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BARRIERS AND THE MILK INDUSTRY

Edgar L. Burtis*

Importance of Barriers in the Milk Industry

The sale of milk and other dairy products is the most important single source of income to the farmers of the United States. According to estimates made by the Bureau of Agricultural Economics, cash income received by farmers from the sale of dairy products totaled \$4,283,000,000 for the years 1937, 1938, and 1939, an average of \$1,428,000,000 per year, and equal to 18 percent of the entire cash income received from the sale of all farm products during the same period.¹

The size of the dairy industry constitutes in itself a good reason for paying special attention to barriers to trade in dairy products; the prevalence of these barriers adds an even better reason. Although no comprehensive study of the extent of dairy barriers has been made, students of dairy marketing have long been aware that they exist, and a surprisingly large number are cited in "Barriers to Internal Trade in Farm Products," a report published about a year and a half ago by the Bureau of Agricultural Economics. Apparently, hindrances to the entry of fluid milk into local markets are widespread. Obstacles to trade in other dairy products are apparently less common, but still occur frequently enough to have serious effects on the marketing of dairy products. It is difficult to ship cream into some of the Eastern States and cities from beyond certain limits; a few States and cities have extended their restrictions to ice cream mix; and even canned milk is affected by the regulations in a few places.

The importance of the dairy industry to Indiana agriculture can be measured by the cash income of farmers from sales of dairy products, averaging approximately \$44,000,000 annually over the three years 1937, 1938, and 1939. This was roughly one-sixth of Indiana farmers' cash income from

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¹ Dairy farmers also have a secondary source of revenue in the sale for slaughter of surplus calves and of heifers and cows culled out of their herds.

sales of farm products. It has been estimated that somewhere around sixty percent of the dairy products produced in Indiana is shipped out of the State.² Most of this undoubtedly moves to Eastern consuming centers.

Trade barriers have affected the dairy industry in Indiana principally by making it difficult to ship cream to many of the Eastern markets. No adequate figures on the trend of these shipments are available, but there is some evidence that they have been decreased by restrictive measures. The same evidence indicates that there is a substantial volume of cream that would be shipped East, were it not for the trade-barrier aspects of the health regulations of some of the Eastern markets.³

Nature of Barriers in the Milk Industry

Barriers to trade in dairy products have arisen from two sources. Only one of these is important at present; the other at one time threatened to become important and may perhaps again do so. The first source is the insistence of many local and State health authorities on sending their own inspectors out to all the farms and milk plants that furnish supplies of milk—and sometimes to those that furnish supplies of some of the other dairy products—for the markets under their care, regardless of how far the farm or milk plant is from the market. This in itself does not create a trade barrier but is the basic element of most trade-barrier situations in the dairy industry. The second source was the attempt of State milk boards to fix the prices to be paid to producers in other States for milk shipped into the State.

1. *Public health measures as barriers.*—The method by which the health authorities in most States and municipalities ensure a clean, disease-free supply of milk for the market area under their care is to forbid the sale of milk there unless it comes from farms and milk plants that have been licensed to ship into the area. These licenses are issued by the health authorities after the dairy farms and milk plants have been

² See the testimony of Mr. Walter R. Freeman, Secretary of the Indiana Milk and Cream Improvement Association, Indianapolis, Indiana, before the Temporary National Economic Committee, March 20, 1940.

³ See the testimony of Mr. A. T. Money, Mr. Freeman, and Mr. W. T. Creighton before the Temporary National Economic Committee, March 20, 1940.

inspected and found to meet the prescribed standards of cleanliness and sanitation. Farms or milk plants that fail to meet these standards are not granted licenses and accordingly may not ship into the market area in question. Licenses once granted are revocable. The health authorities make periodic inspections, and if the sanitary standards are not maintained, licenses are revoked. In addition to inspections to see that sanitary standards are kept up, bacteria counts are usually taken, both of the raw milk as it is received from the farmers and of the bottled milk ready for the consumer.

