
<td>----</td>
<td>175,095,005</td>
</tr>
<tr>
<td>1973</td>
<td>.520</td>
<td>Increase</td>
<td>169,466,406</td>
</tr>
<tr>
<td>1974</td>
<td>.554</td>
<td>Increase</td>
<td>167,394,202</td>
</tr>
<tr>
<td>1975</td>
<td>.530</td>
<td>Decrease</td>
<td>173,492,612</td>
</tr>
</tbody>
</table>


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indicator of consumer preference.

The elasticity of demand will allow reasonable predictions on consumer overpayments and decreases in milk producer income in the event that minimum retail prices are established at higher-than-minimum prices. The loss in dairy farmer income is a direct result of reduced consumption of fluid milk. Table 2 on page 71 shows the estimated overpayments and losses at various levels of elasticity where the retail price is "excessive" by twelve cents per gallon. The overpayments decrease as elasticity approaches minus one, but this indicates that milk purchases are falling and dairy farmer losses are increasing.

The question of where consumer overpayments are absorbed is easily answered:

Under the present price setting procedures, some of the implied overpayments are channeled into the processing and distribution segment of the Montana milk industry . . . others are lost because milk is not being used at its highest and best economic use—i.e., drinking. Deregulation of resale prices would allow . . . a decrease in consumer payments. This decrease . . . would be borne entirely by the processors and distributors . . . the resultant decrease in revenue to the processor would not necessarily be a reduction of profit but could substantially be absorbed by increased efficiency in milk distribution and increased consumption.15

These conclusions tend to be upheld by other sources. The operator of a now-defunct processing plant has insisted that for every one cent per half-gallon increase in the price of milk, a store in his area could eventually expect a
TABLE 2

ESTIMATED ANNUAL EFFECT OF A MILK PRICE EXCESSIVE BY TWELVE CENTS PER GALLON

<table>
<thead>
<tr>
<th>Level of Demand</th>
<th>Effect at Each Level of Elasticity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Elasticity</td>
<td>Decrease in Gallons of Milk Consumed</td>
</tr>
<tr>
<td></td>
<td>- .1</td>
<td>154,000</td>
</tr>
<tr>
<td></td>
<td>- .4</td>
<td>629,000</td>
</tr>
<tr>
<td></td>
<td>- .7</td>
<td>1,128,000</td>
</tr>
</tbody>
</table>

2½ percent decrease in volume sold.\textsuperscript{16}

Consumption patterns and milk prices have been involved in a dynamic process through the years. A short-run increase in milk purchases may deceive one as to its long-run consequences.\textsuperscript{17} Even a sustained increase in sales may be lower than the level possible under market pricing. Of course, the availability of substitutes for milk and changing perceptions of its necessity in the human diet have their effects. If regulation is to be continued, there is a presumption in favor of watching retail prices very carefully so as not to upset the stability of the entire industry. This would seem to be part of the board's rationale for trying to induce some competition into retail markets.

**Producer Price Dilemmas**

The review of pricing externalities has so far concerned resale prices. Producer price-fixing is subject to derived externalities also, as the following examination indicates.

One fear of producers and regulators is that producer prices may be so high as to attract raw milk from out-of-state. Evidence of this problem exists; during a 1960 dairy industry conference, several eastern Montana producers expressed the belief that recent producer price increases had made their part of the state an oasis for surplus milk from North Dakota.\textsuperscript{18} Transportation was no
longer seen as a barrier to these local farmers.

Out-of-state shipments can be controlled by requiring inspection under the Montana Food and Drug laws and a dealer's license. This can prevent "bootleg" shipments and control the flow of commerce. These are not substitutes for diligence on the part of the board and industry in developing a producer price formula sensitive to potential trade from nearby states. To this end, the provision in the law requiring the board to consider prices in neighboring and adjacent states is a suitable incentive.19

Another form of derived externality in producer pricing is the problem of using cost survey data to establish minimum tariffs. It was suggested earlier that the use of such data opens up regulators to inconsistent decisions and dangerous time-lags. Montana has solved this problem with the use of flexible formulas. If a formula is generating uneconomical prices, it can always be adjusted by the board after petition and public hearing.

Summary

The replacement of the market with government regulation has not been a panacea for market failures. Regulation in Montana has created difficulties unforeseen by early advocates of the Milk Control Act. Inefficiencies in distribution, the possibility of excess retail pricing, illegal non-price competition, fluctuating rates of consumption,
and sensitive producer prices do not work to the benefit of the industry or the consumer. Deregulation—at least at the level of retail prices—is preferred by some as the only acceptable alternative to the status quo.

In later chapters, the author will assess the political acceptability of deregulation. For the meantime, it is important to understand the views of the modern industry and the regulators on the Milk Control Act. This will be the subject of Chapter VII.
NOTES

CHAPTER VI


2Ibid., 128-129.

3Office of the Legislative Auditor, Report, pp. 35-37; Montana, Montana Administrative Register no. 6 (1979): 284-85; Garry Moes, "Court Challenge of milk price proposal to be considered," Great Falls Tribune, 18 April 1979, p. 38.


5Roland Bartlett, Is State Control of Consumer Milk Prices in the Public Interest? (Urbana: University of Illinois Agriculture Experiment Station, 1965), 1965), p. 22.

6Montana, Montana Administrative Register no. 6 (1979): 884-85.


8Office of the Legislative Auditor, Report, p. 46; Personal notes, Hearing on HB 292, House Business and Industry Committee, January 30, 1979. During this hearing, a Butte jobber revealed that he tacked a small charge on top of the minimum retail price paid by his customers in Fairmont Hot Springs. No other exceptions have been found.


13Ibid., p. 53.

14Ibid., p. 57.
15 Ibid., pp. 58-59.


A New Economic Order

Edwin Briggs has captured the essence of the dairy industry's views on regulation in the following observation of a milk price hearing:

There was not even an echo from the past of the sentiment that industry should not be regulated or that efforts should be made either to restore or to maintain as much as possible of the principle of the free market. Everyone present apparently had been conditioned completely to think and to act within the framework of a very strict system of market and price controls—though, of course, this does not mean that all groups agreed as to how far the board should dictate the nature of or regulate the producer-distributor relationship. But judging from the views expressed in this hearing, the milk industry appears to be irretrievably lost to free enterprise and the free market. The very idea of competition seemed strange and out of place in this setting.

What specific fears does the industry have about a deregulated market? Do they view the world like their predecessors of the 1930s? How valid are their views? This chapter will attempt to answer these questions.

Industry Views of Regulation

Montana milk dealers continue to accept the basic philosophy that prompted enactment of the first control law in 1935. For example: Everett Hartman, owner of Skyline
Dairy in Kalispell, believes that deregulation of resale prices would be the financial undoing of him and his competitors. Although he is a processor-distributor, he, like many associates, believes that without complete price control, instability in retail markets would be shifted back to the distributor and in turn to producers. That is why Hartman views retail control "as the stabilizing force of the law." Similarly, Hartman and his fellow distributors and producers believe that economic exploitation of consumers is a fallacy. The only alternative to milk control—deregulation—is a loaded proposition.

