

The NEW RULES

EXPLORING COMMUNITY, MOBILITY, SCALE AND TRADE FALL 1999

Hogging the Market

Big pork is a dominant force in the Midwest's agricultural economy.

By Greg Miller

A Case of the Good Stuff



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The New Rules (ISSN 1521-9917) is published quarterly by the Institute for Local Self-Reliance, 1313 5th Street SE, Minneapolis, MN 55414; telephone: 612-379-3815; fax: 612-379-3920; website: www.newrules.org. Washington, DC, office: 2425 18th Street NW, Washington, DC 20009; telephone: 202-232-4108; fax: 202-332-0463; website: www.ilsr.org. Send all subscription requests to the Minneapolis office: 1 year \$35; \$25 nonprofit organizations, governmental agencies, libraries, students; \$45 foreign (U.S. funds drawn on U.S. bank). For subscriptions of more than a year, multiple subscriptions, bulk copy sales, or for rights and permissions, contact Elizabeth Noll.

The New Rules is printed with vegetable-based inks containing no less than 20 percent vegetable oil on processed chlorine-free recycled paper containing 50 percent post-consumer waste fiber. This publication is printed in the United States by Sexton Printing, a certified environmentally responsible Great Printer.



Cover Illustration
Ken Avidor/Avidor Studios



Designing rules as if community matters



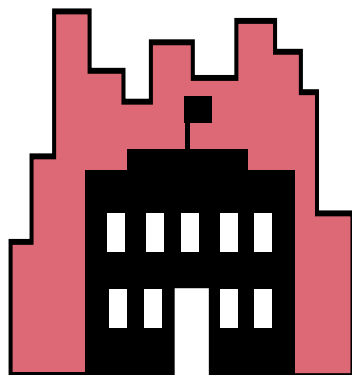
Devolution as if Community Matters

In May 1998, President Clinton issued Executive Order 13083 on federalism. Its centralizing language generated such a firestorm of opposition from conservatives and state and local elected officials that the House of Representatives voted 417-2 to reject it. On August 5, 1998, the President “suspended” the order and went back to the drawing board.

Exactly a year later, the President issued a second executive order (13132). This one tilted in the opposite direction, forbidding federal agencies from preempting state law unless the Congressional bill contains an overt intention to do. In determining whether to establish uniform national standards, the President orders federal agencies to “defer to the States to establish standards.”

Two days before Executive Order 13132 was issued, the Senate Governmental Affairs Committee voted 12-2 in favor of the Federalism Accountability Act of 1999, the contents of which are far more restrictive of federal actions than the President’s, and, unlike the contents of an executive order, would be enforceable in the courts. This time the firestorm of opposition came from an unlikely coalition of centralists: 300 environmental, labor, consumer and business organizations. In late September they succeeded in derailing a companion federalism bill in the House (HR 2245).

“Who should have the power to make the rules?” is rapidly becoming a central question in American politics. Much of the discussion revolves around the relationship between Washington and the states. But why frame the question so narrowly? Brooklynites probably find Albany (New York’s state capital) as remote and unresponsive as Washington. ILSR’s position, outlined in the first issue of this magazine (see “Debate:



“Preserving our federal system...

ensures that essential choices can be made by a government more proximate to the people than the vast apparatus of federal power.”

—Supreme Court Justice Anthony

Kennedy

The Devil in Devolution,” *Groundwork*, Vol. 1, Issue 1, Summer 1998), is that whenever possible authority should be pushed down to the lowest possible level. Higher levels of government (and the courts) have the ultimate responsibility to protect minorities from the tyranny of the majority, especially with respect to civil liberties and rights. When higher levels of government do act, they should create minimum (not maximum) standards, allowing communities to craft superior standards at their discretion.

The articles in this issue of *The New Rules* reflect how the debate about devolution and preemption

now pervades virtually every sector and every product we buy. My article on hogs, for example, explains that stripping communities of their authority was an essential first step in establishing giant industrial hog farms. Unable to regulate these enterprises and deprived of their right to sue over damages caused by the massive manure lagoons, communities were rendered helpless in the face of an invasion that threatened both their livelihoods and their health. As a result, the hog sector has been transformed from one populated by hundreds of thousands of family farmers to one controlled by a few dozen industrial hog facilities.

While states undermined the ability of local governments to protect family hog farmers and their communities, Congress was giving states more authority to protect their family dairy farmers. As part of the 1996 Farm Act, Congress allowed the New England states to collectively do what the Constitution bars them from doing individually: form a dairy compact that sets minimum farm prices for milk sold within the region. The compact expired in October and, as we went to press, Congress seemed unlikely to renew it. Yet as Stacy Mitchell reports, our short experiment with creating a tiny “dairy nation-within-the-nation” has much to recommend it.

Family hog farmers and family dairy farmers are dwindling in numbers, but the ranks of family wineries are swelling. Shut out of many markets by the increasing concentration of wholesalers, small wineries have begun to use the internet to sell directly to customers. This has raised federalism issues. Because of the historical controversies regarding the role of liquor in America, when Prohibition was repealed in 1933 states were allowed to con- →

tinue to regulate and even ban the sale of liquor, even when their actions interfere with interstate commerce. That is why we still have “dry” counties and states where liquor can only be sold through government outlets. But although states can prohibit the sale of liquor, in the age of the internet they cannot reach into another state to penalize the seller. Today, as Simona Fuma Shapiro reports, Congress is deciding whether to give states the right to sue in federal court for “injunctive relief” to stop out-of-state sellers.

Electronic commerce itself has become another battleground in the federalism wars. To effect competition, the federal Telecommunications Act of 1996 banned local and state laws that “have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunication service.” In several rulings regarding this provision, the Federal Communications Commission (FCC) seems to have come down on the side of eliminating local authority. When a Kansas town prohibited a private company from providing what the town thought were duplicative local phone services that would inevitably raise rates, the FCC warned it was violating the law. But when Texas eliminated the right of its cities to own telecommunications lines, even when those same cities owned roads and electric distribution lines, the FCC refused to intervene.

The FCC has also intervened on behalf of the centralists in a dispute between Portland, Oregon, and AT&T. As a condition for allowing AT&T to provide high-speed internet service through its newly acquired cable subsidiary, TCI, Portland required the telecommunications giant to allow customers to choose any internet service provider without having to pay a premium to AT&T’s own internet provider, @home. After a lower court upheld the city’s authority to demand “open access,” FCC Chairman William Kennard received

a standing ovation from the National Cable Association members when he urged local governments to keep their hands off cable companies’ internet services and invited opponents to formally request that the FCC strip

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Higher levels of government (and the courts) have the ultimate responsibility to protect minorities from the tyranny of the majority, especially with respect to civil liberties and rights. When higher levels of government do act, they should create minimum (not maximum) standards, allowing communities to craft superior standards at their discretion.
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Portland and other cities of their power. (Miles Fidelman, president of the Center for Civic Networking and director of the Center’s Municipal Telecommunications Strategy Program, will examine the importance of local authority in the next issue of *The New Rules*.)

The debate over federalism is a debate about the locus of decision-making. As such it should not be restricted only to units of government. Consider the credit union, a financial institution owned by its depositors—one depositor, one vote. Recent changes to federal statute and regulatory rules have allowed—even encouraged—credit unions to expand. As Stacy Mitchell reports, the changes have sparked a debate within credit unions about the relationship of scale

and geography to democracy and effectiveness. Some believe growth will enable credit unions to reach more people and remain competitive in an increasingly complex market. Others question the effect of this expansion on the community bonds once critical to the mission of these cooperative institutions.

In Washington, the debate about federalism often seems abstract. Indeed, even the cognoscenti get confused. On September 6, 1999, the *New York Times* issued the following correction. “A headline yesterday about efforts in Congress to shift political power to the states referred incorrectly to the movement to limit Congress’ ability to impose laws on the states. It is known as Federalism, not anti-Federalism.”

But in our communities labels are far less important than content. For it is there that remote decisionmakers affect our personal lives. In order to sort out the needs and rights that must be balanced, we need to keep in mind Justice Kennedy’s caution that proximity should be accorded a high value. As the articles in this issue reveal, the most important question of all might be, “How can we embrace a devolution as if community matters?”

—David Morris

Power to the People: Ohio Gets Community Choice

A recently signed electricity deregulation law in Ohio is only the second in the nation to offer "community choice." The community choice provision is modeled after that in Massachusetts' 1997 electric restructuring law.

Electric deregulation, enacted in 19 states, gives customers the ability to choose their electric supplier. But experience has shown that the vast majority of consumers choose not to choose. In most states the incumbent utility is simply handed this huge pot of customers. But Massachusetts and Ohio have given local governments the right, after a vote by their city council, to become the default supplier.

Any individual household that wants to purchase power on their own can "opt out" of the deal. This distinguishes community choice from the "opt in" municipal aggregation model legislated in other states such as California. In California, a city that wants citizens to join its municipal buyers' cooperative must conduct a public relations campaign asking them to "opt in" to the plan. In Massachusetts and Ohio, municipalities have the right to act as the default supplier unless a household indicates otherwise, making the default supplier an elected local government as opposed to a for-profit business.

National Net-Metering Bill Introduced in Congress

On September 17, 1999, U.S. Representatives Jay Inslee (D-Wash.), Roscoe Bartlett (R-MD) and Vernon Ehlers (R-MI) introduced the Home Energy Generation Act. This bill would allow consumers who generate electricity in their homes to effectively sell excess energy back to the local utility by reversing their utility meters. Currently, in 22 states, customers with home generators have two meters in their household, one

for incoming electricity and the other for electricity that they sell to the utility at a wholesale, or "avoided cost" rate. In the 28 states that have net-metering laws, home generators have a single meter, and this meter runs backwards when the consumer/generator is producing more energy than her household needs. In other words, any excess electricity that would have been sold to the utility at the wholesale or "avoided cost" price is instead being used to offset electricity the customer would have purchased at the retail price.

