

FOOD MARKETING POLICY CENTER

NEWSLETTER

Department of Agricultural and Resource Economics
College of Agriculture and Natural Resources
University of Connecticut

Mission

The Food Marketing Policy Center conducts research on food and agricultural marketing and related policy questions. It facilitates research by maintaining large scale data bases and a visiting research scholars program. The general intent is to provide information that can contribute to improved performance of the food production and marketing system. Key users include farmer and consumer organizations, agribusiness firms, public agencies, state legislatures, and the U.S. Congress.

Tel. (860) 486-1927
FAX (860) 486-2461

fmpc@uconn.edu
http://www.fmpc.uconn.edu

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Newsletter Editorial:

Fluid Milk Market Channel Pricing: Monopolistic Pricing by Processors and Retailers Hurts Farmers, Consumers, and Federal Market Order Pricing

by Ronald W. Cotterill

Fluid milk market orders are routinely criticized by many because they force consumers to pay higher fluid milk prices. The Northeast Dairy Compact was also attacked as a cartel that if eliminated would result in lower prices to consumers. The fluid milk processors through their trade group, the International Dairy Food Association, and the supermarket chains, through the Food Marketing Institute, aggressively push this viewpoint in Washington and more recently in the state houses in New England. In fact, what one has is the pot calling the kettle black. Soon after the Dairy Compact's demise raw milk prices plummeted 50 cents per gallon. According to IDFA economists' model, retail prices should have dropped 90 cents per gallon in New England. They dropped only 10 cents. IDFA and FMI are silent on this point today.

Noncompetitive pricing occurs in milk processing markets and urban grocery markets that have experienced dramatic consolidation. The few remaining larger firms no longer compete on price. Just like a cartel they have power over wholesale and retail milk prices. Consider New England. Dean Foods processes over 70% of the fluid milk. It has a 20-year strategic alliance (contract) with the region's leading supermarket chain, Stop & Shop, and also supplies private label milk to all but two of

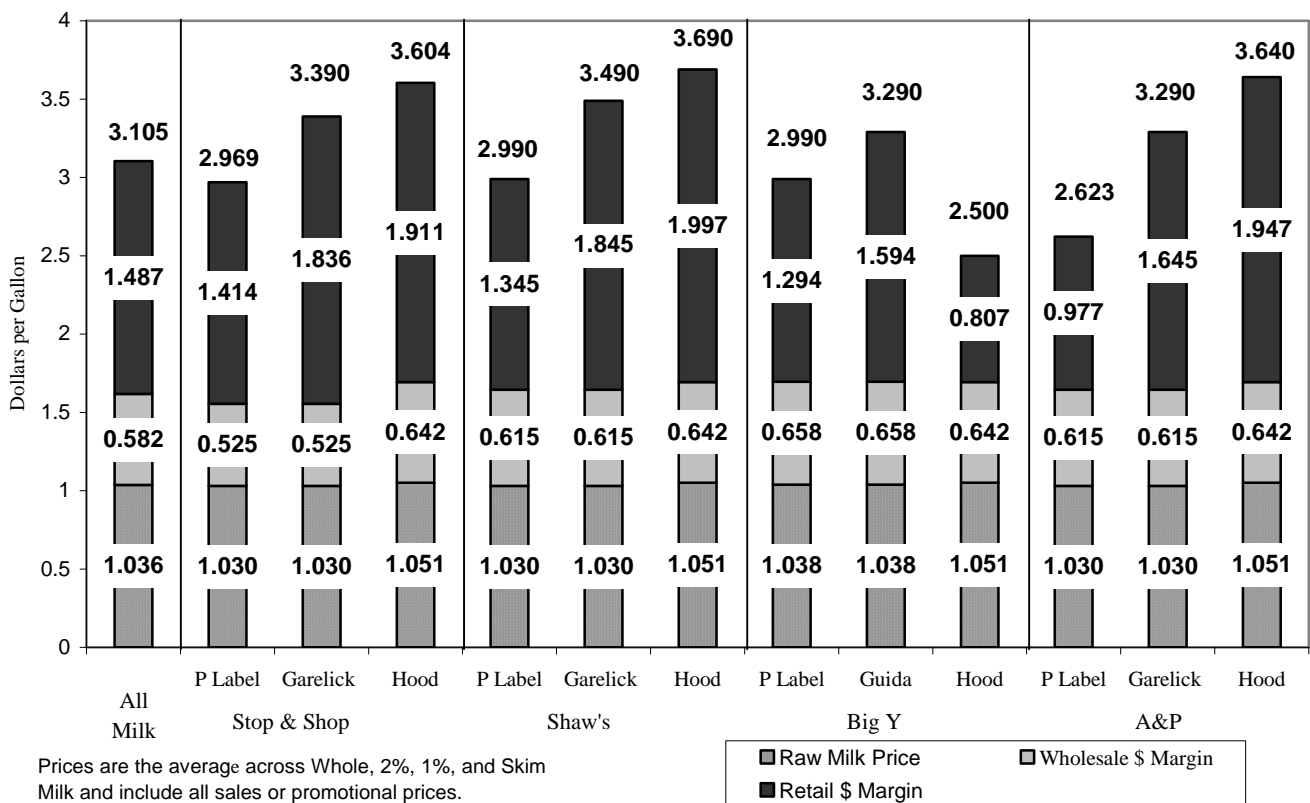
the region’s supermarket chains. Stop & Shop is the dominant player in many southern New England retail market areas with a market share above 40% and no close competitor. Similarly, Hannaford is dominant in northern New England. As dominant firms they announce milk prices, and the others follow their lead to sustain retail milk prices far above costs.