The industry's concerns can be grouped into three categories. The first fear of dairymen is that deregulation of Montana resale prices would encourage the "dumping" of surplus milk from adjacent states. They reason that surplus milk would be hauled into Montana and sold at lower prices despite higher transportation costs. Out-of-state dealers would still find themselves with a decent profit margin—better than one achieved by marketing surplus milk in their own states. Competition from out-of-state milk would be so intense as to drive some Montana milkmen out of business.
It will be recalled that a similar argument was made regarding producer prices. It should also be remembered that out-of-state milk shipments must be inspected under pure food and drug laws. An out-of-state dealer must also be licensed in Montana. A Milk Control Division official insists that processing a license application for an out-of-state seller could take up to two years. Thus, potential competition from adjacent states cannot be immediate in impact.\footnote{5}

Imports may not occur for two additional reasons despite the supposed advantages. Montana producer prices are or at least should by law be comparable to those of adjacent states. Price competition at this level may therefore, be unlikely. It is difficult to imagine "surplus" milk entering the state when there is no price advantage. Many Montana distributors also enjoy a natural transportation-location advantage over out-of-state firms. This advantage tends to obviate the fear of interstate competition. Something must also be said for consumer support of local brand-name products.\footnote{6}

A second fear of the industry is the arrival of higher prices for rural and home delivery and in small store sales. Under deregulation, one would expect to see higher prices for milk on these more costly delivery runs. Deregulation would likely raise the retail price in small
stores since they could not be expected to handle large volume discounts that would be available to larger supermarkets. These higher prices are considered undesirable for several reasons. Many processors cringe at the burden higher prices would place on low income and senior citizens as well as the general public. Some small retail stores believe that they will be undersold by the supermarkets since milk is now one of their biggest selling items; price competition would cut deeply into their profit margins.\(^7\)

The expectation of higher prices from costly distribution runs is valid; this is true of nearly every commodity. However, it is wrong to assume that retail prices would automatically be higher than the fixed minimum prices now observed. A range of retail prices would be an obvious outcome. The actual prices will depend on market forces, and they could be higher or lower.\(^8\)

As far as detrimental effects on low income and senior citizens are concerned, analysis of the real world bears close attention. Agricultural and welfare officials have found that most low income and senior citizens patronize larger supermarkets rather than the small convenience stores or home delivery service. About 85 percent of the food stamps in Montana are used in large supermarkets, and 14 percent are used in large local grocery stores or convenience marts. Only 1 percent of the stamps are used to pay
for milk on home delivery. Since lower deregulated retail prices would be most common in the large supermarkets and grocery stores, the majority of destitute Montanans would reap some benefits. Home delivery will not be generally available to many low income people, because distributors often regard these people as possible credit risks.  

Ironically, many low income organizations and some outspoken senior citizens do not see resale price controls working to their advantage. Several representatives of these groups have testified in favor of some form of decontrol, viewing the present system as a deck stacked in favor of the stores and the middlemen. Even a small decrease in the retail price of one gallon of milk adds up to big savings over the course of a year's purchases.

Would the small retailer suffer from adverse price competition from larger chains? This is not easily predictable. If sales and turnover of milk are now quite high as has been claimed, competition may not have too adverse effect on profits. Convenience stores also benefit from a traffic that finds grocery shopping impossible or inconvenient. Should retail prices in Montana ever be deregulated, this situation would bear some close observation.

Perhaps the greatest concern of the many independent processor-distributors is that large multistate corporations and chain supermarkets would engage in predatory pricing.
practices to increase their share of the market and eventually drive the independents out of business. Predatory practices would probably include so-called "weekend specials or use of milk as a loss leader to attract customers. The larger firms would supposedly even sell milk below cost in order to perpetuate their subterfuge. The market would ultimately consist of a few large firms charging higher prices. This reasoning allows Everett Hartman to conclude that "controls preserve competition" in Montana.\textsuperscript{12}

An inspection of milk distributors now operating in Montana reveals that the number of firms is already quite limited. The national milk distributing chain, Beatrice Foods, owns three processing plants. Safeway Stores Inc., an interstate grocery chain, operates one processing plant in Butte. Albertson's, another large food chain, has proposed buying raw milk from a Bozeman firm, shipping it to Riverton, Wyoming for processing and packaging, and selling it as Janet Lee brand milk in all Albertson's stores. A Helena district judge recently ruled that Albertson's would not need a license to deal in milk, since the law does not mention firms which handle all their own operations. This decision is currently on appeal to the state Supreme Court.\textsuperscript{13} Table 3 on page 83 lists each plant and its percentage share of the total Class I milk sales in pounds for April 1978 and April 1979.
TABLE 3
MARKET SHARES OF MONTANA PROCESSORS,
APRIL 1978 AND APRIL 1979

<table>
<thead>
<tr>
<th>Marketing Area</th>
<th>Plant</th>
<th>April 1978</th>
<th>April 1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>2, 8, 10</td>
<td>Beatrice Foods*</td>
<td>35.5%</td>
<td>40.7%</td>
</tr>
<tr>
<td>1</td>
<td>Gallatin Co-op</td>
<td>16.1</td>
<td>15.8</td>
</tr>
<tr>
<td>2</td>
<td>Jersey Creamery</td>
<td>11.0</td>
<td>10.0</td>
</tr>
<tr>
<td>11</td>
<td>Safeway, Inc.</td>
<td>9.8</td>
<td>8.8</td>
</tr>
<tr>
<td>6</td>
<td>Vita-Rich</td>
<td>8.7</td>
<td>7.8</td>
</tr>
<tr>
<td>9</td>
<td>Equity Supply</td>
<td>5.0</td>
<td>5.5</td>
</tr>
<tr>
<td>9</td>
<td>Skyline Dairy</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>12</td>
<td>Cloverleaf Dairy</td>
<td>3.7</td>
<td>3.8</td>
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<tr>
<td>5</td>
<td>Gate City Dairy</td>
<td>3.3</td>
<td>3.1</td>
</tr>
<tr>
<td>10</td>
<td>Consolidated Dairies</td>
<td>3.5</td>
<td>out-of-business *</td>
</tr>
<tr>
<td>10</td>
<td>Ravalli County</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Creamery</td>
<td></td>
<td>0.7</td>
</tr>
</tbody>
</table>

TOTAL: 100.0% 100.0%

*Beatrice Foods operates in Great Falls, Billings, and Missoula. In April 1979, their respective shares of the market were 15.0%, 11.9%, and 13.8%.

*Consolidated Dairies of Ronan had its business picked up by other western Montana processors.

Source: Data compiled from worksheets, Milk Control Division, Department of Business Regulation, June 1979.
Clearly, Beatrice Foods and the Gallatin Co-op Creamery already control over 50 percent of the fluid milk market in Montana. The pattern is like that throughout the nation; i.e., the processing-distribution industry has become an oligopoly. An oligopoly is characterized by many firms, but not so many that they are unaware of each other's market activities. Usually there is one dominant firm which serves as a price leader. Note that Beatrice alone controls 41 percent of the market. Firms in an oligopolistic industry tend toward stability with little or no price competition. The price leader would usually avoid over-pricing its product, since there exists enough competition to underprice it and capture part of its market. The leader is subject to larger sales losses in a price war. If all firms would agree to raise prices in conjunction with the leader, the higher price could be maintained. The major difference between Montana's oligopoly and that of many other states is that most states do not have resale price controls.

If wholesale price deregulation were phased in under the given market structure, would predatory pricing or monopolistic price gouging become a reality? There is much evidence to suggest this would not be the case. First, oligopolies have a natural tendency in the direction of price stability as was indicated in the previous paragraph. Any concerted action to raise prices in the absence of
normal market factors could be interpreted as a violation of federal antitrust law. Remember the results of such a uniform action in 1966.