In states without net-metering laws, customers who generate excess electricity one month (and sell it back to the utility at a wholesale rate) might find themselves needing to purchase electricity the next month, when their demand exceeds that supplied by home generators, for which they would have to pay standard retail price. The Home Energy Generation Act seeks to put the consumer on a more equal footing with

the utility by allowing net excess generation to be carried over from month to month and sold only at the end of the year. This month to month carry-over provision would allow customers to apply the previous month's excess to the current month's meter, mini-

mizing the hours of energy use for which they would be charged full retail price.

This bill would extend net metering to the 22 states that do not have the provision, and sets uniform national reliability and safety standards for the practice. The generator that can be used under this bill must be no larger than 100 kw and can be either a fuel cell or power plant fueled by renewable resources (solar, wind or biomass).

City Puts Brakes on GM

The city of Troy, Michigan, recently trumped General Motors' billion-dollar construction plans by vetoing tax breaks offered to the corporation by the nearby town of Warren. A little-used provision of a 1974 Michigan law (Act 198) allows one city to veto corporate tax breaks from another city, if the corporation intends to transfer employees from the former city to the latter. Despite vociferous opposition from the governor's office and Warren officials, the part-time Troy city council voted 5-2 in July to nix Warren's 50 percent property tax discount for the world's largest corporation.

John Truscott, press secretary for Governor John Engler, said Act 198 was intended to protect economically distressed cities like Detroit from losing jobs to other communities offering generous tax breaks. "The problem here is, Troy is using it incorrectly," Truscott said. "I don't think anyone could conceivably make the argument that Troy is a distressed city." The Engler administration plans to lead a campaign to remove the veto provision.

Other observers want to do away with tax abatements altogether. Michigan allowed cities to offer tax abatements of up to 50 percent during the 1970s, a time when the state's economy was struggling to compete against Southern states with lower wages and generous tax breaks of →



their own. Almost 14,000 businesses have received such tax breaks. But critics argue that they pit one city against the other for the gain of an individual business.

In 1986 the city of Troy adopted a policy granting "exit visas" to corporations only if "the move involved an area which needs economic revitalization." Since that time Troy has allowed 19 other corporations to leave (by approving the receiving cities' tax break offers). Warren, apparently, did not meet this criterion.

French Shoppers Enlisted in Farmers' Battle with Distributors

In an effort to appease farmers' protests over low prices, the French government has instituted a unique labeling system that seats consumers in judgement over profit gouging in the industry.

Protests rocked France this summer as farmers blamed concentration in the retail food industry for their low revenues. Farmers crowded the parking lots of chain supermarkets and blocked their entrances with piles of produce.

In a three-way meeting with farmers and distributors, the French Agriculture Ministry agreed to impose a temporary double price labeling system for a number of fruits and vegetables. Since mid-August every retailer has been required to display the price the grower received for his product in addition to the retail price for that product. The rule applies to apples, pears, grapes, peaches, nectarines, apricots, melons, tomatoes and cucumbers, as well as to the 30 percent of produce bought from non-French farmers. The idea is that French consumers will be outraged if a label shows too great a price disparity and will refuse to buy that product. The Parliament of Great Britain, where farmers face similar difficulties (the British National Farmers' Union

blames consolidating supermarkets and other factors for a 75 percent collapse in its members' incomes in just two years) is currently debating a similar law.

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"Roquefort is made from the milk of only one breed of sheep, it is made in only one place in France, and it is made in only one special way. It is the opposite of globalization. Coca-Cola you can buy anywhere in the world and it is exactly the same."

- Mayor Phillippe Folliot

Tiny Town Protests U.S. Sanctions with Coca-Cola Tax

In July, the U.S. imposed 100 percent tariffs on European specialty foods as retaliation for lost U.S. beef sales due to the European Union's ban on hormone-treated beef. U.S. government officials evidently determined that a markup on Roquefort cheese, foie gras and Dijon mustard would minimize the harm to the American consumer. But they did not realize that targeting such monuments of French cuisine would constitute an insult to their cultural pride.

Now the mayor of the village of St. Pierre-de-Trivisy (population 610) in the Roquefort region of southern France has retaliated with a 100 percent tax on Coca-Cola. "Roquefort is made from the milk of only one breed of sheep, it is made in only one place in France, and it is made in only one special way," explains Mayor

Phillippe Folliot, "It is the opposite of globalization. Coca-Cola you can buy anywhere in the world and it is exactly the same." Cafes throughout the Roquefort and Dijon regions of the country have banned Coke or added huge surcharges to the product.

South Dakota Prohibits Corporate Ownership of Land and Livestock

South Dakota has taken a major step to support the local ownership and production of livestock and crops. The recently passed Amendment E states that corporations, syndicates, limited-liability partnerships, business trusts and other limited-liability companies cannot be involved in raising crops or in owning, keeping or feeding livestock. However, corporations owned by farm families, non-profit corporations and agricultural cooperatives can own land and engage in farming. Following South Dakota's lead, several national efforts to limit the vertical integration of producers and packers have begun. Senator Kerry (D-NE) and Senator Grassley (R-IA) are introducing legislation to restrict packers from owning cattle by capping the percentage of slaughter that packers may take from their own herds. Tim Johnson (D-SD) has proposed similar legislation that would ban all packer ownership of livestock.

While the Packers and Stockyards Act of 1921 bars price discrimination, it has been loosely interpreted and is rarely enforced. National efforts are currently underway to enact both price discrimination and price reporting legislation.

For more information, contact the Center for Rural Affairs, 402-846-5428, www.cfra.org [!]

Deep Pockets or Open Hands: Credit Unions Struggle Over Size

The credit union on your block is supposed to serve “people of small means.” In today’s economy, can they do that better by staying small or getting as big as . . . a bank? *By Stacy Mitchell*

BANKS HAVE LONG COMPLAINED THAT CREDIT unions enjoy tax and regulatory advantages that give them an unfair advantage in the marketplace. Earlier this year, the American Bankers Association (ABA) sued the National Credit Union Administration. The ABA contends that new regulations issued by the agency allow for the nearly unlimited growth of large credit unions, which have the market strength to compete directly with banks.

The lawsuit seemed to be just the latest joust in a 20-year feud between banks and credit unions, but in April the Irondequoit Federal Credit Union, a tiny outfit in upstate New York, joined the lawsuit—on the side of the banks.

This action is the most visible sign to date of a growing debate within the credit union movement. The debate raises important questions about the role that credit unions should play in the American financial system. Large credit unions say they need to grow in order to offer the range of services that consumers now demand. This expansion serves a worthy goal: it has given more people access to a credit union than ever before. But small credit unions fear they will be swallowed up in the process. They argue that large credit unions are losing sight of their original mission as they become increasingly less tethered to the communities they serve.

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Stacy Mitchell is a researcher with The New Rules Project of the Institute for Local Self-Reliance, and the author of The Home Town Advantage: How to Defend Your Main Street Against Chain Stores . . . and Why It Matters.

The History of Credit Unions

The federal government authorized the formation of credit unions in 1934 to make credit available to “people of small means” who could not obtain financial services elsewhere. The National Credit Union Administration (NCUA) was established to oversee their development.

In keeping with the spirit of those times, credit unions were structured as nonprofit, member-owned institutions. They were and are run by volunteer boards of directors. They operate on a one member, one vote basis. In exchange for tax-exempt status, credit unions operate under very strict limitations governing everything from lending to capitalization. While banks serve the business market, credit unions are largely restricted to the household market. Finally, the customer-owners were expected to share a common bond: they were neighbors, co-workers, co-parishioners. In the beginning credit unions typically offered only basic savings accounts and personal loans.

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Credit unions proved popular and grew rapidly. By 1980 there were 21,465, with a total of \$69 billion in assets and 44 million members. Credit unions were beginning to offer more services, like checking accounts and credit cards.

The Membership Controversy

The economic recession of 1981-82 battered many credit unions. The NCUA responded in 1982 by changing its rules to allow credit unions to merge or expand their membership to include multiple common bonds (e.g., employees of several different companies could share the same credit union). →

Diversifying and expanding membership was aimed at stabilizing credit unions and making them more resilient in economic downturns. Allowing multiple common bonds also extended credit union access to those who worked in companies too small to form a viable credit union on their own.

Banks challenged the new rules in court, arguing that the single common bond was the core tenet of the credit union concept as defined by Congress. By expanding in every direction, credit unions would soon function like other financial institutions, but with the unfair competitive advantage of being tax-exempt.

After years of litigation, the U.S. Supreme Court finally sided with the banks in 1998, concluding that a credit union must draw its members from a distinct group with a single common bond. By that time, more than half of all federal credit unions had expanded to include multiple common bonds. Overall membership had grown to more than 71 million and combined assets had reached \$382 billion (about 5 percent of the total assets of U.S. depository institutions).

Congress responded within six months of the decision by enacting the Credit Union Membership Access Act (CUMAA), which allows credit unions to include multiple bonds.

The NCUA's Rules

Credit unions big and small cheered the Congressional action. Then it came time to turn broad policy into specific regulations, and the NCUA issued new membership and chartering rules for credit unions in December 1998. These are the rules that led to the latest lawsuit and sparked the current debate.

The dispute centers around two changes that have to do with the appropriate size and scope of a credit union. One concerns the threshold at which groups become too small to form their own credit union. The NCUA's rules presume that groups with fewer than 3,000 potential members are too small. (Potential membership means the number of people who share the common bond that the credit union is chartered to serve, for example, all the employees of one business. Typically, about one-third of potential members become actual members.) In order to form a credit union, these groups must jump through a number of hurdles to prove economic viability. Or, through a much simpler route, they can join an existing credit union.

The second change has to do with the geographic scope of credit unions. The new rules make it easier for credit unions to convert from an employer-based charter to a community-based charter, a reasonable change in an era of downsizing and frequent job changes. But by law community credit unions must serve a "well-defined geographic community," and

the NCUA's new rules take a more expansive view of what constitutes a community. Furthermore, for the first time these credit unions are allowed to "overlap" existing credit unions. Thus a new countywide credit union could take members away from a small neighborhood credit union.

Too Small or Too Big?