How far above costs? Since last November staff at the University of Connecticut Food Marketing Policy Center have checked retail prices on three separate occasions throughout southern New England. We also obtained wholesale milk prices, i.e., the price that processors charge for delivering bottled fluid milk into the dairy case coolers of supermarket chains, from Dairy Technomics. This firm routinely measures raw milk prices, processing, and delivery costs for supermarket chain buyers who use the information to bargain for

lower wholesale milk prices. Even when one accounts for sales and price specials, retail milk prices are far above supply costs.

Here we discuss prices for March 2003; however, this pricing pattern has existed since December 2001. Figure 1 gives prices for the top four supermarket chains that account for 75% of supermarket volume in Connecticut. Processors paid farmers \$1.036 per gallon and collected 58.2 cents per gallon for processing and distribution of milk to supermarket chains. The average wholesale price was \$1.618 per gallon. The average retail milk price is far higher—\$3.10 per gallon. Supermarkets kept \$1.487 per gallon, nearly half of the retail price for in store costs and profits. Research at the University of Maine and Penn State University indicate that in store costs for large chain stores is as low as 20 cents per gallon and ranges up to 40 cents per gallon in smaller supermarkets. We

Figure 1: Actual Raw Milk, Estimated Wholesale, and Actual Retail Milk Pricing by Brand for the Four Leading Supermarket Chains in Southern New England: March 2003



conclude that supermarkets are charging at least a dollar per gallon more than they would be able to charge in a competitive market channel.

Let's restate these prices on a per hundredweight basis to focus on the issue of market order price enhancement versus retailer price enhancement. At \$3.10 per gallon consumers are paying \$35.96 per cwt for fluid milk. Processors are paying farmers $\$1.036 \times 11.6 \text{ gal/cwt} = \12.01 per cwt for this milk. (Since much of the milk is skim/low fat, this pay price does not include excess cream.) A recent FAPRI study suggests that eliminating the federal market orders would reduce processor pay prices by roughly \$1.50 per cwt. This elimination of "cartel power" pales in comparison to the $\$1$ per gallon $\times 11.6 \text{ gal/cwt} = \11.60 per cwt market power premium that supermarkets are extracting from consumers.

Not all areas of the nation have New England style milk channel pricing problems, but many including Seattle and Chicago do. Moreover as consolidation in fluid processing and supermarket retailing increase the scenario will become more common. Private economic power and excess milk profits outweigh federal market order price enhancement by a ratio of 10 to 1. Those who think doing away with federal market orders would benefit consumers and farmers in low fluid utilization areas (due to lower retail prices and increased fluid milk consumption) need to think again. The primary beneficiaries of order deregulation may well be processors and retailers.

Moreover the use of private power in the channel is destroying the economic basis of the orders. Retailers will elevate milk prices until the demand for milk becomes elastic, i.e., the percent decline in milk sold is greater than the percent increase in price. When milk prices are elastic the class 1 price discrimination scheme of the federal orders reduces rather than increases the blend price that farmers receive. At that point private economic power completely destroys the classified pricing system of the federal orders.