Second, cutthroat competition by Beatrice or Safeway can be considered unlikely. Beatrice is watched very closely by the Federal Trade Commission and the U.S. Department of Justice. In 1966, Beatrice was found guilty of violating federal antitrust laws by virtue of their attempted monopolization of the national dairy industry. The FTC ordered divestiture of four major operations including their Missoula plant. (Under the terms of a consent decree adopted in 1967, Beatrice alternately gave up a number of creameries located in the southwestern U.S.) The commission noted that Montana's market was already highly concentrated in the early 1960s when the number of processors was far greater than 1979. Any price cutting or mergers with the intent of undermining competition would be an open violation of the law. There is no reason to believe that the FTC or the Justice Department would not respond accordingly. The same would be true of Safeway, which has also been found guilty of antitrust violations outside Montana.14

The willingness to ignore the law, despite the consequences, cannot be left undiscussed. It has been stated that many Montana distributors and retailers have violated state unfair trade laws in the past. It is
possible that someone could attempt predatory practices with the hope of grabbing an immediate financial gain before the state or federal government intervenes. There are several ways in which federal trade regulation policies could be supplemented. One is the presence of Montana's Antitrust Bureau in the state Department of Justice. Another would be the requirement of posting all prices with the state. Distributors would have to file their exact prices with the Milk Control Board. Competitors and the regulators could then easily observe unfair pricing practices. Posting is now required in Colorado, it has been successful in catching major infractions on the state's unfair trade practice rules. Still another protective device would be a legal provision against sales below cost. This law is utilized in several states without resale price controls as a means of protecting competition.15

Distributors operating under price controls probably forget that when facing competitive pressures, there will be an incentive to seek more efficient methods of distribution. Capitalizing on this incentive could insure successful operation at even lower DGMs. Consumers would benefit from these increased efficiencies. Thus, any competition which might take place among distributors may not have detrimental consequences unless inefficient firms are unable to cope with the rest of the market.
In addition to the arguments presented on past pages, some segments of the dairy industry have argued that deregulation of the resale level would wipe out independent jobbers. The author recalls the almost tearful display of one Missoula jobber before a committee considering decontrol legislation. He found it unconscionable that anyone would seriously consider undermining his business. Under deregulation, jobbers in the larger cities could have a rough time. However, since most jobbers are located in small communities where milk will continue to be demanded, the accusation that all jobbers would disappear is pure speculation.

The dairy industry as a whole has taken a rather pessimistic view of the thought of any eventual price reductions. It notes with some glee that over the past few years, while the index of all consumer prices has jumped over 100 percent, milk has averaged only an 88-89 percent change. Former State Sen. Terry Murphy sums up the typical milk dealers perspective:

I t is an unfounded hope to think decontrol will bring any long-term reduction in the retail price of milk. I've been trying to think of any necessary consumer items that have gotten cheaper lately in this time of inflation. Automobiles certainly haven't. Petroleum hasn't. Housing and clothing certainly haven't. Appliances aren't going down in price. How can anyone seriously expect food to get cheaper? Of course its the "impossible dream."

While there is an element of truth in the above argument, one should remind the dairymen that they are
avoiding some important facts. The use of CPI data is deceiving; is it really appropriate to compare the rather large increase in the price of one commodity—milk—with an average of increases in several commodities, including some which are probably not applicable to Montanans? Is it right for consumers regardless of their economic status to acquiesce in the inflationary cycle over which they have little control? Is it wrong to question prices which are based on inefficiencies? Why should a society seriously accept the consequences of distributional inequities? The milk industry should engage in more responsible debate and not beg the question of deregulation.

Views of the Regulators

The present administrator of the Milk Control Division has expressed personal reservations about major deregulation proposals. Resale price regulation would in his estimation lead to the end of Montana's dairy industry. Milk would be supplied to the state from nearby supply points like Spokane and Fargo; most local producers will have felt the backlash of economic destruction at the resale level. Beatrice and Safeway would dominate the distribution and retail sectors. Consumers would then pay a dear price for their milk.18
The administrator is equally concerned over the board's ability to regulate milk prices under existing procedures. He has criticized the Administrative Procedures Act for shackling the board's capacity to respond speedily and appropriately to needed price changes. This lack of independence does not work to the advantage of the consumer or the milk industry. Unfortunately for this point of view, the Act is probably here to stay. While designed to protect procedural rights of parties in a systematic and equitable manner, the APA forces us to pay a necessary cost in time and independence. It is possible that future reforms may find some solutions to its application, but that solution cannot and should not encompass arbitrary and capricious actions by administrative agencies.

Members of the Milk Control Board have also expressed opinions on deregulation. Two present board members, Curtis Cook and Ed Ward, have come to support resale price decontrol in conjunction with prohibitions against predatory practices. Another member, Ken Mortag, has expressed along the lines of the division administrator. Mortag believes that decontrol would work to the consumer's disadvantage. Prices are not unnaturally high now anyway, and producers are doing well, so why change the system. The entire board membership has endorsed a modest, in-house decontrol bill aimed at retail prices. This bill would also strengthen unfair trade
practice rules and give the board standby authority to regulate retail prices in the event of severe instabilities. This plan was designed to head off more ambitious decontrol measures prepared for the 1979 legislature. The fate of this bill will be discussed in the next chapter.  

Industry and Regulator View the Consumer

The author has indicated that the Milk Control Board has a definite bias in favor of consumers. One may ask how the industry views consumer opinion—especially those complaints over milk prices that have become more pronounced in recent years.

Terry Murphy's comment of a few pages back implies a certain sympathy with the consumer's plight. The industry's concern that deregulation would destroy competition and push prices far beyond current levels also implies that dealers may be interested in maintaining a system which works in the consumer interest. Thus, it would seem safe to conclude that most producers and distributors are legitimately concerned. Disagreement about milk control are grounded in perspectives which desire similar goals but different means to achieve them.

The above argument is somewhat simplistic. The author's personal experiences with some members of the milk lobby in 1979 have led him to conclude that some distributors are especially callous when it comes to consumer complaints.
Some of these individuals and their legislator supporters were considerably disturbed by the author's support of two deregulation bills. Of course, this observation may prove incorrect; it is very difficult to correctly ascertain their motives.

An interesting viewpoint of many dairymen and some of the board members is that so-called consumer complaints are infrequent and overstated. They base their opinion on the fact that few consumers ever testify at board hearings. They base their opinion on the fact that few consumers ever testify at board hearings.21 (A few also question the wisdom of ill-informed citizens making judgments about a highly technical and complex industry.)

These views represent a gross misunderstanding of regulatory politics. The average citizen is not always capable of leaving his or her job or family even for a short time to appear at a milk price hearing. Neither do all individuals have or take the time to understand all the details of the regulatory process; nor does the industry or the regulator spend much time advertising the subject of regulation. These factors do not make consumer complaints "infrequent" or "overstated;" rather, intervening variables usually prevent the consumer, industry and regulator from meeting face-to-face. Consumers can be faulted to some extent for not expanding their horizons beyond their private lives in order to deal with forces which affect them. This
fault does not deny the validity of their complaints; the survey data proves that point.

In the final analysis, consumerism is a form of public good. Individual consumers may be unwilling to seek certain goals because there is no expectation of reward or recognition. Because the individual faces other costly activities, he leaves the achievement of public goals to his neighbor, who in turn leaves it to his neighbor etc. If individuals can organize into an effective mass lobby, the costs of achieving public purposes can be minimized. Effective organization will ultimately be necessary to assure adequate representation before the Montana Milk Control Board.

Summary

The Montana dairy industry adamantly opposes deregulation. It perceives such a change as radically destructive of the peace and vitality it has enjoyed during the past forty years. Its position is somewhat logical, for the perceived comforts of regulation appear advantageous when compared with some of the uncertainties of change. This position is shared by some of those individuals charged with the duties of regulation.

Policy analysis suggest that industry perceptions are for the most part untenable. Fears of out-of-state competition and unnaturally high prices are unfounded or
overly simplistic. Monopolization is unlikely given legal and economic constraints. While price competition at the wholesale level may be less frequent under deregulation, due to oligopolistic conditions in the industry, there is no reason why price-stickiness should be countenanced by government. In fact, the "perceived comforts" of regulation may be detrimental to the industry's ultimate benefit.

The existence of derived externalities as discussed here and in the previous chapter have driven forces other than the board to seek major reforms. The history of this movement will be reviewed in Chapter VII.
CHAPTER VII


3 Ibid.


6 Office of the Legislative Auditor, Report, p. 64.


8 Office of the Legislative Auditor, Report, pp. 64-65.

9 Ibid., pp. 65-66.


"Milk license ruling goes in favor of Albertson's," Great Falls Tribune, 19 July 1978, p. 9; "Judge says license not needed in all milk production phases," Great Falls Tribune, 6 February 1979, p. 12.