To the majority of the NCUA's three-member board of directors, the objective of the new rules is to ensure that credit unions are large enough to effectively compete in a changing marketplace. But to NCUA Chairman Norman D'Amours, the new policy "discriminates against, and threatens the existence of, small credit unions, and is . . . contrary . . . to the history and philosophy of credit unions."

D'Amours argues that "by requiring extra burdens on groups under 3,000 that want to form their own credit union, we further tip the scales in favor of . . . joining an existing credit union." He believes the NCUA should encourage the formation of new credit unions instead of making the process more difficult.

Although 3,000 potential members may seem quite small, most credit unions are very small institutions. The average credit union has \$35 million in assets, nearly 18 times smaller than the average bank. Sixty percent of all credit unions have assets below \$10 million. Thirty-eight percent have one or fewer full-time employees. Almost half have a potential membership base of fewer than 3,000.

Supporters of small credit unions contend that these institutions are uniquely suited to fulfilling the credit union mission: providing financial services to communities and individuals not served by for-profit banks. For instance, because they are closely connected to the community and their members often know each other, small credit unions are able to successfully make loans that distant loan managers would consider too risky.

As Clifford Rosenthal, executive director of the National Federation of Community Development Credit Unions (NFCDCU), points out, in some communities a small credit union is the only source of financial services. These institutions may be run entirely by volunteers, have limited hours, and a small range of services, but they are vitally important to their members. The NCUA's new rules, he believes, send the wrong policy message and place an unfair burden on low income neighborhoods trying to launch a credit union.

But many within the credit union movement—including the trade association that represents nearly all credit unions, the Credit Union National Association (CUNA)—respond that the current crop

Resources

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of Community
Development
Credit Unions
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10th Floor
New York, NY 10005;
telephone:
212-809-1850;
website:
www.natfed.org

National Association
of Federal
Credit Unions
P.O. Box 3769
Washington, DC 20007
telephone:
703-522-4770;
website:
www.nafcunet.org

of small credit unions were formed decades ago and have developed a stable niche, but changing economic conditions make forming a viable small credit union today much more difficult.

Customers are demanding a variety of new services that require larger sized financial institutions. Credit unions with \$100 million or more in assets typically provide most of the services offered by banks, but smaller institutions can only offer a few services. Only 35 percent of credit unions with less than \$10 million in assets offer checking accounts and only 19 percent offer ATM cards.

Supporters of the NCUA's rules point to statistics that seem to confirm that credit unions have to be bigger and less tightly tethered to a neighborhood or a single employer group in order to compete in today's environment. Between 1987 and 1997, credit union membership grew 30 percent and net capital grew 237 percent, but the total number of credit unions fell by 28 percent. Credit unions in every size category below \$20 million are declining in number and total assets, while the largest credit unions are growing the fastest.

Large credit unions are still only a fraction of the size of the largest banks. While these institutions share the nonprofit, cooperative ownership structure of small credit unions, they differ substantially in the breadth and sophistication of their operations. An example of this new breed is Ent Federal Credit Union, the largest financial institution in Colorado Springs and the 23rd largest credit union in the country. Ent has eight full-service branches, 150,000 members from more than 400 companies and \$1 billion in assets.

Like many banks, Ent employs a rate structure that rewards high balances and discourages low balances. So much for serving "people of small means," say critics. On the other hand, Ent's competitiveness explains why so many residents of Colorado Springs own their own financial institution. Credit unions have a 35 percent share of the household savings market in Colorado Springs, compared with an 8.2 percent share nationwide.

Changing market conditions have not only spurred the growth of large credit unions, say supporters of the NCUA's rule, but have made small

credit unions more likely to fail. Raymond Curtin of the National Association of Federal Credit Unions, whose membership represents about 10 percent of credit unions and is skewed towards large institutions, believes that the NCUA's new rules are "economically advisable" given recent marketplace experience. Sixteen of the 18 federal credit unions that were either liquidated or merged as a result of failing

finances in 1998 had potential memberships of fewer than 3,000.

But some argue that the failings of small credit unions are more the result of federal policy than of some inherent weakness. During the Reagan-Bush years, the NCUA had an unwritten policy to encourage fewer, but larger, credit unions. Many who operate small credit unions recall those years as difficult times and say that

they faced a regulatory agency that was downright hostile towards them.

The NCUA's current chair, Norman D'Amours, came into office in 1994 as a strong advocate of small credit unions. D'Amours created the Office of Community Development Credit Unions to nurture and advise small credit unions, but says that despite his best efforts, change has been incremental. The NCUA continues to treat small and large credit unions differently. When large credit unions falter, the agency bends over backwards to get them back on their feet, but when small credit unions falter, the agency looks immediately to liquidate or merge.

Most recently, D'Amours proposed that credit unions with more than \$10 million in assets be required to document their efforts to serve low-income members, something like a Community Reinvestment Act for credit unions. His proposal was rejected by the NCUA board of directors.

The issues and policy questions raised by this discussion are unlikely to be resolved anytime soon. Meanwhile, the struggle is producing some unusual bedfellows. In Buffalo, New York, a coalition of small credit unions and community banks came together in May to protest the expansion of the Olean Dresser Clark Credit Union, which sought to expand county-wide to cover an area with 85,000 residents. The credit union has since scaled back its plans. [!]



Resources

National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314;
telephone:
703-518-6300;
website:
www.ncua.gov

Credit Union National Association
P.O. Box 431
Madison, WI 53701;
telephone:
800-356-9655;
website:
www.cuna.org

Hogging *the* Market

Giant industrial hog producers have practically wiped out the family-owned hog farm, poisoning the land and weakening rural economies in the process. Dramatic shifts in agricultural policies are needed to rescue the independent farmer.

By David Morris

WE MAKE THE RULES AND THE RULES MAKE US. Family farms are in crisis not because of inevitable market forces, but because of public policies that encourage giant, absentee-owned corporate agricultural producers. The ongoing transformation of the hog sector illustrates the intimate connection between public policy and community life.

In 1950, 60 percent of all grain farmers raised pigs. It was a smart strategy. By converting corn to pork, the farmer could often generate a 25 percent return on investment. No wonder hogs were sometimes referred to as "mortgage lifters."

As late as 1980 almost 700,000 farmers still raised hogs: hundreds in each rural county. A typical operation might consist of 10-30 sows, each producing 15-

20 pigs a year in two litters. A 100-sow, 2000-hog operation was considered a major enterprise.

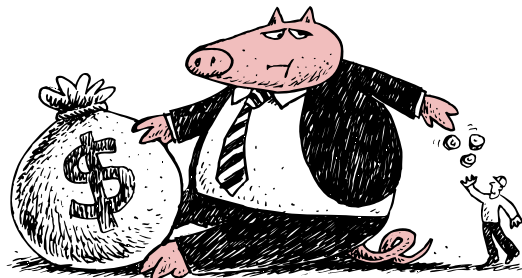
The number of hog farmers dwindled in the 1960s

as farms grew larger and the demand for pork declined. But then an aggressive "The Other White Meat" marketing effort by pork producers revived demand, and booming Asian economies began to import significant quantities of pork.

Engineers and scientists

learned to breed hogs that were more efficient at converting feed into meat, and developed and refined confined feeding and rearing operations, all of which lowered production costs and made possible large birthing (farrowing), weaning and finishing operations.

The profitable hog market began to attract the attention of entrepreneurs driven by a new vision—a single farm with thousands, even tens of thousands of sows and hundreds of thousands of hogs in dozens of acres of climate-controlled buildings surrounding giant open-air manure lagoons that would handle as



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much sewage as that of a large human city.

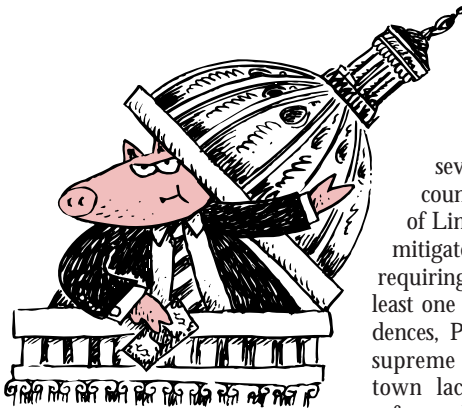
Family farmers in general, and rural residents in the counties targeted by these entrepreneurs, fought back. Rural communities up and down the Mississippi, in the nation's grain-rich heartland of pork, persuaded legislatures to enact rules preventing the entrance or limiting the size and reach of these new entities. In the 1970s and 1980s Minnesota, Missouri, North Dakota, South Dakota, Kansas and other states enacted prohibitions on corporate ownership of livestock.

Because of these states' laws, the revolution in hog farming began not in a major hog-raising state, but in a minor one—North Carolina. The revolutionary was Wendell Murphy, owner of Murphy Family Farms. During the ten years he served in the General Assembly of North Carolina, Murphy shepherded through a series of remarkably self-serving laws that made industrial hog farms not only possible, but inevitable.

The North Carolina legislature pre-empted community concerns about the environmental and social impacts of large-scale industrial hog farms by denying counties the authority to regulate these facilities. Then it virtually exempted industrial hog farms from any liability for environmental or health damages. Finally, the legislature exempted hog farms from gas, sales and property taxes, a benefit eventually worth millions of dollars a year.

Once the state legislature had changed the rules, a breathtakingly rapid change took place in the economic base of rural North Carolina. From 1989 to 1999, the number of hogs raised in the state expanded by more than 500 percent, to 13 million, while the number of hog farms dropped by 70 percent, to under 7,000.

Emboldened by Murphy's example, other entrepreneurs lobbied other state legislatures to enact a similar set of policies. In 1993, in the closing days of the session, the Missouri legislature created an exemption from its 1975 anticorporate farming law and allowed industrial hog farms to locate in several sparsely populated counties. Premium Standard Farms (PSF) immediately established large operations in



The North Carolina legislature pre-empted community concerns about the environmental and social impacts of large-scale industrial hog farms by denying counties the authority to regulate these facilities.

50,000 hogs per year, a size category that did not even exist in 1985. These giants now provide almost 40 percent of all pork production.