If trade barriers were necessarily involved in these measures for protecting public health, there would be no valid ground for advocating their elimination. They would be a cheap price to pay for the prevention of serious outbreaks of disease. Fortunately, this is not the choice that confronts us. The true choice is between public health regulations that have a trade-barrier aspect and equally effective regulations that do not.

The choice, rather, lies between an uncoördinated and a coördinated system of inspection. At present there are many cities and towns and several States which will not admit supplies of milk or of some of the other dairy products unless the sources of supply have been inspected by their own corps of inspectors. They will not accredit the results of inspections made by other States or other municipalities. This is not sufficient in itself to create a trade-barrier situation, but it is the basic element of barriers that have their source in public health regulations.

There are many municipalities and a few States, for example, that fail to provide inspection outside of a certain limited zone, and yet refuse to accept the inspections of any other municipalities or States. As a result, the market is closed completely to farmers and milk plants located outside the limited area within which inspection is provided.

The Executive Secretary of the Commission on Interstate Cooperation of the State of Indiana, Mr. William E. Treadway, in speaking of this type of barrier as it has affected the dairy industry in Indiana, explained how it works, as follows:

"Certain jurisdictions limit the area within which inspections will be made by a definite radius of miles from the point of consumption, while others limit the area within which milk will be inspected to an

arbitrary area such as the State itself, or to certain designated counties of surrounding States. An equally effective trade barrier is afforded . . . by the purported or expressed inability of the States . . . to make the inspection. They profess good faith, they insist they have the best qualified trained staff of inspectors who are acquainted with their local requirements and local laws and regulations, and in whom they have the utmost confidence, and are quite willing to make the inspection, but usually they say, due to lack of personnel or due to lack of funds, they are unable to (send) their inspectors out . . . ”

A study of regulations affecting dairy products marketed in New England discovered three towns in Massachusetts—Haverhill, Walpole, and North Attleboro—that had set a definite limit on the area from which they will accept milk supplies.⁴ Several years ago a similar limitation was placed on the area from which supplies would be permitted to be shipped into Baltimore. In this case the limitation was imposed by a ruling of the commissioner of health.⁵ Since 1926, the area of inspection for the New York City market has been definitely limited, and it is practically impossible to ship fluid milk or cream to New York City from points west of the Pennsylvania and New York State lines.⁶ There are perhaps a few points in Ohio from which fluid milk could profitably be shipped to the New York City market and which can, therefore, be said to be excluded from that market by the inspection regulations. But in the case of cream, which combines greater value with less bulk and can accordingly be shipped for longer distances, the New York regulations have the effect of shutting out Western cream.⁷

Other States and municipalities establish a limited zone within which they provide free inspection, but outside of which they require the dairy farmer or milk plant to pay the costs of inspection. At the same time they refuse to accept

⁴ Milk may not be marketed in Haverhill (1930 population 48,710) if produced more than 40 miles away; in Walpole (1930 population, 7,273) if produced more than 30 miles away; in North Attleboro (1930 population, 10,197) if produced more than 8 miles away. See Bressler, R. G., Jr., *Laws and Regulations Governing the Production of Grade B Milk in New England*. (Issued by the New England Research Council on Marketing and Food Supply); Boston, 1938. (Mimeographed.)

⁵ The ruling was declared invalid by a Federal Court. *Miller v. Williams*, 12 F. Supp. 241 (1935).

⁶ Report of the Federal Trade Commission on the Sale and Distribution of Milk and Milk Products, New York Milk Sales Area, 75th Cong., 1st Sess., House Doc. No. 95 (1937) 7.

⁷ Spencer, *Practice and Theory of Market Exclusion within the United States* (1933) 15 J. Farm Econ. 147.

any inspection other than their own. A farmer or milk plant located outside the zone of free inspection is, therefore, burdened with an inspection fee which his competitor within the zone escapes.