What does this rise of private pricing power in the dairy marketing channel suggest for dairy policy? Regional milk pricing policies in areas where this problem exists are in order. Antitrust enforcement that prevents further consolidation is a good idea. But in many regions shutting this door does no good because the horse is already out of the barn. Recently, in Chicago, a consumer class action lawsuit against the dominant supermarket chains, Jewel and Dominick's failed because the price leadership scheme they use is not price fixing. Jewel sets a high price. Dominick's and others match that price. Since no one talks (conspires) with others to set the price, their conduct is legal.

When antitrust is ineffective, economists look to regulation to improve economic performance. New York has a price gouging law that limits the retail price to no more than 200% of the raw milk price processors pay. Prices, on average, in New York are 83 cents per gallon lower than in New England. New England states are now considering such laws.

Another alternative is a price collar at the processing as well as retail level as was recently proposed in Connecticut. A 140% price collar on the wholesale price provides an incentive for processors to pay higher over-order premiums to farmers. Processors need 60 cents per gallon to cover their costs. At \$1.00 per gallon raw milk price they can charge retailers only \$1.40. If they pay farmers an additional 50 cents, then the raw price is \$1.50, and they can charge \$2.10 and recover the 60 cents. Placing a 130% price collar on retailers means retailers can charge up to $1.3 \times 2.10 = \$2.73$ per gallon. Consumers pay 37 cents per gallon less than \$3.10 per gallon, and farmers gain 50 cents per gallon. Given that farm milk prices are severely depressed, this reallocation of income in the channel may be appropriate.

The bottom line is this. It is time for farmers to re-examine fluid milk channel pricing and consider new approaches to dairy policy. Farmers have opportunities to argue for regional milking pricing policies that promote dairy farming in regions such as New England by promoting more efficient as

well as more fair milk market channel pricing. Doing so also preserves the effectiveness of classified pricing under the federal orders.

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Food Marketing Policy Center Staff and Researchers—UConn and UMass

Ronald W. Cotterill, Director (860) 486-2742
 Ronald.Cotterill@uconn.edu
 Julie A. Caswell (UMass) (413) 545-5735
 Caswell@resecon.umass.edu
 Donghun Kim (860) 486-2826
 Donghun.Kim@uconn.edu
 Bruce A. Larson (860) 486-1923
 Blarson@canr.uconn.edu
 Nathalie Lavoie (UMass) (413) 545-5713
 Lavoie@resecon.umass.edu
 Rigoberto A. Lopez (860) 486-1921
 RLopez@canr.uconn.edu
 Richard Rogers (UMass) (413) 545-5741
 rogers@resecon.umass.edu
 Adam Rabinowitz (Res. Assistant) (860) 486-2823
 Arabinow@canr.cag.uconn.edu
 Lorraine Knight (Secretary) (860) 486-1927
 lknight@canr.uconn.edu

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Cooperating Research Personnel at Other Universities

Adam David Rennhoff, Ph.D. candidate from the University of Virginia, (Dept. of Economics).

Tirtha Dhar, Post doc at Department of Agricultural and Applied Economics, University of Wisconsin, Madison.

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Personnel Changes

Tirtha Dhar, UConn Ph.D. 2001, has accepted a tenure stream assistant professorship in the

Marketing Department, School of Business, University of British Columbia, Vancouver.

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Food Marketing Policy Center Graduate Assistantships Available, Fall 2004

The Food Marketing Policy Center in the Department of Agricultural and Resource Economics has graduate assistantships available at the Ph.D. level. Students with interest in organization of food industries and one or more of the following: demand and price transmission analysis, comparative analysis of U.S. and European foods systems, cooperatives, industrial organization economics, or antitrust policy are encouraged to apply. Support will be for four years. For further information, please contact Ronald W. Cotterill, Director, Food Marketing Policy Center, Storrs, CT 06269-4021. Tel. (860) 486-2742, Fax (860) 486-2461, or Email: Ronald.Cotterill@uconn.edu.

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AGRIBUSINESS: An International Journal update by R. W. Cotterill, Editor

Agribusiness, and more than a dozen other economic journals, are now available on line to subscribers at (www.interscience.wiley.com). The journal is also indexed in Econlit.

Instructions for manuscript submissions are available by email: (FMPC@UCONN.EDU). Manuscripts are submitted electronically to the same address. Articles appearing in Issues No. 1 and 2, 2003 are as follows:

***Agribusiness* 19(1) Winter 2003**

"Effect of Liberalized U.S.–Mexico Rice Trade: A Spatial, Multiproduct Equilibrium Analysis" by Stephen Fuller, Luis Fellin, and Victoria Salin.