The hog industry is now dominated by firms that either didn't exist or were only marginally in the hog business a decade ago. Premium Standard Farms, for example, went from zero hogs to the nation's third largest producer in less than five years by spending over \$500 million in Missouri and Texas. In 1993, Seaboard Industries raised no pigs and sold no ham. By 1998 it was the nation's eighth largest hog producer and expects to double its capacity again.

A single company, Murphy, owns 6 million hogs, more than the entire hog population of Minnesota, Illinois or Indiana, three leading hog-producing states. In August 1999 Murphy, the number one producer, announced its intention to sell to the number two producer, Smithfield. The following month Tyson's announced it too would sell its large hog operation to Smithfield.

The concentration of ownership in hogs has been mirrored by a concentration of ownership in packing and processing plants. Four packing companies control more than 60 percent of the nation's hog market. In 1995, 11 processing plants with over 3 million head of annual capacity processed about 45 percent of →

several northern Missouri counties. When the citizens of Lincoln Township tried to mitigate the odor problems by requiring megafarms to be at least one mile distant from residences, PSF sued and the state supreme court ruled that the town lacked the authority to safeguard the health of its residents. Today PSF raises nearly 2 million hogs in those counties.

Ten Years of Concentration

In the last decade the structure of hog farming has changed profoundly. The number of hogs in the U.S. increased by a staggering 45 million since 1982, but the number of hog farmers dropped by almost two-thirds. Today only 5 percent of farmers, about 150,000 in all, raise hogs. About 90,000 of those farms raise less than 100 head and together own only 4 percent of the nation's herd. On the other end of the scale, 1000 farms raise over

all hogs. The largest 33 plants, with 1 million head of capacity or more, processed over 87 percent of the hogs. Gary Benjamin, vice president of the Federal Reserve Bank of Chicago, offers a glimpse of a possible future, "some 50 producers could account for all the hogs needed in the United States . . . fewer than 12 plants could process all of the country's hogs."

Livestock Serfs

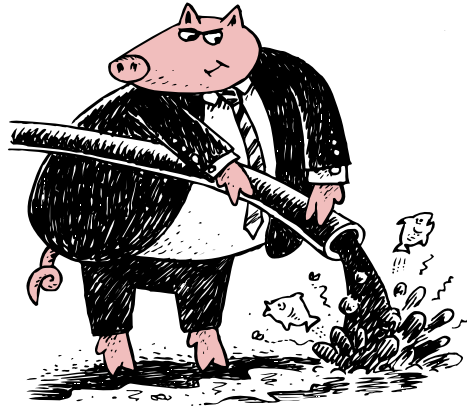
"Most analysts agree that the structure of the U.S. pork industry will soon resemble that of the U.S. poultry industry . . ." writes Mark Drabenstott, economist at the Federal Reserve Bank of Kansas City. The new masters of the hog industry raise some of their own livestock but, like their counterparts in poultry, they've realized that it's more profitable and less risky to own farmers rather than own hogs. Today more and more pigs are raised on contract with Seaboard, Smithfield or Murphy. The share of hogs under contract rose from 2 percent in 1980 to 10 percent in 1990 to over 60 percent today. In North Carolina contracts account for over 80 percent of all hogs raised.

A contract producer, in essence, accepts all of the risk in return for a guaranteed price. The producer borrows from \$200,000 to \$1 million to construct buildings and acquire equipment. The producer provides the pigs and the feed. It is a one-sided relationship. The producer, for example, bears all the environmental liability. Seaboard's contract declares, "ownership of all waste of swine shall be vested in Producer." Despite the long term nature of the producer's investments, the hog company can terminate the contract with only 30 days' notice.

As contracts gain a larger share of the market, prices for independent producers decline. A University of Nebraska study concluded that if 10 percent of the nation's pork production capacity is owned or controlled under contract to pork packers, independent producers will receive 6 percent less per hundredweight (one hundred pounds). If packers control 50 percent of production, they will pay 26 percent less for hogs purchased from independent producers. But increasingly, independent producers cannot find a market for their hogs at any price.

For now, contract hog growers are receiving a good price for their pigs. But that was also true for

contract poultry growers when that industry began to consolidate. Now, as documented in a 1999 series of troubling articles in the *Baltimore Sun*, the poultry industry has taken on a feudal structure.¹ Growers have few rights, no power and little recourse against arbitrary actions. Growers have begun to organize and speak out, but face reprisals when they do so.



Is This Progress?

Conventional wisdom holds that industrial hog farms are an inexorable and welcome development. Most agricultural policymakers and economists believe that bigger produces a better, more uniform product at a lower cost and that the restructuring of the hog market benefits consumers and rural areas alike.

But does it? Even using the narrowest definition of efficiency—cost per pound—

the proposition seems, at best, exaggerated. A Purdue University study that compared big and small operations concluded, "Size by itself contributed only about \$1.50 to \$2.00 per hundredweight to lower costs..."²

Some studies indicate that even very small producers can achieve low costs. A Kansas State University study concluded that the lowest production costs occurred with 75 sows.³ Some believe that a key to low-cost small operations is the development of intensively managed systems that rely on low-cost shelters for the sows and pigs.⁴ As Mark Honeyman, animal science professor at Iowa State University and one of this school's leading advocates, describes the approach, "Our 'road' is a little slower, a little more scenic, a little dustier, a little safer. It is the road consciously chosen for its long term attributes."

Some studies estimate that large hog farms may reduce production costs by \$4-\$8 per hundredweight. This means that an agricultural enterprise 1000 times the size of an average hog farm might reduce production costs by 10-20 percent, or 8 cents a pound. If this price difference were passed on to the consumer, it would lower the price of pork by 4-8 cents a pound. Yet consumers actually see very little of this savings. When prices paid to farmers plunged in late 1998 to unprecedented lows, the retail price of pork did not budge. Instead Smithfield, IBP and Hormel announced record earnings. The packers' share of the pork dollar rose from 16 to 22 cents, and the retailers' share rose from 47 to 60 cents.

Resources

Pennsylvania Environmental Network
This coalition of grassroots environmental groups has a team working on corporate hog farms. Their website focuses on Pennsylvania but contains good links to other state groups and to articles and books on hog farming.
P.O. Box 92
Fombell, PA 16123;
Contact Karl Novak:
telephone:
814-652-5232;
email:
novakpen@crosslink.net;
website:
www.penweb.org/
issues/hogs.

It's Not Just About the Money

Even if megahog farms were putting slightly cheaper bacon on the consumer's breakfast table, a focus solely on the comparative costs of production is far too narrow a perspective to use when designing public policy. A wider lens would examine the economic impact of megahog farms on rural communities. Here the evidence strongly favors smaller production units, which create more jobs and generate more local spending.

One Missouri study found that a \$5 million investment in a large-scale hog farm would generate 40-50 new jobs but would displace about three times that number of independent hog farmers.⁵

A 1993 study in Minnesota found that small livestock farmers (those with annual gross sales of less than \$400,000) spent about 79 percent of their purchases within 20 miles of the farm. Large livestock farmers spent only 47.5 percent.⁶ A study by Virginia Tech compared the benefits that accrue to a community when 5,000 hogs are produced by family farms to those gained when a 5,000-hog vertically integrated corporation sets up shop. It found that independent farmers produced 10 percent more permanent jobs and generated 20 percent more local retail spending and 37 percent higher local per capita income.⁷ The Center for Rural Affairs found that in the two North Carolina counties with almost 50 percent of the state's hogs, the number of farm jobs fell by over a third, population stagnated and sales and property taxes fell behind the state's own growth rates.⁸

Yet for purposes of public policy, an even wider lens is needed: one that takes into account the intimate connection between the structure of the agricultural economy and the structure and quality of community life. Walter Goldschmidt did pioneering work in this area 50 years ago as a researcher for the U.S. Department of Agriculture, when he examined two farm communities in California's San Joaquin Valley.⁹ The communities were chosen for their remarkable similarity: each had the same volume of crop production, comparable soil quality and similar climate. Both communities were equidistant from major urban areas and were similarly served by highways and rail lines. They differed in only one major respect: the Dinuba economy was based on many small family farms. The town of Arvin depended on a few large-scale agribusiness farming operations.

Goldschmidt discovered that Dinuba's family farm economy provided its residents with a substantially higher median income and standard of living. Moreover, the citizens of Dinuba, to a far greater extent than their counterparts in Arvin, were involved in building a strong community.

For example, the quality and quantity of projects that benefited the entire community, like paved streets and sidewalks and garbage and sewage disposal, were far superior in Dinuba. Arvin had no high school and only one elementary school; Dinuba provided its citizens with four elementary schools and a high school. Dinuba had three public parks; the agribusiness town had a single playground, lent by a corporation.

Along with expanding their community's physical infrastructure, Dinuba's residents built up its civic infrastructure. Dinuba had more than twice the number of civic associations as Arvin. In Dinuba, various governmental bodies existed that enabled residents to make decisions about the public welfare through direct popular vote. No such bodies existed in Arvin.

Goldschmidt's findings have been supported by more recent studies. Sociologist Linda Lobao summed up their findings, "an agricultural structure that was increasingly corporate and non family owned tended to lead to population decline, lower incomes, fewer community services, less participation in democratic processes, less retail trade environmental pollution, more unemployment and an emerging rigid class structure."¹⁰

University of Missouri agricultural economist John Ikerd summarizes the empirical findings regarding hog farms, "There is clear evidence that independently-owned, modest-sized, family-operated hog farms can be commercially competitive with current contract production units. There is also clear evidence that successful, modest sized family operated hog farms contribute more to the economic and social well-being of rural communities than do their corporate counterparts."¹¹

Changing the Rules

Giant hog farms and equally giant open-air manure lagoons have generated widespread popular discontent and rebellion. Grassroots alliances of environmentalists and farmers have sprung up in many states: the Land Stewardship Alliance in Minnesota; Stewards of the Land in Kansas; the Missouri Rural Crisis Center; the Illinois Stewardship Alliance.