Testimony of Terry Murphy to House Business and Industry Committee on HB 292, January 30, 1979, xerox copy in author's possession.

Interview with K. M. Kelly, Helena, MT, 22 June 1979.

Ibid.


Kenneth Mortag, Great Falls Tribune, 5 March 1979, p. 6.
CHAPTER VII

LEGISLATORS V. THE LAW: THE POLITICS OF Deregulation

Reform as Deregulation

In Chapter II it was shown how the milk control law was "improved" over the course of forty years. The changes that were made were but one type of suggested reform. Since 1937, the Montana legislature has considered several versions of reform that would repeal the law or at least inject competitive elements into its administration.

Early Proposals

An attempt was made to kill the infant regulatory program in 1937. H. H. Longenecker, a Republican State Representative from Hamilton, introduced a bill to dissolve the Milk Control Board and permanently suspend its activities. The dairy interests in Longenecker's district had been vehemently opposed to the 1935 law. Milk industry spokesmen from the rest of the state obviously had a different point of view; after a lengthy public hearing where pro-control forces were clearly in the majority, the House committee on dairying killed the bill unanimously.¹

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Opponents of the board were silent until 1951, when State Rep. Ed Foley (D-Butte) introduced another repeal measure. Unfortunately there are no available records of public hearings on the bill. All that is documented is that the bill met a swift death in the House Agriculture Committee. During the 1957 crisis over the milk board activities, State Sen. Micheal Ruane (D-Deer Lodge) introduced a repeal measure in the old State Boards Committee. Apparently Ruane hoped for a better hearing from this less agriculturally-oriented group. However, the bill was promptly re-referred to the Senate Agriculture Committee for its formal presentation. In his testimony, Ruane accused distributors of manipulating the milk board for their selfish ends. Board decisions were deemed arbitrary and unfair. Ruane also criticized the board for what he termed "rude" treatment of his constituents at a recent Anaconda price hearing. Except for a rather gruff implication from one of the committee members that Ruane knew nothing about dairying, there was no substantive discussion by the committee. Accepting the advice of milk industry lobbyists, the bill was unanimously killed.2

Another repeal bill was promoted in 1963 by Ruane's successor, Sen. Luke McKeon, and two conservative Republicans, Sen. J. S. Brenner of Beaverhead and A. R. McDonnell of Sweet Grass. This bill died in the Senate
A New Era of Change

The next set of deregulation proposals appeared in the early 1970s. State Sen. Paul Boylan (D-Gallatin), a former dairy farmer who had won an earlier court case against the milk board, called for the abolition of milk control laws in 1971. His bill died in committee as did its predecessors. The new formula pricing bill was seen as the better alternative. Boylan made an abortive attempt to have the entire Senate consider the bill on second reading, but his motion was soundly defeated.

In 1973 and 1975, Sen. Neil Lynch (D-Butte) tried a different approach to deregulation. He sponsored three bills which would have given the board authority to establish different price formulas for different methods of delivery. Home delivery rates would thus be set higher than normal retail store or dock delivery prices. The milk industry saw this as opening the floodgate to total deregulation. The first proposal, SB 379, died in the Senate Business and Industry Committee. Lynch could only muster fourteen senators to favor his proposal on the floor of the Senate. A second attempt to consider the bill in 1974 was ruled invalid by the rules committee; legislative procedures did not allow for a bill to be reintroduced if it had been killed in the same session. (The 1973-1974 legislature constituted
one session.) A final stab was taken with SB 286 in 1975. During hearings, Safeway Stores indicated support for the bill. The bill died in committee again at the request of dairy lobbyists.5

Another deregulation measure was introduced in the 1974 House by Norris Nichols (R-Stevensville) and Larry Fasbender (D-Fort Shaw.) Both men had been sponsors of the flexible formula pricing bill in 1971. Their new proposal would have decontrolled only resale prices; it died on a massive adverse committee report. Another House measure in 1975 sought an interim study of the milk control law. It failed 76-19. The resolution was supported by several Republicans and a few Democrats. Among the supporters were Harold Robbins (D-Roundup,) a creamery operator, and Howard Ellis (R-Missoula,) a small grocery store owner.6

The decontrol bills introduced during the early 1970s came at a time when consumer frustration with milk prices was not yet strong. Dairy industry lobbyists had an easy time convincing house and senate committees that change was unnecessary and potentially harmful. The majority of legislators did not see the matter as controversial and readily adopted the adverse committee reports of their colleagues. With the coming of the 1977 legislature, events would take a new direction.
Decontrol Proposals in the 1977 and 1979 Legislatures

The Legislative Auditor's Office had published a controversial report in late 1976 criticizing the need for milk price regulation. Agreeing with the auditor that major changes were needed in the law, two Democrat legislators took the initiative in sponsoring those changes. Rep. Jerry Metcalf (D-Helena) and Sen. Robert Watt (D-Missoula) drew up separate and unique proposals. Sen. Watt's bill abolished wholesale and retail price controls, but gave the Milk Control Board standby powers to implement them on a temporary basis in the event of serious economic instability. His bill would also have prohibited sales below cost and required retailers to obtain a license before selling milk. Retail licensure had been recommended by the auditor and the Milk Control Board as a method of controlling unfair trade practices in the milk industry. Should a retailer be found guilty of initiating or abetting an unfair trade practice, his license to sell milk could be revoked.

Rep. Metcalf's bill differed in many respects. Although his plan would have required retail licensure and prohibited the sale of milk as a loss leader, deregulation was extended only to jobber prices. The price-fixing powers of the board would continue, although the board would set maximum and nor minimum prices. Under such a system, distributors and retailers might have had some incentive to
compete on a price basis. One dealer could try and raise his price to the maximum, but if his competitors did not follow suit, he could face sales losses.9

Watt's and Metcalf's optimism that some reforms could be accomplished were not matched by the requisite number of votes. Milk industry lobbyists packed the committee rooms with dairymen who recited tales of economic woe should the existing law be changed. Except for the sponsor and a few random consumers, the Senate Agriculture and the House Business and Industry Committees killed the two bills. The full House adopted its adverse committee report 66-19, with liberal-progressive Democrats forming the bulk of the opposition. The Senate adopted its committee recommendation 37-4.10

Promising a tougher legislative fight in 1979, Rep. Metcalf planned an even more ambitious change in the milk control law. HB 292, introduced in the early days of the Forty-Sixth Legislature, sought decontrol of all prices in the milk industry. It also provided for strict prohibitions against certain unfair trade practices including sales below cost. Metcalf's hope that many consumers would support the bill in committee were short-lived. Only a few individuals arrived to endorse the measure. Organized milk lobbyists lambasted HB 292 as dangerous and irresponsible. For the first time since 1935, however, a legislative committee
disagreed with the milk industry. On a narrow majority vote, the House Business and Industry Committee gave the bill a do-pass recommendation and sent it to the full House. Liberal Democrats and a few Republicans provided the major support for HB 292 in committee.\textsuperscript{11}

The House did an about-face on the measure, killing it 60-33. Liberal Democrats were joined by a few urban Republicans in endorsing the bill, but the sentiments of rural Democrats and Republicans were too overwhelming for the decontrol cause. The Business and Industry Committee then sent another decontrol bill to the floor. HB 526, sponsored by Ken Nortvedt (R-Bozeman,) was less ambitious in scope; it called only for the elimination of retail price-fixing powers. It resembled to some extent the proposal endorsed by the Milk Control Board in late 1978. Before sending it to the floor, the committee broadened it to include wholesale price deregulation. The committee vote was again not representative of the full House's feelings. Another lopsided vote similar to the first spelled doom for the bill.\textsuperscript{12}

A senate bill revising the milk control laws—SB 365—received a hearing in the Senate Agriculture Committee but was killed at the sponsor's request when the House defeated both of its bills. As introduced by Sen. Paul Boylan, SB 365 would have abolished the Milk Control Board
and replaced it with a milk marketing administrator. This individual was empowered to set minimum retail prices on an emergency basis. Producer and wholesale price controls would not have been lifted. Some dairymen were disturbed at the idea of replacing the five-member board with a single official; one processor, Ed McHugh, was apparently delighted with the prospect as he believed it would be easier to "deal" (1) with an administrator.\(^{13}\)

**Analysis of Legislative Attitudes**

Despite the apparently strong sentiments for price deregulation, reform-minded legislators have been unable to press their case beyond the committee room. Consumer representation at these hearings has been small; industry lobbies have been large and skillfully orchestrated. The legislative arena is little different than that of a milk board hearing. Industry is carefully organized to protect its interest while consumers generally rely on low income citizens, university students and chance passers-by. The public goods problem discussed previously is rampant.