Mr. Treadway has also given an example of how this second type of barrier works out in relation to the Indiana dairy industry. "Connecticut," he said, "has never declined to make any inspection, to my knowledge, in the Middle West, but its inspection service is only good for a period of 6 months and must be renewed twice a year to permit our shippers to engage in that market." There has been some controversy over what the inspection fee would be. The manager of one milk plant in Indiana with 1,200 patrons estimated that Connecticut inspection would cost \$3,500 a year.⁸ This estimate seems to have been based on a misunderstanding, and the true figure may be as low as \$1,300 a year. The principle remains the same in either case—Indiana producers must pay a fee, not required of their Connecticut competitors, for entry into the Connecticut market—and the sum involved is large enough to make a difference.

A similar situation was reported by the manager of a Missouri creamery. He said, in part:

"... some time ago our company considered applying for a permit to ship sweet cream into an eastern market. It was discovered that we would have to have inspection from four municipalities, and decided this expense, estimated at four to eight thousand dollars, would be too great and would overcome the advantage of that particular market for our farmers."⁹

Connecticut is, of course, not the only jurisdiction that follows the practice of requiring producers beyond a certain zone to pay the costs of inspection. The cities of Baltimore and Cleveland and the State of Pennsylvania, among others, have the same requirement.¹⁰

A third type of barrier that sometimes occurs is the multiplicity of inspections that some dairy farms and milk

⁸ See the testimony by Mr. Treadway and Mr. Money before the Temporary National Economic Committee, March 20, 1940.

⁹ Quoted from the testimony of Mr. Creighton before the Temporary National Economics Committee, March 20, 1940.

¹⁰ Taylor, Burtis, and Waugh. *Barriers to Internal Trade in Farm Products*, a Special Report by the Bureau of Agricultural Economics to the Secretary of Agriculture, Washington, D. C. (March, 1939) 9.

plants have to undergo. In its investigation of the New York milkshed the Federal Trade Commission found that:

"Usually each State, subdivision of a State, and municipality, insists on making its own inspection and will not accept inspections by authorities of other jurisdictions. Operators of country receiving plants and farmers supplying them sometimes find it necessary to submit to as many as seven or more separate inspections."¹¹

How this affects cream shippers is well illustrated by the following example:

"Here is the way some of these trade barriers affect certain farmers in Ohio. A plant shipping cream into New Jersey must have the inspection of New Jersey and this inspection is quite thorough. The same plant ships to Cleveland, and this city will not recognize the New Jersey inspection because it has one of its own.

"Furthermore, the local health department of the city where the plant is located will not accept the inspection of Cleveland nor New Jersey, and both of these are reported to be more rigid than the inspection of the local health department. In order to sell milk locally it would be necessary to have three different sets of inspectors bothering farmers as well as the plants. If they were to ship into Pennsylvania farmers would be required to have still another inspection."¹²

Another example, referring to Indiana cream shippers, is the following:

"Indiana at times sends this product (sweet cream) to markets in Massachusetts and it goes as far sometimes as Florida. It has a wide range, depending upon the season and the demand. . . . If a specific market . . . would have a use for several cans of cream, then before our cream could get to that market it would be necessary that an inspection of the farm and the plant be made. . . . That would entail considerable expense, not only in equipping farms and the plant but the actual expense of having the inspection made.

"Then another market requires possibly the same amount (of cream), and it means a reinspection, and some difference in equipment, both of plants and of farms. When we add these all together, we find too much expense to allow us to ship the cream into those markets."¹³

¹¹ Report of the Federal Trade Commission on the Sale and Distribution of Milk and Milk Products, New York Milk Sales Area, 75th Cong., 1st. Sess., House Doc. 95 (1937) 3.

¹² Quoted from the testimony of Dr. Harrison A. Ruehe, Head of the Department of Dairy Husbandry, University of Illinois, before the Temporary National Economic Committee, March 20, 1940.

¹³ Quoted from the testimony of Mr. Freeman before the Temporary National Economic Committee, March 20, 1940.

The hampering effect of multiple inspections is a subject for complaint from another surplus-producing State, Vermont. An official of this State is quoted as follows:¹⁴

"The utter lack of uniformity in sanitary inspection requirements among the States into which our dairy products are shipped is a serious handicap to Vermont dairy interests. It is a source of constant difficulty and annoyance and if these requirements could be made uniform it would be very helpful indeed."