They have had some success. In 1997 coalitions in North Carolina convinced the legislature to impose a two-year moratorium on further industrial hog farms. In 1998 Oklahoma enacted legislation that severely inhibited the growth of large hog operations. In 1998 the Iowa Supreme Court struck down 7-0 a state law that had shielded hog confinement units from lawsuits. In November 1998, a constitutional amendment that prohibits corporations from breeding, farrowing or fattening swine was approved 59-41 percent by the citizens of South Dakota. →

Resources

The National Pork Producers Council represents the industry and the view that bigger hog farms are necessary and beneficial. Their website is an excellent source of data, articles and news.
P.O. Box 10383
Des Moines, IA 50306;
telephone:
515-223-2600;
website:
www.nppc.org

The Humane Farming Association is the country's largest membership organization looking at factory farming from the animal's point of view.
P.O. Box 3577
San Rafael, CA 94912;
telephone:
415-771-CALF;
website: www.hfa.org

Yet for all the public anger and legislative obstacles, the hog barons refuse to slow down. A suit has been filed to overturn the South Dakota referendum. Seaboard wants to triple hog production in Oklahoma and recently went to court to secure a water permit, denied by the Oklahoma Water Resources Board, for a 25,000-sow operation. In the days before the North Carolina moratorium was to go into effect, state agencies approved permits for an additional 500,000 hogs, in some cases turning around permit applications in 48 hours.

The federal government largely has been missing in action. The Secretary of Agriculture claims he has no authority to regulate livestock contracts under the 1921 Packers and Stockyards Act. Yet even where the U.S. Department of Agriculture has authority, it has been reluctant to exercise it. The USDA's Grain Inspection, Packers and Stockyards Administration, according to the *Baltimore Sun*, "has proven to be a less than combative foe . . . The agency has fielded more than a thousand complaints from poultry growers around the country but has gone to court on their behalf only twice, resulting in a single penalty in 1996 of \$477 in court costs against a small poultry firm in South Carolina."¹²

The Prescription: Better Policies

The struggle over the future of the hog industry is part of a much broader struggle over the future of American agriculture and rural America. If we were designing agricultural policies as if community mattered, what might they be?

1. Enact a moratorium on livestock farm mergers.

The federal government should deny the proposed merger of Smithfield, Murphy and Tyson's pork company, and impose a moratorium on future mergers of livestock firms with market values exceeding \$50 million. In October Senator Paul Wellstone (D-MN) introduced a bill to impose an 18-month moratorium on acquisitions of more than \$10 million by grain, livestock, seed, fertilizer and processing companies with annual revenue of more than \$100 million.

2. Allow more local control. An industrial hog farm poses a profound threat not only to the socioeconomic fabric of a rural community but to its physical health as well. The odor from hog manure is not simply a nuisance. Susan Schiffman, medical psychologist at Duke University Medical Center, has shown that people exposed to swine odors and the gases that accompany them suffer from "significantly more tension, more depression, more anger, less vigor, more fatigue, and more confusion than control subjects."¹³ Odors can affect people up to five miles away.

States should allow county and city governments the right to regulate industrial hog farms. If they

refuse to do so, Congress should direct them to do so. Not surprisingly, local referenda almost always favor smaller, more rooted farms. In nonbinding referenda, for example, 18 of 20 Kansas counties have voted against allowing new corporate hog farms.

3. Hold corporations liable for environmental damages. In 1995 a tidal wave of manure rolled through North Carolina creeks when a hog sewage lagoon broke. Twenty-five million gallons of hog manure killed 10 million fish and closed 364,00 acres of coastal shellfishing. That same year PSF had five major spills, and another six in 1997. In North Carolina alone there are more than 640 abandoned hog manure lagoons, according to the Environmental Defense Fund, because the owners are not liable.

4. Abolish industrial hog farm subsidies. Early in 1999 the Secretary of Agriculture announced a moratorium on government loans for new pork production plants. That's a step in the right direction, but state governments continue to offer hundreds of millions of dollars in direct grants and tax credits to industrial hog farms. In 1996 the federal government appropriated \$100 million to help factory farmers solve the manure problem caused by the concentrated nature of industrial farms. There is no reason the public should subsidize this cost of concentration.

5. Improve small producers' competitiveness. Small producers can compete with the big boys. But they may need management training or access to new technologies (e.g., superior genetic stock). Some producers are cooperating with their neighbors to pool resources and adopt a division of labor and specialization among them. Others are looking to adopt new techniques that lower the capital investment required for farrowing and finishing pigs. To date, there has been very little government support for these endeavors.

6. Uncouple hog ownership from hog processing. Vertical integration in the hog industry shuts out independent producers. Corporate packers should not be allowed to own hogs. In October Senator Tim Johnson (D-SD) introduced a bill that would ban meatpackers from owning livestock. Exceptions would be allowed for farm cooperatives in which a majority of members are growers.

7. Require price disclosure and nondiscrimination in purchases. Under current law, packers need divulge only prices paid on open markets, not prices paid under contract. Not only should packers divulge prices paid to contracted suppliers but they should be prohibited from discriminating between large and small producers when that is not justified by administrative cost reductions. The Packers and Stockyards Act bars price discrimination but has been loosely interpreted and rarely enforced. South Dakota barred

Resources

The Environmental Defense Fund runs "Hog Watch," a website that focuses on North Carolina's hog industry. Its wide-ranging information is pertinent for any state.
www.hogwatch.org

GRACE (Global Resource Action

Center for the Environment) maintains a website with state-by-state updates, research links and policy information on concentrated livestock operations.
15 East 26th Street
Suite 915
New York, NY 10010
telephone:
212-726-9161;
website:
www.factoryfarm.org

The Center for Rural Affairs
P.O. Box 406
Walthill, NE 68067
telephone:
402-846-5428
website: www.cfra.org

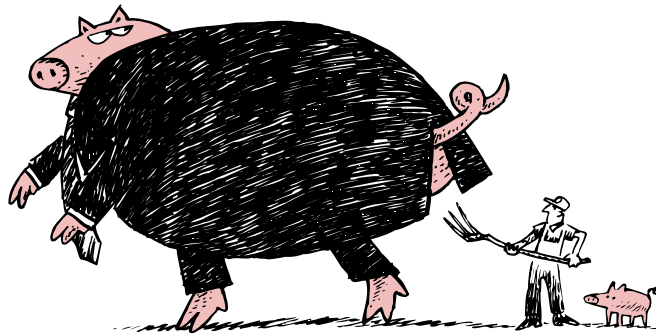
price discrimination in its November 1998 livestock legislation, but in July 1999 a federal court overturned this part of the law as a violation of interstate trade. At this writing, Congress is developing legislation regarding price discrimination and price disclosure. Unfortunately, it is likely to be weaker than several state laws and may preempt those laws.

8. Reduce the size and increase the number of packing plants. Unlike farms, meat packing plants do have considerable economies of scale: larger facilities lower unit costs. However, the scale of new packing plants is so large that it undermines competitiveness and reinforces concentrated livestock raising. Cost savings are often at the expense of the community and the workers.

9. Support farmer-owned packing plants. This recommendation contradicts the previous call for uncoupling livestock rearing and livestock slaughtering. The reason: farmer-owned packing plants encourage diversity of size and placement and provide small farmers with the opportunity to gain a share of the processing dollar.

10. Deconcentrate hog production. Enactment of the first nine rules would go a long way toward establishing a marketplace in which existing small hog farmers can survive. However, given the concentration that already exists and the massive exodus of hog farmers that has already taken place, reestablishing significant numbers of family hog farmers may require further intervention. In theory, antitrust laws might be used to decentralize hog operations. (For an excellent and sobering discussion of the evolution of antitrust policy see Michael Sandel's *Democracy's Discontent: America in Search of a Public Philosophy* [Cambridge: Harvard University Press, 1996].) If not, as a last resort, the federal government could purchase the hog operations of the largest firms and shut them down. This could result in the dispersal of a million sows. A very rough estimated cost to achieve this is \$2-3 billion. This cost should be compared to the \$170 million Congress has already appropriated to bail out hog farmers directly and the several billion dollars it has appropriated to assist grain farmers in 1999 alone. The Supreme Court's upholding of the mandatory purchase of large landholders as part of a land reform effort in Hawaii indicates that such a move would be held constitutional (Hawaii Housing Authority v Midkiff, 467 U.S. 229 [1984]).

The explosive growth of industrial hog farms could not have happened had state legislatures and the federal government not changed the rules to encourage bigness, concentration and absentee ownership. Yet the demise of the family hog farmer is not a done deal. There's still time to design rules that pro-



tect the environment, nurture higher productivity and safeguard rural communities. [!]

Notes

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4 See John Crabtree, "An Alternate Vision for Pork Production," Center for Rural Affairs, 1998. Also see M. Brumm, et al. "Hoop Structures for Grow-Finish Swine," *Agricultural Engineers Digest*, Volume 41, 1997.

5 John Ikerd, "The Economic Impacts of Increased Contract Swine Production in Missouri: Another Viewpoint," University of Missouri, 1997.

6 John W. Chism and Richard A. Levins, "Farm Spending and Local Selling: How do they match up?," *Minnesota Agricultural Economist*, Spring 1994.

7 Suzanne Thornsbury, S. Murphy Kambhampaty and David Kenyon, "Economic Impact of a Swine Complex in Southside Virginia," Virginia Tech University, Department of Agricultural and Applied Economics, 1994.

8 Ikerd, op. cit.

9 Walter Goldschmidt, "Small Business and the Community: A Study of the Effects of Scale of Farm Operations," Report of Special Committee to Study the Problems of American Small Business, December 1946.

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11 Ikerd, op. cit.

12 *Baltimore Sun*, April 16, 1999.

13 Susan Schiffman, et al. "The Effect of Environmental Odors Emanating From Commercial Swine Operations on the Mood of Nearby Residents," *Brain Research Bulletin*, Vol. 37, No. 4, 1995.

Got (Local) Milk?

A few years ago, New England tried to save their local dairy farms with a regional pricing structure called a dairy compact. Now Congress has nixed the compact's renewal, blunting one of the small dairy farmer's only tools for surviving.