There are some interesting conclusions to be made about legislative attitudes on milk price control. It is overly simplistic to categorize the division of opinions along urban/rural lines. Urban legislators from both parties have formed the core of support for deregulation, but there are intervening variables which tend to dilute this core.
Why, for example, have many Republicans supported the milk control law? Political novices have suggested that this support runs counter to the free enterprise ethic so often endorsed by that party. The author has a theory which may explain this apparent contradiction. First, opinions and beliefs about free enterprise are nebulous and multifaceted. Many proponents of the general concept are willing to allow for exceptions in their own businesses, especially when the market is not producing results in their favor. Adam Smith recognized this fact as early as 1776. There is a good argument in suggesting that milk dealers are not subject to the same conditions as are other markets. That case was made in Chapter I. Regardless of the motivations, the argument is often made that one's own enterprise should not be subject to the discipline of the market.

Second, many dairymen are quite possibly Republicans. Republican legislators may be aware of this distinction and identify with their economic plight through the medium of party comradery. Along these same lines, it should be remembered that the milk lobby is generally the only group present in legislative hearings. Their arguments sound very convincing without a critique from organized decontrol advocates.\textsuperscript{14}

The unwillingness of some Republicans to endorse deregulation may have been due to the fear of federal
control. Should all price controls be lifted or break down, producers have the option of seeking protection of their prices through a federal government milk marketing order. (This program will be explained in Chapter VIII.) Many Republicans turn livid when they see anything with the word "federal" stamped on it. The author is convinced after conversations with some Republican legislators that they accept state control of milk prices as the lesser of two evils.¹⁵

Urban Democrats have in recent years more closely identified with consumer interests. Their suspicion of industry domination of the milk control process also accounts for their support of deregulation. These legislators do not have a bone to pick with small dairy producers. They are concerned with preserving small businesses in Montana, but have no desire to give unjust and uneconomic protection to the middleman.¹⁶

Summary

The decontrol constituency has had its roots primarily in urban legislators who believe milk control to be an abysmal statement of economic realities. While support for deregulation crosses party lines, it is not enough to counteract the well-organized and convincing dairy lobby. Consumer groups display their pent-up frustrations in letters to the editor and telephone surveys, and not where it would have the most impact—in legislative and administrative
lobbying. Before deregulation or other reforms will come about, advocates of change will have to translate their knowledge into practical political power.
CHAPTER VIII


House of Representatives, Montana, An Act to Revise the Milk Price Control Laws; etc., 46th Legislature, 1979, HB 526 (Second Reading); "House committee contemplates bottle clubs, sawdust and milk," Great Falls Tribune, 12 February 1979, p. 7.

Senate, Montana, An Act to Generally Revise the Milk Control Laws to Authorize a Milk Marketing Administrator; etc., 46th Legislature, 1979, SB 365; Personal Notes, Minutes of the Senate Agriculture Committee, February 16, 1979.

These observations have been made by Sen. Bob Brown (R-Whitefish.)

This comment was made to me by two Republican legislators in 1979; both of them represented urban districts.

Personal observation based on conversations with several Democratic legislators in 1979.
CHAPTER VIII

ALTERNATIVES TO EXISTING REGULATION

Varieties of Change

Previous chapters have listed many arguments advanced in favor of removing price controls. Many of the dairymen's doubts about decontrol were claimed to be unfounded. Some of former arguments have been drawn from the experiences of several states that have undergone deregulation in past years. It is instructive to view these varied experiences with an eye on possible changes in Montana. Decontrol of at least resale price controls has been pursued by a number of states since the 1950s. Less than ten states now control resale prices. Producer price controls have remained virtually untouched due to the peculiarities of the producer/distributor relationship.¹

Virginia, Georgia, Louisiana and California have relaxed much of their price-fixing power during the past twelve years. The results have been mixed. Virginia repealed retail price controls in 1974. Volume discounts are now observable in many areas of the state. Retail prices are relatively flexible with weekend specials being

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the common price-saving technique. Virginia law also allows for temporary standby powers to correct massive price instabilities. This power was used twice to restore retail prices to levels above producer prices in two marketing areas. Although five processing plants closed by 1976, regulators attributed the shutdowns to a number of factors aside from retail price deregulation.2

Georgia's price-fixing laws were declared unconstitutional in the late 1960s. Price wars did not occur in the state as a consequence, but retail prices did measure an increase over the past ten years. Processor-distributors have continued to depart from the industry at a rate that prevailed under price controls. The markets have remained relatively stable.3

Louisiana's first decontrol plan applied only to retail prices, but allowed discounts on various methods of wholesale delivery. Retail prices dropped some fourteen cents per half-gallon; supermarkets offered the most competition. After administrative problems damaged the wholesale price scheme, it was repealed by the 1976 legislature. Wholesale prices are now allowed to float, and sales below cost—defined as 106 percent of producer prices—are prohibited.4

California's minimum retail price controls were temporarily suspended in the San Francisco area by the state
director of the Food and Agriculture Department in January 1977. The impetus for change came from consumers and a cooperative food store in San Francisco; both complained that high milk prices were discouraging consumption. The test suspension reportedly saved consumers between $50 and $100 million. Producers did not suffer although the profits of the major supermarket chains were reduced. Small processors were also able to compete effectively according to government officials. The last available information to the author indicated that all retail controls were lifted by the end of 1977.  

On the matter of the processing industry, various studies have contended that resale price regulation has been associated with a greater number of plants and that relatively inefficient processors are protected. These firms are guaranteed a higher profit margin to compensate for the lack of innovation. A Federal Trade Commission report, however, contends that smaller-size operations can survive profitably under deregulation due to limited competition or transportation advantages. Idaho is one example of this phenomenon; twenty-four small and medium sized plants are able to thrive in this small state.  

Deregulation, then can produce a mixed bag of results. In some states retail price competition and lower prices are manifest. Instabilities have occurred in some states that
have prompted temporary government supervision. Many processors and distributors have survived the changes; others have disappeared due to inefficient operations condoned by price controls. Determining factors appear to be population, location, transportation costs, efficiency of operation, and the market structure of the processing-distribution industry.

There is no reason to believe that Montana could not achieve a level of deregulated stability similar to adjacent states, provided that certain checks and balances are built into the system. A proposal encompassing these goals will be presented in Chapter XI.