A fourth type of barrier arising from health regulations may be mentioned briefly. A number of cities have enacted ordinances forbidding new permits to be issued to distributors who do not have a pasteurizing plant within the city limits.¹⁵ One Eastern State requires all grade A bottled milk to be pasteurized and bottled within the State. Another requires milk shipped into the State to go directly from the farm where it is produced to the consumer or dealer in the State.

The restrictive effect of all these regulations is apparent. They tend to limit the area from which supplies of dairy products can be shipped into the market, regardless of whether the excluded supplies are satisfactory from a health standpoint.

2. *Economic stabilization measures as trade barriers.*

Falling prices for dairy products in the early thirties resulted in a wave of State milk control laws. Since 1933, when the first of these were enacted, 24 States in all have adopted them.¹⁶ Some have been repealed, however, and others have been invalidated in court tests.¹⁷ At the present time they are to be found in the statute books of 20 States.

The outstanding feature of the State milk control laws is the setting up of a State milk control board empowered to fix the prices that milk distributors must pay the producers.

¹⁴ Taylor, Burtis, and Waugh, *supra*, note 9; 12.

¹⁵ A Minneapolis ordinance to this effect was declared unconstitutional by the State Supreme Court. *State ex rel. Larson v. City of Minneapolis*, 190 Minn. 138, 251 N. W. 121 (1933).

¹⁶ Not counting some sketchy laws of doubtful effectiveness.

¹⁷ Some of the laws invalidated have been replaced by new legislation. Unconstitutional delegation of legislative power played a large part in the adverse decisions. See *Uhden v. Greenough*, 181 Wash. 412, 43 P. (2d) 983, (1935), *Grifiths v. Robinson*, 181 Wash. 438, 43 P. (2d) 997, (1935), *Maryland Cooperative Milk Producers v. Miller*, 170 Md. 81, 182 Atl. 432 (1936), and *Rowell v. State Board of Agriculture*, 99 P. (2d) 1 (1940). The decision in *Baldwin v. Seelig*, 294 U. S. 522 (1935), mentioned in the text below, was based upon the effect of the law upon interstate commerce, but it invalidated only a portion of the act in question.

In all States except one the board also has the power to fix minimum prices to be paid by consumers.

In some of the Eastern States it soon proved impossible to set the price to be paid producers within the State at the desired level without also specifying the price that distributors must pay for milk produced in other States. Some of the early milk control laws provided that milk must be purchased from out-of-State producers at a price not lower than that "required to be paid for milk produced within the State purchased under similar conditions."¹⁸

A New York dealer who purchased Vermont milk to sell in the New York market contested the application of this provision of the New York law. The case reached the United States Supreme Court, which denied the right of the State of New York to fix the prices to be paid Vermont producers. In delivering the opinion of the Court, Justice Cardozo said:

"Such a power, if exerted, will set a barrier to traffic between one state and another as effective as if customs duties, equal to the price differential, had been laid on the thing imported."¹⁹

Having thus pointed out the trade-barrier aspect of the provision in question, Justice Cardozo went on to say:

"If New York, in order to promote the economic welfare of her farmers, may guard them against competition with the cheaper prices of Vermont, the door has been opened to rivalries and reprisals that were meant to be averted by subjecting commerce between the States to the power of the nation."²⁰

¹⁸ Section 258 (m) (4), Article 21-a, New York Agriculture and Markets Law, L. 1934, c. 126.

¹⁹ *Baldwin v. G. A. F. Seelig, Inc.*, 294 U. S. 522 (1935). However, the reasoning in the case of *Welch Co. v. New Hampshire*, 306 U. S. 79 (1939) does not seem to be entirely consistent with the holding in *Baldwin v. Seelig*, *supra*, and may perhaps be considered as weakening the authority of that case.

It should perhaps also be pointed out that in *Milk Control Board v. Eisenberg Farm Products*, 306 U. S. 346 (1939), a Pennsylvania statute authorizing the control board to fix the prices for milk bought in Pennsylvania for shipment outside the State was upheld by the Supreme Court. It is not clear whether a general rule was established by this decision. The Court was at pains to state that "the purpose of the statute under review obviously is to reach a domestic situation in the interest of the welfare of the producers and consumers of milk in Pennsylvania. . . . Only a small fraction of the milk produced by farmers in Pennsylvania is shipped out of the Commonwealth. There is, therefore, a comparatively large field remotely affecting and wholly unrelated to interstate commerce within which the statute operates."