By Stacy Mitchell

DAIRY FARMS ARE AN ESSENTIAL FEATURE OF NEW England's culture and the character of its rural landscapes. Indeed, one can hardly think of Vermont without picturing rolling pastures, red barns and black-and-white dairy cows. But this scene may not last for long. New England's dairies are fast disappearing and the effort to save them has produced a heated congressional battle hardly befitting the serene image these farms evoke.

There are many reasons New England's small dairies are declining, but the most significant have to do with

corporate dairies are expanding, taking advantage of the latest technologies and producing more milk for less.

To save their dairy farms, the six states of New England took an unprecedented step in 1996. With authorization from Congress, they formed the Northeast Interstate Dairy Compact, which enables the states to collectively set a minimum price that dairy farmers receive for milk sold in New England.

Other regions want to adopt the New England model. Five mid-Atlantic states are seeking to join the compact and fourteen southeastern states have petitioned Congress to allow them to form their own.

But the federal law authorizing the Northeast Compact expired October 1.

Attempts are underway to resurrect it, but the prospects seem grim.

Although it may well prove short-lived, the Northeast

Interstate Dairy Compact offers an opportunity to examine the economic impact of drafting farm policies that make the survival of local, small-scale producers

their primary goal.

Opponents of such policies describe them as protectionist and argue that they distort the market by artificially raising prices. If it's cheaper to produce milk in other regions and large-scale dairies can do it more efficiently, then why preserve obsolete farms?

Supporters counter that paying a few cents more for a gallon of milk is rather trivial compared to

changing economics. Milk prices haven't kept pace with rising costs of production. Small dairies have been unable to weather sharp price declines in an increasingly volatile market. What's more, it's cheaper to produce milk in other regions, where massive

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what's at stake. The region's 3,000 dairy farms are not only integral to New England's culture, but they maintain open space in an area anxious to ward off the sprawling urbanization of the eastern seaboard. Dairies yield important economic benefits for rural communities. The typical New England dairy—a small, family farm with about 90 cows—requires more than \$400,000 in inputs annually, nearly 75 percent of which are purchased locally. Local economic benefits accrue from the output of dairy farms as well: milk is usually processed, bottled and distributed within a relatively localized area. Moreover, supporters argue, losing this local supply of fresh milk is nothing to take lightly. Dependence on distant milk processors may well lead to higher consumer prices over the long term.

A Dairy for Every Dale

Ensuring that fresh milk flowed in every corner of the country has in fact been the primary goal of national and state dairy policy for the last 60 years. The federal government began regulating farm-level milk prices in the 1930s under the Agricultural Marketing Agreements Act (AMAA). The aim was to ensure a stable supply by setting a minimum price that processors had to pay farmers for their milk. According to most economists, the market conditions that necessitated price regulations then still exist today. Because milk is perishable and expensive to ship, and there are relatively few processors in a given area, dairy farmers have little leverage to negotiate a fair price.

Today, the U.S. Department of Agriculture (USDA) sets milk prices using a complex formula based on the market for cheese in the Upper Midwest. These prices vary from region to region and generally increase with distance from Eau Claire, Wisconsin. Producing milk in some regions has always been more difficult and expensive than in others. To an extent, the federal system was designed to reflect these differences and to create incentives to supply certain areas, like the Southeast, that were once plagued by chronic shortages of fresh milk.

Congress intended the federal pricing system to be complemented by state regulation and, under the AMAA, allowed states to set higher prices within their borders. This enabled states to address the particular needs of their local markets and to establish minimum prices that best protected the state's producers and consumers. At one time, nearly half the states maintained milk prices above the federal level.

With this dual approach, nearly every state was able to maintain its own dairy industry. Although cheese markets have long been national in scope and dominated by a handful of states, beverage milk rarely came from very far away.

The Birth of the Northeast Dairy Compact

State pricing rules were rolled back beginning in the 1960s, as interstate milk transportation expanded. Some states abandoned their price programs as cheaper imported milk undercut locally produced milk. Others tried to apply their regulatory systems to both in-state and imported milk, only to face invariably successful legal challenges under the Constitution's Commerce Clause, which bars states from regulating interstate trade.

The last decade has seen renewed interest among states in mandating higher milk prices, largely in response to major changes occurring in the industry. Large dairies are replacing small dairies. The number of dairy farms has declined from more than 300,000 in 1980 to just 92,000 today. Many of these large dairies are locating where costs of production are lowest: in the West, a region that now leads the nation in dairy production. Much of the East, in turn, has become a milk "deficit" region, dependent on dairy foods imported from other areas. New England supplies roughly 60 percent of its own dairy needs. The Southeast is in danger of losing its dairy industry all together.

To save their farms, Connecticut, New York, Massachusetts, Vermont, New Hampshire and Minnesota implemented milk pricing rules in the early 1990s. All were overturned by the courts, however, because states do not have the authority to regulate milk entering or leaving their borders.

Although the Constitution bars states from interfering with interstate commerce, it does contain a mechanism (Article I, Section 10) that allows multiple states to form a regional compact and collectively regulate trade. Compacts must be approved in identical form by each state involved and then by Congress.

According to William Van Alstyne, professor of law at Duke University, during the last two centuries, Congress has authorized some 300 interstate compacts, nearly all of which were enacted to settle boundary disputes, allocate shared natural resources or administer bridges and other shared infrastructure.

In the late 1980s, Vermont Representative Robert Starr and Daniel Smith, legislative counsel for the Vermont House, galvanized a movement to use this constitutional provision in an unprecedented fashion: to create a regional dairy compact that would give New England the authority to set minimum farm prices for milk consumed within its territory.

By 1993, all six New England states—Maine, New Hampshire, Vermont, Massachusetts, Connecticut and Rhode Island—had passed compact legislation. In 1996, Congress approved the Northeast Interstate Dairy Compact. →

How it Works

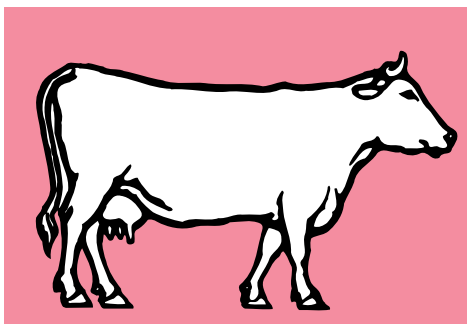
The Northeast Dairy Compact is governed by a commission composed of delegations from each state. Each delegation must include both farmers and consumers. The commission has the authority to establish a minimum farm price for beverage milk, known as fluid or Class I milk. Other classes of milk, those destined for manufacture into cheese, butter, ice cream and other products, are not regulated by the commission. Nationally, about 30 percent of milk is sold as fluid milk. New England, like other deficit regions, drinks a larger share, about 45 percent, of its locally produced milk.

Prices are established through a public hearing process. The commission takes testimony to determine the price necessary to provide a reasonable rate of return to producers and distributors, while taking into account the ability of consumers to purchase milk. Pricing decisions require a two-thirds majority of the member states and must also be approved by a two-thirds margin in a producer referendum.

The commission implemented its first price regulation in July 1997. The minimum price for fluid milk was set at \$16.94 per hundredweight (cwt). (One hundred pounds of milk is equivalent to 11.6 gallons.) Whenever the federal price for the New England region drops below the compact price, milk processors who supply the New England market must pay the difference to the commission, which in turn distributes this premium to dairy farmers. The premium has averaged \$1.06 per cwt over the last two years.

The commission diverts a percentage of the premium to cover its costs and to negate the Northeast Compact's impact on school milk purchases and the Women, Infants and Children (WIC) food program.

The compact price applies to all fluid milk sold within New England. Processors outside of New England are subject to the price rules for any milk they sell in New England. Likewise, farmers outside of the region are eligible for the premium if their milk is consumed within New England.



Though perhaps not as competitive on the simple measure of price, a local, small-scale dairy industry generates significant social and economic benefits for rural communities and, some argue, produces the best long-term value for consumers.

Has the Northeast Compact Helped Dairy Farmers?

Since its inception, the Northeast Dairy Compact has generated \$68 million in additional income for dairy farmers. This amounts to a 3 percent increase in total milk receipts, or 45 cents per cwt. Because all farmers who have fluid milk sales in New England are eligible, dairy farmers in New York, part of the region's traditional "milkshed," have received more than one-quarter of the benefits to date.

It's still too early to tell whether the compact has slowed the decline of dairy farms. Popular opinion in New England is that it has, but statistics don't yet

bear this out. In Vermont, 145 dairy farms failed in the two years prior to the compact. In the two years since, 150 farms have gone under. But Vermont officials contend that changes in the capital gains tax concurrent with the start of the compact are to blame for the numbers, because many who planned to sell their farms waited for the tax changes to take effect.

Small dairy farmers say that, while the added income is significant, the Northeast Compact's biggest benefit is the price stability it creates. "Because dairy farmers can't store or stockpile their milk due to its perishable nature, they really have no leverage in the market," according to Leon Graves, commissioner of Vermont's Department of Food and Markets. "When a drastic price swing occurs, they have no recourse but to settle for it no matter how great the cost of production has been. Those of us who already belong to the existing Northeast Dairy Compact have been able to soften the blow to our farmers."

A particularly brutal blow came this past spring when the federal government cut producer milk prices by 37 percent across the nation. The price drop meant dairy farmers outside of the Northeast were losing money every time they sold a gallon of milk.

Resources

For information on the Southern Dairy Compact, contact: Dewitt Hardee, domestic marketing manager, North Carolina Dept of Agriculture, P.O. Box 27647, Raleigh, NC 27611, telephone: 919-733-7912, website: www.agr.state.nc.us/markets/commodit/dairy/compact.htm

Has the Compact Hurt Consumers?

When the Northeast Dairy Compact first took effect, the retail price of milk in New England jumped by 26 cents per gallon. Dairy farmers and compact supporters accused processors and retailers of taking advantage of the highly publicized policy to raise their prices. Within a couple of months, retail prices declined and have remained fairly flat. According to William Thomas, a dairy economist at the University of Georgia, New England's milk prices are comparable to the national average.