Federal Milk Marketing Orders

In advocating the total elimination of Montana's present milk control law, Rep. Jerry Metcalf attempted to console producers with the fact that they could always seek a federal milk marketing order (FMMO) to protect their prices. An FMMO is a regulation issued by the U.S. Secretary of Agriculture requiring processors to pay no less than certain minimum prices established according to use of the milk. The order is established after a public hearing on market conditions in a given area. The secretary's order becomes effective only after the producers approve it in a referendum. Much of the United States is covered by some fifty-five FMMOs. The orders differ little in purpose from existing producer price controls in Montana.7
An FMMO could be utilized in Montana under a scheme of total deregulation. Local dairymen are not too keen on the idea of federal assistance, however. Wholesale prices are not regulated under these orders, and distributors are opposed to any system without resale price protection. Producers have also expressed misgivings about the program. Should decontrol come about, time amassed in holding a public hearing, determining the basis for an order, and conducting a referendum could take many months. During this time, uncontrolled producer markets would be destabilized and the new marketing order would take effect in a state with few if any producers and distributors left to participate. There is also some question as to whether the order would cover all milk or only milk designated for drinking. Decontrolled non-fluid prices could bring lower incomes to dairy farmers.\(^8\)

Should total deregulation become the state of affairs, producers would likely scramble for an FMMO despite their concerns—even some dubious control is better than none at all. The fight for existing state controls has been and will continue to be intense as producers seek to maintain what they think is a better deal.

**An Incomes Policy: Target-Pricing**

Some experts in the field of agricultural policy have long suggested that the real problem of any agricultural sector is inadequate income. Low prices generate low
incomes which prevent the farmer from purchasing capital equipment, consumer goods, and the like. Since price-fixing that is not in line with market conditions tends to create distortions—shortages with lower-than-market prices, surpluses with higher-than-normal prices—it would be better to insure a proper income through subsidization. This can be accomplished by setting a target price above that which the market would establish. Producers would sell at the market price but would be compensated at a level equal to the target price less the market price multiplied by the number of goods the producer has sold. This plan, now used as a tool of federal agricultural policy, eliminates price distortions while giving consumers the opportunity to make purchases at lower prices. The producer is assured a target price that would provide him with a reasonable return on investments.\(^9\)

Such a scheme could be a theoretical substitute for Montana's existing control law. Producers and perhaps distributors could be compensated at target price levels while selling goods at lower market prices. The target prices could be established by the existing flexible formulas. The state would subsidize the industry to the extent that target prices exceeded market prices. Of course, the event that market prices exceeded the target price, there would be no subsidy. Payments could be made on a
regular basis after submission of actual cost and price data is submitted to the regulatory industry. Economists endorse an incomes policy of this type since it would bring the social cost of food production down to the level of consumer preferences, even if it costs the government; i.e., the taxpayer, in tax dollars.¹⁰

Serious workability questions can be raised about such a plan. To the author's knowledge, no policy of this kind is carried on at a state level. The economic resources required to make this plan feasible may be too enormous for a state to handle. There is also a question as to the perceived advantage of subsidies. When the target pricing plan was first advocated by the U.S. Department of Agriculture in the 1940s and early 1950s, many producers and politicians denounced it as "socialistic" and destructive of individual incentive.¹¹ There is no reason to believe that some segments of the Montana dairy industry and general public would react any differently as the 1970s comes to a close. Income subsidies are also quite visible and therefore, subject to public scrutiny and political logrolling. "Price" subsidies like the existing law hidden behind administrative doors. For reasons of economic and political impracticality developing an incomes policy may be a moot point. It would be interesting to further study its feasibility, though.
Cooperatives and Collective Bargaining

Another substitute for existing producer price regulation would be the formation of cooperatives among producers. The cooperative would collectively bargain for prices with a local distributor, or enter the processing-distribution business on its own. Formation of cooperatives among agricultural producers is permissible under state law and the federal Capper-Volstead Act of 1922. Minor adjustments in the state law could be made if necessary to accommodate special milk marketing co-ops.\textsuperscript{12}

Cooperative power restores a proper balance in the relationship of producers vis-a-vis their distributor. Some northwestern and south-central Montana producers consolidated in this fashion years ago to compete more effectively. Minimum price regulations should be enforced by law if necessary to provide floors beneath which strong distributors could not force a weaker producer association. A cooperative would also be able to take advantage of pooled human, capital, and financial resources.\textsuperscript{13}

Cooperatives are not without their problems. Abuse of internal authority is a common problem in cooperative management. Indeed, one observer of the Montana milk industry has suggested that the few dairy co-ops now operating in the state are not co-ops in the sense that their founders envisioned. They have taken on a monopolistic and
undemocratic nature not unlike the processor firms they were designed to counter in the 1920s and 1930s.\textsuperscript{14} The market power of large mid-western U.S. cooperatives in their dealings with distributors, retailers and even their own members speaks of the constant need for vigilence by the true owners of any cooperative organization.\textsuperscript{15}

The economic feasibility of producer-owned supply plants is also questionable. A study of such a plan was done several years ago at Montana State University and concluded that the projected returns did not justify the required investment by producers.\textsuperscript{16} Should the same results prove true today, only government subsidy could effect a profitable investment. The problem of subsidy was examined earlier.

The notion of cooperative marketing or collective bargaining by strong producers also raises the spector of abuse of that power insofar as the public is concerned. Memories of an interstate agricultural "holding action" by the National Farmers' Organization in 1967 are all too clear in the minds of many. The spectacle of seeing thousands of gallons of milk dumped in order to cut supplies and raise prices seems immoral in the minds of most citizens, even in it does make economic sense. Abnormal marketing actions and undue price enhancement are forbidden under Capper-Volstead and federal antitrust law, but even these restrictions have
not stopped farmers from engaging in questionable activity. Even price control looks better to some in comparison with this activity.17

Despite their inherent problems, cooperative marketing and processing could be a viable institution even with some minimum price fixtures left intact. As agriculture faces continuing demands on its land, labor and other resources, they may be the only feasibly farm organization for a state like sparsely-populated Montana.

Public Enterprise

During a period of milk market instability in Wisconsin in the 1930s, the state's legislature considered putting state or local government into the milk distribution business. This program of "municipalization" of private processor-distributors was designed to cut supposedly outlandish price-gouging by the industry in its dealing with producers and consumers. The bill had broad support, but not enough to insure its final passage.18

If Montana's oligopolistic distribution system would be unstable and exploitive under deregulation, then perhaps the proper safeguards would be the infusion of so-called "public enterprise" by the government. The enterprise could be of three kinds: (1) Direct state ownership and operation of one or more processing plants purchased from private owners or newly built with public funds. Montana has
already established a precedent of public ownership in the liquor business. The state-owned facilities would serve as a "yardstick" in measuring the practices of privately-owned distributors. The public firms could be required to operate at a profit and submit payments in lieu of taxes paid by a regular private firm. This would insure some parity in the competition between public and private firms; (2) Partial public ownership and/or supervision of privately-owned distributors. The state would purchase an interest in an existing company's activities, or appoint "public directors" as part of the management of the firm. The director would have access to records and activities of the distributor. This would insure the state an opportunity to measure the equity and economy of the firm's business practices; (3) Regulation of milk distributors as a "public utility" like Montana Power or Mountain Bell. The state would insure specific and reasonable profits to each firm at rates that are fair and just to retailers, producers and consumers.19

There is little likelihood of the third alternative becoming a reality. The U.S. Supreme Court ruled in Hegemen Farms Corporation v. Baldwin that while affected with a public interest, the milk industry cannot be considered a public utility in the legal sense.20 The first and second options would surely be seen as alien and too ambitious by the industry, government, and the public. The cry of

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socialism may prove too effective even in a day when more citizens urge the nationalization of the oil industry. Wholly-owned public firms may prove inefficient and seek legislative subsidization as a bail-out for ineptitude. Partial ownership may be impractical and ill-suited to the internal ownership-management structure of Montana distributors.

Wolf's theory of non-market failures easily applies in the case of public enterprise. There is also a question as to whether the problems of an oligopolistic industry really require drastic government supervision. The costs of regulation may outweigh any potential gains, although the provision for public directors or supervisors might provide a means of preventing unfair trade practices.