²⁰ *Baldwin v. G. A. F. Seelig, Inc.*, 294 U. S. 522 (1935).

The decision in this case thus removed much of the danger that price fixing by State control boards would create trade barriers. There remains a possibility, however, that the State control boards might exercise their broad powers in such a way as to discourage dealers from buying out-of-State milk. In the States having control laws, the dealers must obtain licenses from the control board in order to do business; and these licenses may be revoked for failure to observe the rulings and requirements of the board. In many States a dealer's license may be revoked for action "demoralizing to the price structure." There are also other ways by which in-State producers can be favored. In at least one market drawing its supplies from more than one State, the control board of the State in which it is located has granted home-State producers a more than proportionate share in the sales of milk used for fluid milk. In other words, a more than proportionate share of out-of-State milk is allocated to other uses than as fluid milk. Since milk used as fluid milk is paid for at a higher price than the milk that goes into other uses, discrimination against out-of-State milk results.

Possible Ways of Eliminating Barriers in the Milk Industry

Of great importance is the problem of securing safe and wholesome supplies of milk and other dairy products without interposing obstacles to their free flow in interstate (and even intrastate) trade. As has been brought out in earlier paragraphs, the factor common to most barriers arising from health regulations is the refusal of health authorities of one jurisdiction to accredit the inspections made by the authorities of another. They do so sometimes because the sanitary requirements of other jurisdictions are not the same as their own; sometimes because the efficiency and integrity of other inspection services are felt to be not unquestionable. Also, it must be admitted that in some instances the erection of a trade barrier has not been the incidental result of a health regulation, but its motive.

These difficulties would all disappear (1) if the sanitary requirements were to be made reasonably uniform from State to State, and (2) if all grounds for suspicion of the reliability of inspections could be removed. Two methods of accomplishing these objectives have received serious consideration in recent months.

The first of these was proposed over a year and a half ago by the Committee on Agriculture of the National Conference on Trade Barriers—a conference of State legislators and administrative officials from all over the nation called together by the Council of State Governments to discuss ways and means of checking and reversing the rising trend of internal trade barriers. The report of the Committee on Agriculture (which was adopted by the entire conference) included the following paragraphs setting forth a plan for the elimination of trade barriers in the dairy industry:

“In order to reconcile public health requirements with free interstate movement of milk and dairy products, it is recommended that states adopt uniform minimum standards with respect to acceptable sanitary requirements. It is further recommended that milk and dairy products from a state having such minimum standards be accepted in another state having like standards, upon certification by the state of origin.

“Under such a plan, it is urgently suggested that the Federal Public Health authorities or other Federal agency designate those states in which the inspection services meet the agreed standards.”

Nine Midwestern States have taken steps along the lines of this plan. At the present time a special committee of technical experts in dairy sanitation and others representing these States is engaged in drafting not only a code of sanitary requirements but also a standard of qualifications for dairy inspectors. When the proposed code and standard are completed, they will be submitted to the several States for adoption. The final step in the plan, to request a Federal agency to “designate those states in which the inspection services meet the agreed standards,” must wait, of course, until the States have officially adopted these standards.

The other method proposed for eliminating dairy trade barriers arising from health regulations is also designed to bring about a reasonable degree of uniformity in State sanitary regulations and to set up the conditions under which supplies from a dairy farm or milk plant inspected and approved by a local inspector would be accepted without question by health officials throughout the country. It is similar to the first method in depending upon the voluntary participation of the individual States, but differs in placing the initiative with the Federal government rather than with the States.