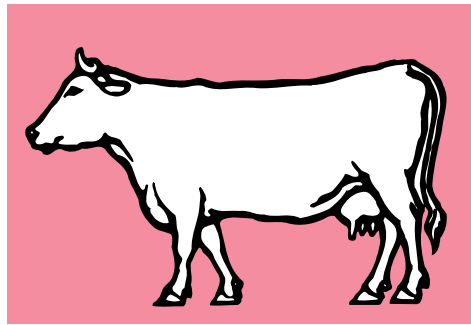
Even if the entire cost of the compact has been passed on to consumers, it only amounts to about \$2.50 per person annually (or 10 cents a gallon). This is a small price to pay for viable

dairy farms and locally produced milk, according to Kathy Lawrence of Just Food, a New York City-based organization that works to increase the availability of locally grown food to low income citizens. "Will we get better consumer prices as more farmers go out of business and our food production is monopolized by mega-corporations?" she asks.

Could a Dairy Compact Save Farms in Other Regions?

Under the current law, six states—Delaware, Maryland, New Jersey, New York, Pennsylvania and Virginia—are allowed to join the Northeast Compact provided that at the time of entry the state is contiguous to a participating state and receives the consent of Congress. Five have declared their intent to join. In addition, fourteen southeastern states (including Virginia) have petitioned Congress to allow them to form their own.

These states are facing much the same situation as exists in New England: higher production costs, disappearing dairy farms and increased dependence on out-of-state milk. Conditions are particularly dire in parts of the Southeast, which will probably lose their dairy



.....
"When a drastic price swing occurs, dairy farmers have no recourse but to settle for it no matter how great the cost of production has been. Those of us who already belong to the existing Northeast Dairy Compact have been able to soften the blow to our farmers."

— Leon Graves

.....
in Minnesota and Wisconsin, and, since this is only a small fraction of the area's total milk production, the premium would have to be quite high to make much difference. Farmers fear that a high premium would force retail prices up and reduce demand.

Furthermore, Upper Midwest dairy farmers believe that the expansion of compacts in the East will hurt their export-driven industry. They advocate a more market-oriented approach and argue that policies designed to support local dairy production are outdated now that milk can be shipped longer distances. Dairy processors agree. "We don't need a dairy farm in every backyard in New England," contends Kathleen Nelson of the International Dairy Foods Association, which has joined with Upper Midwest farmers to convince Congress to let the Northeast Compact die.

"The Northeast Dairy Compact is a cartel that rewards farmers in one region at the expense of farmers in the Upper Midwest," argues Paul Zimmerman of the Wisconsin Farm Bureau Federation. He believes that, by raising prices, compacts encourage more milk production. Increased production means fewer opportunities for the Midwest dairy industry to supply eastern markets. It also lowers milk prices →

farms altogether within the next year or two. Without a local supply, state officials fear that consumers in these areas will ultimately pay higher milk prices.

Dairy farmers in the Upper Midwest, once the undisputed capital of the dairy industry, have fallen on hard times as well. Wisconsin and Minnesota rank first and second in the number of dairy farm failures, with a combined total of more than 10,000 since 1993.

But producers here say a dairy compact would be of little help. Less than 20 percent of the region's production is sold as fluid milk. The rest is converted into cheese, most of which is shipped to other states. A compact premium would apply only to fluid milk consumed with-

Resources

The legislation authorizing the Northeast Dairy Compact Commission can be found on the Family Farms section of the New Rules web site:
www.newrules.org/biz/farms/index.html

Northeast Dairy Compact Commission
34 Barre St, Suite 2
Montpelier, VT 05602
telephone: 802-229-1941
website: www.dairycompact.org
Contact: David Ferch, public information director

nationwide, because excess milk is manufactured into “storable” products like cheese, and the more cheese, the lower the price of cheese. Since the entire federal milk pricing system is based on the price of cheese, the lower the price of cheese, the lower the price of milk.

Milk production has indeed risen 4.6 percent in New England since 1996, compared to 1.7 percent nationally. But milk production varies with the weather and New England has enjoyed two mild winters.

Regardless, New England is a drop in the national milk bucket, representing less than 3 percent of total production and unlikely to have much influence on national prices. What worries farmers in the Upper Midwest is the addition of five more states and the formation of a new southern compact. Combined, the compacts would represent nearly 40 percent of the nation’s milk production and 60 percent of its consumers.

Supporters of regional compacts contend that several factors mitigate against increases in production. The Northeast Compact premium is fairly small. It would be still smaller if excess milk were converted to cheese, since this would lower the fluid milk percentage, which would lower payments to farmers. An unreasonably high compact price would encourage out-of-state producers to ship more milk into the compact region, undermining the compact’s purpose. Finally, the Northeast Compact is required to reimburse the USDA’s Commodity Credit Corporation for any surpluses it purchases as a result of increases in regional milk production greater than the national average. (This is federal program that acts as an emergency safety net for the industry.)

By law the Northeast Dairy Compact Commission must take steps to ensure that the premium “does not generate additional supplies of milk.” Two supply management proposals are currently under consideration. One would establish a production quota for participating dairies. The other would divert a portion of the current premium to farmers who did not increase production over the previous year and would be weighted to provide smaller dairies with a disproportionately larger share of the diverted benefits.

Neither is of much comfort to farmers in the Upper Midwest, who feel increasingly under siege. But the real threat to these farms arguably lies, not to

the east, but to the west. Dairy production in the West has jumped more than 20 percent in the last five years and the region now accounts for 37 percent of the nation’s milk supply. Half of this comes from California, which surpassed Wisconsin in 1993 to become the nation’s number one milk producer. Dairy is big business in California, where the average farm has more than 600 cows—eleven times the size of an average Upper Midwest farm—and commands significant economies of scale.

No longer able to compete in the West, the Upper Midwest’s only salvation is to replace declining Southeast and Northeast production with Midwest milk, according to Ed Joiner, dairy farmer and chairman of the Louisiana Farm Bureau Dairy Advisory Committee. “In other words, they feel we must die for the Midwest to survive.”

Recent changes to the federal milk pricing system have moved the Upper Midwest closer to its goal of a uniform national dairy policy indifferent to local production costs. Regional differences in federal milk prices are being narrowed under the new rules, giving Upper Midwest producers a boost, while lowering prices along the coasts.

Should Congress fail to renew and expand the dairy compact model, these changes in the federal pricing system will accelerate the loss of eastern dairies. While Upper Midwest farmers may benefit in the short term, this free market approach to dairy policy holds out little long term hope for this region’s farms. Although many of the newest Midwest dairies house hundreds or even thousands of cows, the vast majority of farms here are small family operations. They may be able to produce milk more efficiently than their counterparts in the East, but they cannot match the scale economies of the latest generation of corporate dairies.

Though perhaps not as competitive on the simple measure of price, a local, small-scale dairy industry generates significant social and economic benefits for rural communities and, some argue, produces the best long-term value for consumers. As much of the eastern U.S. has concluded, these advantages easily justify policies that support local farmers, even at the risk of paying a few cents more for a gallon of milk. [!]

“Will we get better consumer prices as more farmers go out of business and our food production is monopolized by mega-corporations?” — Kathy Lawrence

A Case of the Good Stuff

Small wineries have cleared themselves a space on the shelf, making them an unusual case in this era of consolidation. Now their alternative methods of distribution are threatened. *By Simona Fuma Shapiro*



IN AN ERA OF CONSOLIDATION, ONE INDUSTRY IS partially bucking the trend: nearly 2,000 small wineries are holding their own against the Gallos and Inglenooks. According to the American Vintners Association, there were 377 wineries in the U.S. in 1963. Today there are 2,082. Over half of these produce less than 10,000 cases a year.

How can this trend be explained? There is no simple answer, but the multiplication of vintners and labels is clearly driven from both ends of the market.

U.S. Wine Grows Up

From the end of Prohibition into the 1950s the wine industry was dominated by large wineries that produced mostly inexpensive generic wines. These wines were high in sugar content and had a robust, unsubtle flavor. Towards the end of the 1950s a new group of vintners—many of whom were urban professionals entering winemaking as a second career—began making high-quality wines in small quantities. They launched the “boutique winery” movement.

Earlier generations of Americans had generally consumed jug wines, but the 1960s saw stirrings of interest in premium varietals. Jay Stuller and Glen Martin, authors of *Through the Grapevine: the Business of Wine in America*, attribute this shift to the unprecedented numbers of young people who traveled through Europe in the 1960s and early 1970s. There they were exposed to inexpensive, high-quality wines. As this generation grew older, it became financially able to indulge its taste for premium wines. Correspondingly, the number of premium labels has grown. In 1985, 81 percent of California wine shipments were generic and 19 percent varietal. In 1997, the figures were 39 percent and 61 percent.

An Upscale Audience

The wine industry regularly chastises itself for failing to appeal to a larger or younger segment of the popu-

Simona Fuma Shapiro is a researcher with The New Rules Project of the Institute for Local Self-Reliance.

lation. Consumers of wine, whether premium or generic, are wealthier than average and middle-aged. But the forces that keep wine exclusive also help small wineries. A 25-year-old boom in wine magazines and clubs has created audiences that are willing to research and seek out small labels. Fifteen percent of table wines are consumed in restaurants, where new brands are showcased to affluent consumers.

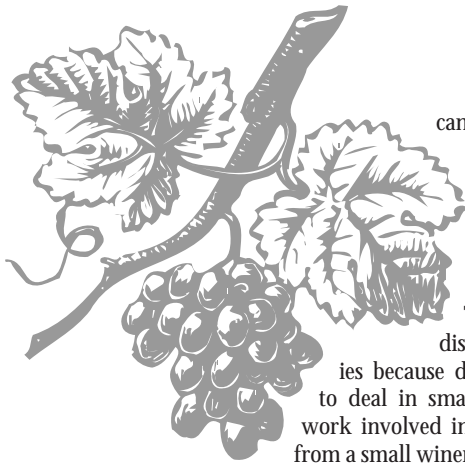
Small producers are often former professionals attracted to the bucolic lifestyle of grape growing. They are content to exist in a market niche, earning just enough to sustain their lifestyle. Small wineries aspire to a volume of no more than 35,000 cases per year: what is described as chateau size, after the celebrated wine-producing chateaux of France. It is a maxim of winemaking that quality suffers beyond production of 100,000 cases.