“Asymmetric Price Transmission Due to Market Power in the Case of Supply Shocks” by Frank Bunte and Jack Peerlings.

“The Effects of Information on Producer and Consumer Incentives to Undertake Food Safety Efforts: A Theoretical Model and Policy Implications” by Elamin H. Elbasha and T. Lynn Riggs.

“Household Meat Demand in Greece: A Demand Systems Approach Using Microdata” by Panagiotis Lazaridis.

“Changes in Food Consumption Expenditure in Malaysia” by Akira Ishida, Siong-Hook Law, and Yoshihisa Aita.

“Consumer Demand for and Attitudes Toward Alternative Beef Labeling Strategies in France, Germany, and the UK” by Jutta Roosen, Jayson L. Lusk, and John A. Fox.

“Consumer Beliefs and Attitude Towards Genetically Modified Food: Basis for Segmentation and Implications for Communication” by Annelies Verdurme and Jacques Viaene.

“An Assessment of the Strategies and Strengths of Medium-Sized Food Processors” by Erna van Duren, David Sparling, Calum Turvey, and Linda Lake.

Book Review by Terry Roe
Agricultural Policy for the 21st Century by Luther Tweeten and Stanley R. Thompson (Eds.)

***Agribusiness* 19(2) Spring 2003**

“The Role of Consumer Ethnocentrism in Food Product Evaluation” by Ulrich R. Orth and Zuzana Firbasova.

“The Effect of Trust on Public Support for Biotechnology: Evidence from the U.S. Biotechnology Study, 1997-1988” by Harvey S. James, Jr.

“Marketing Research and New Product Development Success in Thai Food Processing” by Prisana Suwannaporn and Mark Speece.

“An Economic Analysis of California Raisin Export Promotion” by Harry M. Kaiser, Donald J. Liu, and Ted Consignado.

“Analyses of Consumers’ Dietary Behavior: An Application of the AIDS Model to Supermarket Scanner Data” by Eugene Jones, Cuma Akbay, Brian Roe, and Wen S. Chern.

“Modeling Coupon Values for Ready-To-Eat Breakfast Cereals” by Gregory K. Price and John M. Connor.

“The Relationship Between Economic Value Added and Stock Market Performance: A Theoretical Analysis” by Stephen P. Keef and Melvin L. Roush.

“Further Thoughts on the Relationship Between Economic Value Added and Stock Market Performance” by David Sparling and Calum G. Turvey.

Book Review by F. Larry Leistritz
A Cooperative Approach to Local Economic Development by Christopher D. Merrett and Norman Walzer, Eds.

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Activity Report

Ronald W. Cotterill
(*Ag. Econ., University of Connecticut*)

Ron spent a good deal of this Spring working with Attorney General Richard Blumenthal and his staff and Representative George Wilber of the Connecticut Legislature on the development of a state level regulatory solution via a new law for profit gouging that FMPC researchers documented in the New England milk market channel.

On February 26th Ron testified before the Committee on the Environment of the Connecticut Legislature. His written testimony is available on our website.

On April 9th Ron met with the co-chair of the Committee on the Environment and lobbyists from International Dairy Foods Association and the state's supermarket chains as well as staff from the Attorney General's office and State Department of Agriculture. At that time, Ron presented a more detailed report on how a proposed price collar law would work. Ultimately, the legislature did not pass the proposed legislation.

On May 16th Ron spoke at the New Hampshire Cooperative Extension organized meeting in Concord, New Hampshire titled, "Dairy Crisis Briefing."

On June 11th Ron appeared on the Wayne Norman WILI 98 FM radio talk show here in Connecticut to discuss the dairy pricing problem.

Ron assisted staff from the Vermont Department of Agriculture in their analysis of retail and wholesale prices.

Julie Caswell

(*Ag. Econ. University of Massachusetts*)

Julie Caswell taught an advanced course on *Quality Assurance in agro-Food Marketing: Normatives, Systems, and Business Implications* at CIHEAM, the Mediterranean Agroeconomic Institute of Zaragoza, March 17-21, 2003.

Julie Caswell made an invited presentation on *Food Safety Concerns, Regulation, and World Trade* in the Seminar Series on Analysis of U.S. and International Agricultural Issues, Woodrow Wilson School of Public and International Affairs, Princeton University, April 2003.

Julie Caswell made an invited presentation on *An Economist's View of Risk Assessment* to the Food

Science Strategic Research Alliance, Department of Food Science, University of Massachusetts, May 2003.