A Consumer Council

When public utilities in Montana seek a rate increase, the consumer is assured of representation by trained, supervised economists and attorneys; i.e., the Montana Consumer Council. The creation of a "milk consumer council" that would intervene on behalf of consumers during public hearings on price order or board regulations could insure a consistent pattern of misrepresentation that the board does not now see. A small staff consisting of accountants, economists and attorneys could be supported by a small checkoff fee on the retail price of milk, just as
public utilities pay a small consumer tax today. The council could be supervised by a bipartisan legislative committee paralleling the present Legislative Consumer Council.

It can be argued that such a mechanism duplicates existing functions of the Montana Milk Control Board. The board is presently made up of consumers. They and the staff of the Milk Control Division presumably establish prices that are fair to all parties. However, this same argument could be made about the Public Service Commission. Elected commissioners theoretically represent the legitimate interests of the public as well as the utilities. The Consumer Council insures that public representation is real and not assumed. The prospects for a legislative milk consumer council should be pursued as a means of solving the public goods problem if the existing regulatory machinery is to remain intact.

Summary

Although there are alternatives to the present system, the practicality of each one can be called into question. Some form of deregulation, possibly combined with bits and pieces of other proposals, seems to be the only practical alternative from an economic standpoint. Milk price regulation operates within a political framework, however. The evidence presented in Chapter VII suggests that radical reform of the existing law has been an impossibility. Such
reforms are advancing more rapidly nowadays and may receive support in constituencies other than the legislature. Developing a base for political change will be the subject of Chapter IX.
NOTES

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2 Office of the Legislative Auditor, Report, p. 72.

3 Ibid., p. 73.

4 Ibid., p. 73.


10 Ibid., p. 395.

11 Personal conversations with several farmers and ranchers in Cascade and Chouteau counties.


The name of this individual is withheld upon request.


Letter from K. M. Kelly, Administrator, Milk Control Division, Department of Business Regulation, to the author, 7 June 1979.


293 U.S. 163 (1934).
CHAPTER IX

SOURCES OF REFORM: AN EVALUATION

Building a Constituency for Change

Various legislators and the Milk Control Board have tried and failed to direct new ideas into constructive action. Assuming the continued saliency of milk prices as a political issue, it is wise to consider whether these groups can translate a knowledge of reform into political change. This consideration will be examined in the following pages, keeping in mind the proposition that the dairy industry is not likely to compromise the law much further.

The Legislature

While decontrol legislation has failed to pass every time since 1937, the legislature is still a likely forum for change. Optimists point to one existing mechanism as a means of controlling potential abuses and indiscretions of public regulatory agencies. This mechanism, the so-called "sunset law," is designed to abolish or restructure agencies that are no longer serving the purposes for which they are intended. Legislative policy declares that business and professional regulation must serve the public health and
welfare and not have an adverse effect on the competitive market. Theoretically, all agencies involved in such regulation are automatically terminated unless a performance audit indicates that the agency serves a useful purpose. If it is reestablished, its life is extended for six years, whereupon a new performance audit will be conducted. Sunset is an action-forcing mechanism which forces legislators to review their creations periodically. The burden of proof of service is shifted from the legislature to the agency.\(^1\)

All agencies are reviewed on a cyclical basis. Fourteen agencies were reviewed between 1977 and 1979. Another twenty-one agencies will be reviewed between 1979 and 1981. The final cycle will extend from 1981 to 1983. The Milk Control Board will be included in the final cycle. The legislative auditor's office is responsible for developing performance audits of each agency during the examination period.\(^2\)

Like performance budgeting, management by objectives, and zero-based budgeting, there is something of political naivete in the establishment of sunset legislation. Not all individuals concur on one definition of the "public health and welfare" or "efficiency?" These terms take on a political meaning as various interest groups jockey to save those boards and agencies that "truly" serve the public, and eliminate the "unnecessary" or "detrimental" ones. A sunset
law can provide information on agency activities and perhaps force the consideration of that information, but it cannot require the information to be believed or accepted by all individuals.\footnote{3}

Of the thirteen agencies up for review by the 1979 legislature, only three were abolished; none of these were of much significance in the regulatory framework of the state. The rest were reenacted with only modest revisions. Legislative action did not follow recommendations in many cases. A notable exception was the restructuring of real estate regulation. Still, the future may prove the better of sunset; after all, it has nowhere to go but up.\footnote{4}

The legislative auditor has already questioned the need for resale price protection of milk. It remains to be seen whether the legislature will ultimately carry out those recommendations. That will depend on whether several legislators are either convinced of the need for change or replaced by people who are already convinced. This puts a great burden on the public—especially urban voters—to relay any dissatisfaction they might have with milk control.

The Governor

Montana governors have not been known to provide much effective leadership in legislative matters; there are a few exceptions to this rule (e.g., Joseph Dixon and Forrest Anderson.) The present governor, Thomas Judge,
sides with the advocates of control. One Republican candi- 
date for governor in 1980 has supported deregulation mea-
sures as a legislator, but he may not press the issue in his 
campaign. Taxing, government spending, and environment/
energy problems will be given more importance in the hierar-
chy of campaign politics. It is also unlikely that a gover-
nor or governor candidate will alienate rural constituents 
on the issue of milk control. All the major farm organiza-
tions have opposed deregulation in previous sessions.

Other Executive Branch Agencies

The Milk Control Board has been skewered on several 
occasions when trying to devise new price orders. Should the 
board's recent proposal survive an August 1979 hearing and 
possible court challenge, it will be the first significant 
change in many years. The outcome is not easily predictable.

Another executive agency has indicated an interest in 
criticizing the present regulatory structure. The Antitrust 
Enforcement Bureau (AEB) of the Montana Department of 
Justice is presently investigating state agency practices 
which may adversely affect competition. The milk board has 
been selected as one of their prime areas of investigation. 
The Federal Trade Commission has let it be known that it will 
strike down regulations that have outlived their purpose and 
which perpetuate inequities and inefficiencies. The FTC has 
already acted on legal and dental advertising, and eyeglass
manufacturing and sales. Milk control is another potential area of study. The AEB program gives Montana a chance to "put its own house in order before the federal government sends in a housekeeper." 8

AEB files are confidential, so this author is unaware of their contents. All that is known is that the investigation has proceeded as planned. 9

The Courts

The Montana judiciary is not a proper forum for revamping economic regulation. The Supreme Court has made it clear that the milk control law is constitutional; it will not question the economic wisdom of the lawmakers. A recent Nebraska Supreme Court decision striking down that state's milk control law is inapplicable to Montana. The Gillette Dairy Inc., v. Nebraska Dairy Product Board ruling uses a substantive due process test to question economic judgments. This test is almost never applied in economic cases—at least that has been the rule since the Nebbia decision in 1934. 10

District courts and attorneys in Montana will likely follow the lead of the Supreme Court in assessing the validity of milk price regulation. Attorneys who defended Rehberg in 1962 were conservative Republicans opposed to government regulation. The Chief Attorney, Rex Hibbs, voted against the 1959 amendments when serving as a state senator
from Yellowstone County. Courts will only provide a check on questionable administrative decisions of the Milk Control Board.

**Political Parties**

Montana's political parties will not force the issue of milk price deregulation. The issue would be hotly contested and would leave bad feelings more than party unity. Also, parties are notoriously incapable of enforcing many platform decisions on their legislators. In the absence of sanctions; i.e., control over candidate selection, primary endorsements, etc., political parties are not a sound constituency for change.

**The Dairy Industry**

One cannot leave out the possibility that the industry itself will support a reform proposal—at the very least, a compromise measure which would take some of the steam out of a full-blown reform effort. One eastern Montana producer remarked to this writer after a legislative hearing that "something has got to be done with the law to keep everybody happy, but I just don't know what that is." Another source within the industry has indicated that even Jimmy "the Greek" Snyder would not lay good money down on the chances of getting the industry to change—much less even estimate the odds. This source characterizes the
dairymen—mainly the distributors—as too stubborn and unwilling to change despite the pleadings of their more astute lobbyists. Some of them are legitimately concerned for their financial welfare; the others are described as selfish souls who have only disdain for the public.¹³

Unless a respectable opposition develops in the political arena, the dairy lobby will wage a heated battle for its views. The comfort of the status quo is not worth a sacrifice.