Briefly, the plan is to set up a Federal-State inspection

service for the dairy industry. The inspectors would be appointed by the several States but would be subject to the supervision of a Federal agency. States participating in the plan would agree to accept dairy products from farms and milk plants certified by the Federal-State inspection service. The sanitary standards to be used would be established by the Federal agency after hearings open to all interested parties. Presumably the standards would be patterned closely after those recommended by the United States Public Health Service, which have already been widely adopted by States and municipalities throughout the country.

Some of the details of this plan may be of interest. The organization and operation of the inspection service would probably be similar to the organization and operation of the Federal-State services that have been set up for the inspection and grading of certain other agricultural commodities. The expenses of these services are shared by the Federal and State governments. The Federal agency establishes a minimum standard of professional excellence that all appointees to the service must meet. The men are appointed, however, by the State in which they are to work. Having qualified and having been appointed, each inspector receives a Federal license, which, however, may be revoked if his work is not satisfactory. In this way each State is enabled to keep control over the personnel of its own inspection service, and at the same time the Federal agency can maintain a minimum level of performance in every State in which the service is organized.

The inspection and grading services now in operation usually issue a certificate to accompany each lot of produce inspected and graded. The certificate states that the lot it covers is of a certain quality and grade. Purchases and sales are commonly made on the basis of the quality and grade as indicated. Inspection of dairy products is somewhat different. In the first place, each separate shipment of milk, or other dairy product, is not inspected; the inspection applies rather to the dairy farm or to the milk plant where the milk or milk product originates. In the second place, the inspection does not usually determine the grade of milk shipped. Its primary purpose is to determine whether the milk may be shipped at all into the market for which the inspection is being made. A certificate issued by a dairy products inspection service, therefore, would guarantee that a given dairy

farm or milk plant had met the requirements of the sanitary code. It would serve as a passport into all cooperating States for the milk or other dairy products originating at the certified farm or milk plant.

It is not likely (and perhaps not desirable) that all the States participating in a plan for mutual recognition of each other's inspection work would be willing to subscribe to the same set of sanitary requirements. Some health officials may believe that stricter requirements are necessary than do others. Under either of the plans that have been described here the sanitary code could be drawn up in such a way that it would go far to meet these differences of opinion. More than one set of requirements could be written into the code, each successive set being stricter than the preceding one. In effect this would be providing for a number of grades of milk. Then any State might choose whether it would permit only Grade A milk to be sold within its borders, or whether it would also permit Grade B, or Grades B and C, and so on.

With a system of grades in force, each dairy farm and milk plant could decide whether to qualify for the production of the highest grade milk or for the production of a lower grade. Then, if it qualified for the production of Grade A milk it would be so certified by the inspection service, and its output of milk or other dairy products would be accepted in all the cooperating States. If, however, it qualified only for a lower grade, only the markets in States accepting that grade or a lower one would be open to it.

In addition to the two plans described here, which depend for their success upon the voluntary participation of the States, suggestions have been made for more drastic action by the Federal government. Under the commerce power, Congress could guarantee Federally inspected and approved milk the right to cross State lines. According to some students of the question, there is also at least the possibility that Congress could protect milk of interstate origin against discriminatory State inspection after it had ceased to be in interstate commerce.²¹

Aside from the legal problems involved in this line of attack, the question of States' rights and the philosophy of the federal nature of our government will enter largely into

²¹ See the testimony of Professor William Y. Elliott before the Temporary National Economic Committee, March 23, 1940.

any decision as to the part the Federal government should take in removing the trade barriers in the milk industry. It is plain that Congress, in the exercise of its power to regulate commerce between the States, can go much farther in this field than it has gone heretofore. How far it may be wise for Congress to go is a matter that political scientists, students of government, lawyers, and legislators themselves are better trained than economists to discuss.

Whatever the decision may be as to the best method of eliminating the barriers in the milk industry, there can be no doubt that serious ones exist, that they are detrimental to the dairy industry of Indiana and the Midwest generally, and that they are contrary to the spirit of the Constitution. As Justice Johnson said in a concurring opinion in *Gibbons v. Ogden*: "If there was any one object riding over every other in the adoption of the Constitution, it was to keep commercial intercourse among the States free from all invidious and partial restraints."²²

²² 9 Wheat 1, 229. (U. S. 1824.)