Three-Tier System Tilts the Scales

Consumer demand and the appeal of winemaking have converged to spawn a winery movement, but the playing field is far from level. Despite the success of small vintners, the top 20 wineries still control 90 percent of the market. One out of every four bottles comes from the Ernest and Julio Gallo winery.

Distribution is a large factor in this imbalance. In most states, liquor is subject to a three-tier system, where producers sell to a distributor, who in turn may supply a restaurant or retailer. Enacted after the repeal of Prohibition, the three-tier laws were meant to prevent alcohol manufacturers from selling directly to customers. State lawmakers feared Mafia control of the industry or abuses like the turn-of-the-century “tied-houses,” distiller-owned taverns where working men were offered salt pork or free sandwiches to induce them to come in and drink. The wages men lost in these taverns inspired the phrase “there’s no such thing as a free lunch.”

In some states, local wineries have wholesaling privileges that allow them to sell directly to in-state retailers or restaurants, even though it is illegal for an out-of-state producer to do so. In this way, wineries →



can get around the three-tier system within their own state, but are still subject to it elsewhere.

Big Names

Want Big Numbers

The three-tier system disadvantages small wineries because distributors are reluctant to deal in small volumes. The paperwork involved in handling 5 or 10 cases from a small winery can cost more than the profit made from the sale.

In addition, consolidation of distributors has exacerbated the problem. The number of distributors of alcoholic beverages has shrunk to 300 from about 5,000 in 1950. A handful of large distributors dealing in large volumes now dominate the market in every state. Large wineries are where they make their money.

Steve Gross, state government relations manager for the Wine Institute, a trade group of California winemakers, acknowledges that the current distribution system is shutting out small wineries. "Let's say there are 800 viable commercial wineries in California," he said. "Each produces on average five labels. In California alone, you're talking a minimum of 4,000 labels every year.

"Physically, it's impossible for the present wholesale and distribution structure to handle that kind of volume of labels. The retailers don't have the shelf space. Wholesalers can't physically handle that many labels in their catalogs, or provide the necessary floor space in their warehouses."

While some "hot" or trendy small labels do occasionally get picked up by distributors, the majority do not. One vintner compares the situation to an hourglass, where, "You've got a tremendous number of wines and an expanding consumer base. And then you've got this very small channel of distribution that all these wineries have to go through to reach the consumer base."

Getting Around the Big Boys

Such conditions would suffocate most producers, but wineries have developed creative marketing methods. California has a full-blown wine tourism industry. Visitors travel from winery to winery for tastings, meals, concerts and festivals. Other wineries host corporate events. Some draw traffic by enlisting volunteers to pick grapes and paying them with bottles of wine. Many very small wineries rely almost exclusively on on-site sales.

Other wineries do seek distribution, but from a crop of new distributors that cater specifically to small wineries. And in states like California, where direct shipping is permitted, they sell directly to local retailers, restaurants and individuals, or hire a broker to market their products statewide. Still, obtaining shelf space is a struggle, which is why small wineries have turned increasingly to mail order and internet sales.

Saved by the Net

Internet sites are the ideal marketing venue for small labels. They have unlimited "virtual shelf space" and a vast pool of potential customers, and they eliminate the bottleneck of middlemen. Since 1995, sites like Virtual Vineyards have done a brisk business in premium and high-end wines.

Wine wholesalers began to view these developments with alarm and launched a lobbying campaign of the state and federal governments. Americans for Responsible Alcohol Access, founded in 1997 and funded by the Wine & Spirit Wholesalers of America, argued that direct shipment robbed states of excise taxes and allowed minors easy access to alcohol. In 1996 Kentucky became the first state to upgrade direct shipping from a misdemeanor to a felony. Eight other states, including Florida, Georgia and Maryland, have followed suit. Wineries that had previously ignored direct shipment laws immediately curtailed their business in those states.

On the federal level, the House and Senate have passed bills that would prohibit interstate internet and mail order sales of liquor. These bills would allow states with direct shipment prohibitions to obtain injunctive relief against direct sellers in federal court. In 1997, Florida filed suit against several wine clubs licensed in California and New York for shipping wine into their state. Florida courts threw out the case due to lack of jurisdiction over out-of-state businesses. The bills sponsored by Sen. Orrin Hatch (R-Utah), Rep. Joe Scarborough (R-Fla.), and others are an attempt to remedy this situation.

Wine & Taxes

Currently, all mail-order and internet sales are exempt from sales tax, on the basis of a 1967 Supreme Court decision (National Bellas Hess, Inc. v Department of Revenue of Illinois, and reaffirmed in the 1992 case, Quill Corp. v Heitkamp). This decision gives remote merchants a 6 to 8 percent price advantage over main street merchants in towns and cities. Because of this, booming internet sales continue to erode local tax bases.

Wine producers have been the first to come forth and agree to pay taxes on internet sales. John DeLuca,

president of the Wine Institute, is concerned that a federal law might pre-empt an industry effort to work out individual agreements with states. Wineries are perfectly willing to pay state excise taxes, the Wine Institute insists. It is true that some internet sales currently bypass those taxes, but that is because there is no system in place to collect them. But states like Louisiana and New Hampshire have worked out compromises with liquor producers, whereby a shipper can register with the state, pay all appropriate taxes and ship a limited number of bottles directly to customers.

Wine producers are also lobbying for state reciprocity laws. These are, in effect, treaties between states allowing shipments to and from states that afford each other the same privilege. Reciprocity laws restrict the amount and uses of the beverage shipped. But within these limits, sales are tax-exempt. For instance, the Idaho law allows shipment of two cases of wine per month. The shipping container must be labeled with instructions that it may not be delivered to a minor. Nor may alcoholic beverages be delivered to a visibly intoxicated person. Twelve states currently have more or less restrictive versions of these laws.

One state even encourages small wineries through tax breaks. In 1977 Oregon passed an amendment to its tax laws providing favorable tax treatment for small producers. Oregon's tax on wine, levied on wine producers or importing distributors, is 67 cents per gallon (there are 2.38 gallons in a case). But the law provides that "no tax shall be levied, collected or imposed upon the first 40,000 gallons, or 151,000 liters, of wine sold annually in Oregon from a United States manufacturer of wines producing less than 100,000 gallons, or 379,000 liters, annually." Thus wineries that do not surpass the 42,000-case (100,000-gallon) mark do not pay beverage taxes on their first 16,800 cases (40,000 gallons) sold in Oregon. Nationwide more than 90 percent of wineries qualify for the tax exemption.

Free the Wine Trade

Wholesalers have lobbied hard against compromises such as reciprocity laws, proposing an alternative setup: customers should order the wine they want through a

toll-free number. The wholesaler would then locate the product and ship it to the closest retail outlet.

Wineries insist that wholesalers have nothing to fear from direct shipping. High shipping costs mean that shippers serve a specialized market in high-end premium wines. Beer, cheaper wines and other liquors are not affected. Mail order and internet sales constitute 1 percent of total liquor sales, according to Seana Wagner of Free the Grapes, a direct-shipment advocacy group. "Direct shipping is a way to augment the three-tier system," Steve Gross of the Wine Institute asserts. "We're not arguing that the three-tier system doesn't work, because it does work for a vast majority of products."

Consumer demand and the appeal of winemaking have converged to spawn a winery movement, but the playing field is far from level. Despite the success of small vintners, the top 20 wineries still control 90 percent of the market.

For these same reasons, wineries reject the argument that direct shipping is a lure for minors. Teenagers do not order \$40 bottles of Chardonnay, they say, and then wait a week for delivery. Free the Grapes has developed a code of voluntary guidelines for direct shippers, including provisions to ensure liquor does not reach minors. These include labeling containers with instructions not to deliver to persons under age 21 and asking recipients to show identification.

Trade associations like the American Vintners Association and the Wine Institute are also backing the efforts of an organization called the Coalition for Free Trade in Licensed Beverages. CFT has gone on the attack, helping consumers sue their states on behalf of the Commerce Clause of the U.S. Constitution. The Commerce Clause prohibits any state from setting up trade barriers with respect to other states. Until now, the 21st Amendment, which repealed Prohibition, has widely been interpreted as exempting state liquor regulation from the Commerce Clause. However, the Commerce Clause has twice been successfully invoked to overturn state laws regulating the liquor industry, so a victory is not out of the question.

Small wineries are an uncommon phenomenon in an age of product homogenization. It is important that these local enterprises thrive: their success may provide lessons for other small-scale businesses. [!]

Resources

The Wine Institute, a trade organization of California wineries, has in-depth information on direct shipping laws.
425 Market Street
Suite 1000
San Francisco, CA 94105;
telephone: 415-512-0151;
website: www.wineinstitute.org

American Vintners Association
1200 G Street NW
Suite 360
Washington, DC 20005;
telephone: 1-800-879-4637;
website: www.americanwineries.org
Contact: Simon Siegl, president

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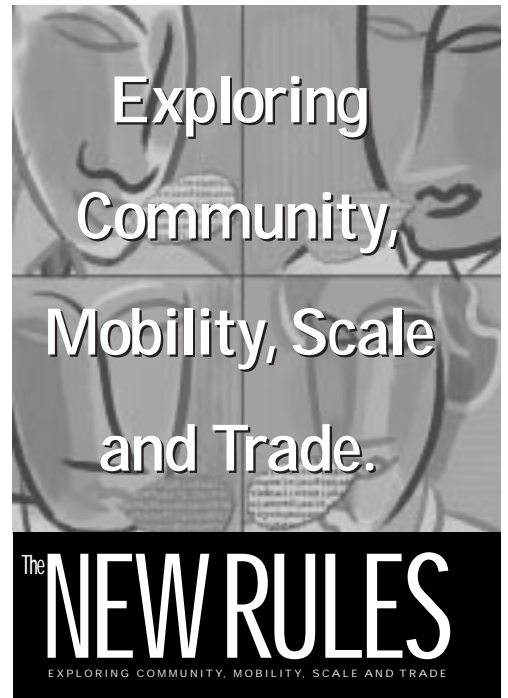
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