The Public

The problems of consumer organization have been thoroughly explained. One group is now attempting to solve that problem by sponsoring an initiative to repeal price controls. Not much is known about this effort, although its existence has been confirmed by several sources.¹⁴ Assuming surveys are registering a correct reading on public view, a small, inexpensive repeal effort could garner many signatures in the urban areas and gain ballot status. The liberalization of requirements for obtaining signatures on an initiative has contributed to the eventual success of many recent ballot issues. Thus, a popular initiative may be the easiest means of reforming the milk control law between now and 1981.¹⁵
One problem with voter initiatives is that they can be hastily and sloppily written without regard for legal, economic, and political consequences. Two such measures, a recall procedure for public officials and a state budget ceiling, found their way to the 1976 ballot. Both proposals contained ambiguous and inconsistent wording. Voters defeated the budget proposal but passed the recall plan. The 1977 legislature had to amend the procedures to remove ambiguities. An improperly worded initiative on milk control would have to be drastically revised by the legislature. Even a well-written proposal could face retaliation by dairymen in the 1981 legislature. Consumer vigilance would have to extend beyond the November election to make any successful initiative a lasting proposition.

Summary

Few of Montana's political institutions offer themselves as viable constituencies for radical restructuring of the milk control law. The people have often responded directly when their elected officials fail to act according to their wishes. The events of the coming year will prove whether milk price controls will be subject to this direct action.
NOTES

CHAPTER X


2Ibid., pp. 1828-1831.


4Personal compilation of sunset activities and reform measures.

5"Judge says milk price not the real problem," Great Falls Tribune, 10 March 1979, p. 31.

6Jack Ramirez voted for HB 292 and HB 526 during the 1979 legislative session.

7Personal notes, testimony of Terry Murphy on behalf of the National Farmers' Organization, the Montana Farm Bureau, the Montana Farmers' Union, Women Involved in Farm Economics, and the Agricultural Preservation Organization.


13Interview with "Mr. X," Helena, Montana, 2 February 1979.

14Interview with Al Dougherty, Helena, Montana, 22 June 1979.


16Ibid., pp. 279-80.
CHAPTER X

ANALYSIS AND CONCLUSIONS

A Historical Overview

The history of milk price regulation in Montana has a dual face. Sincerity of purpose in designing the law has often been matched by abuse and domination in its implementation. The chaotic conditions which prompted enactment of the law in the 1930s have been replaced by new market realities. Although processor-distributor control of the board and the direction of the law has been muted in past years, a consumer-oriented board has been frustrated in its attempt to further rectify the economic and political imbalance. The public's dissatisfaction with milk prices has not been channeled into constructive change due to the public goods problem and the definite political advantage held by the organized dairy lobby.

In short, the operation of the Milk Control Board falls neatly within the confines of Wolf's theory of non-market failure. Regulation seems to have a logic all its own; its path is embellished with increasingly detailed controls and the inequities and externalities that arise as a
consequence of those controls. One political scientist has recently suggested that the breakdown of bureaucratic control in states like Montana may lead to federal preemption of many traditional state responsibilities.\(^1\) The Federal Trade Commission may in fact be the agent which ultimately corrects deficiencies in the milk control law. Ironically, Montana dairymen have insisted that the state rather than the federal government is in a better position to keep the economic peace of their industry!

A Modest Proposal

In order that Montana might put its own house in order, the author has some suggested proposals which could correct economic inefficiency and diffuse industry political clout:

1. Wholesale and retail price controls, including the setting of jobber prices, should be phased out gradually. The legislature or the people by initiative should specify a deadline for termination of controls. The milk board would develop the administrative details for the phase-out.

2. The board should retain authority to reimpose resale price controls on a temporary basis in the event of emergencies. The law should define "emergency" so as not to not allow broad administrative discretion or unwarranted influence by the industry. A presumption in favor of competitive markets should be established by the legislature as a guide to the board when exercising their power. An emergency order would be adopted without need of a public hearing and would be in effect for, say, 120 days. During the period of the order, a hearing should be held to determine whether the order should be extended.
3. Mechanisms should be established to protect against predatory pricing in the dairy industry. Useful tools could include requiring dealers to post their costs and prices on a periodic basis, and prohibiting sales below cost. Continuous monitoring by state antitrust authorities of potential abuses in the industry will be necessary.

There are some problems with prohibiting sales below costs. Unless a workable definition of dealers' cost can be agreed upon, enforcement of this provision would be difficult. Such prohibitions could themselves be interpreted under certain conditions as a form of resale price maintenance and therefore, potentially damaging to the public interest. The legislature should devise a workable standard based on the experiences of other states.

4. Producer price controls should be continued. While this might seem discriminatory to distributors, it can be justified on the basis of the unique relationship between producer and distributor. Guiding principles behind this proposal are protection of small agricultural units as a social good, and realization of the political clout of the dairy lobby.

Legal price protection always involves the possibility of economic inefficiencies. In the long run, it would be more economically advantageous for producers to develop cooperative processing and/or marketing programs as an alternative to producer price controls. These efforts could provide suitable prices and the ability to exploit economies of scale. Economic efficiencies derived from cooperative ventures could then be transferred to consumers.

5. All milk retailers should be licensed. The license would be purchased for a nominal fee and would be subject to suspension or revocation upon a finding that the law or board rules and orders have been violated by the retailer. The license should not be issued on a quota basis. The purpose of retail licensure is to give the board greater authority in controlling unfair trade practices.

6. The independent testing program of the board should be strengthened. The 1977 legislature gave the Department of Business Regulation the authority to inspect milk on an independent basis. The 1979 legislature cut this program back. Despite the
existence of Proposition 13 fever, the legislature should be obligated to fund those laws it has enacted. The testing program can be used to catch unscrupulous processors and assist honest firms to update the quality of their testing program.3

With the major exception of wholesale price deregulation, and the provision for lesser items, this proposal is remarkably similar to one endorsed by the Milk Control Board in late 1978.4 Processor-distributors should not be entitled to full price protection, given the arguments advanced earlier. The provisions of items 3 and 5 of the above proposal should be sufficient safeguards. Government price protection of an oligopoly is practically unnecessary if not down right absurd.5

One point not yet stressed is that processor-distributors have been departing the industry at a standard rate under price control. This has been due to a number of factors: inefficiency of operation; poor management; etc. There is no reason to believe that these problems will cease when and if price controls are lifted. Legislators, the board, and the public should be on guard that the industry does not use the phenomena of natural departure as a guise for reimplementing a permanent price-fixing scheme.

This package of reforms may appear to be a less-than-logical outcome of the critical analysis presented in previous chapters. The author has tempered the necessity of reform with political realities. It is reasonable to expect

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reformers to implement a proposal without making certain concessions to dairy interests. Unless the balance of power is overwhelmingly in favor of the reformers, trade-offs and compromise of economic and political values will be necessary. This "modest proposal" is designed with political realities in mind.

Conclusion

Harold Lasswell once described politics as a process of who gets what, when, and how. Obviously the design, implementation, and continuation of milk price control fits into this general category of political intrigue. Alternatives to existing regulations will come about only at the expense of a fierce lobbying effort by many interests. Efforts to dissolve the inequities of regulation have been successful in many states. It remains to be seen whether Montana will accomplish the same goal without contributing to economic chaos. Failure to proceed in a reasonable fashion may lead to "Big Brother" in Washington becoming the final arbiter.
NOTES

CHAPTER XI

1"Unicameral legislature could cure state's political ills, says UM prof," Great Falls Tribune, 8 July 1979, p. 15.


5"Milk ruling lauded," Great Falls Tribune, 27 April 1976, p. 5.

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