Donghun Kim

(*Assistant Professor in Residence, FMPC*)

Donghun is working with Nathalie Lavoie and Dan Lass on a project evaluating market power in the U.S. butter and margarine industry using a discrete choice model.

Donghun continues working with Robert Masson, George Jakubson (Cornell University) and Kap-Young Jeong (Yonsei University) on various projects using firm level panel data. They submitted papers, "Oligopolistic Agreement and/or Superiority? New Findings from New Methodologies and Data" to the *American Economic Review* and "Business Cycle, Export Cycle, Price-Cost Margins and Concentration" to the *Rand Journal of Economics*.

Donghun participated in the Industrial Organization Society Meeting, Boston, April 2003. The paper with K. Jeong, G. Jakubson and Rob Masson, "Oligopolistic Agreement and/or Superiority? New Findings from New Methodologies and Data" was presented at the meeting.

Donghun is working with Ron on the U.S. processed cheese market. Donghun presented a paper, "Estimation of the Effect of New Brands on Incumbents' Profits and Consumer Welfare: The U.S. Processed Cheese Market Case" at the department seminar in May 2003. They submitted a paper, "Market Structure, Price Pass-Through and Welfare with Differentiated Products" to the *Journal of Industrial Economics*.

Donghun is currently working with Benaissa Chidmi on a project evaluating the relative market power between manufacturers and retailers using chain-level scan track data.

Bruce Larson*(Ag. Econ., University of Connecticut)*

Sara Scatasta and Bruce Larson developed an empirical paper, “Environmental Product Standards and Trade: Evidence from the German Packaging Ordinance,” from Sara’s dissertation. Larson presented the paper at a seminar on May 9th in the Department of Resource Economics at the University of Massachusetts in Amherst. Scatasta will present this paper during the annual meetings of the European Association of Environmental and Resource Economists in Bilbao, Spain on June 28.

Larson and Scatasta are also finishing a revision of “European Union Environmental Policies and Imports of Agricultural Products from the United States.”

Nathalie Lavoie*(Ag. Econ. University of Massachusetts)*

Nathalie continues her work on the impact of reforming wheat-importing state traders on the quality of wheat imported, as well as estimating market power in the U.S. butter and margarine industry.

Rigoberto Lopez*(Ag. Econ., University of Connecticut)*

Rigoberto continues his industrial organization work on U.S. city milk markets, collaborating with Ron Cotterill, Benaissa Chidmi (Ph.D.) and Alessandro Bonanno (M.S.). He will be on sabbatical leave at Yale University during the fall 2003 semester.

Rigoberto, Emilio Pagoulatos, and Mara Gonzalez (Ph.D. candidate) are collaborating on estimating the degree of home bias in the importation of processed food products, i.e., the underlying preference for domestic products vis-à-vis imported food products using trade and domestic production data for 30 U.S. food industries.

Richard Rogers*(Res. Econ., University of Massachusetts)*

Rich has been appointed special assistant to the UMass Chancellor for undergraduate teaching and is on leave from the department and Policy Center.

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Data Corner**Recent acquisitions include:**

Metro Market Studies *Discount Store Distribution Analysis and Guide 2003.*

Metro Market Studies *Drug Store Distribution Analysis and Guide 2003.*

Metro Market Studies *Grocery Distribution Analysis and Guide 2003.*

Trade Dimension’s *Market Scope. The Desktop Guide to Category Sales 2003.*

Trade Dimension’s *Directory of Mass Merchandisers, 2003.*

Trade Dimension’s *Directory of Convenience Stores 2003.*

The Food Marketing Policy Center has extensive holdings of Competitive Media Reporting, Leading National Advertisers, national advertising data, 1987-1997. Contact the Policy Center for details on specific holdings.

The Food Marketing Policy Center subscribes to the following trade journals; the current holdings are listed for each publication:

Promo, Promotion Marketing Worldwide, November 1997-current.

Progressive Grocer, The Publication for Strategic Management, November 1987-current.

Sales and Marketing Management, January, 1989-current.

Supermarket Business, 1996-current.

Supermarket News, The Weekly Newspaper of Food Retailing, 1980-current.

Food Institute Report, 1984, 1985, 1988-current.

Private Label, The Magazine for the Brands. 1993-current.

Cooperative Grocer, For Retailers and Cooperators. 1994-current.

Cheese Reporter, Serving the World's Dairy Industry Weekly, 2000-current.

The Griffin Report of Food Marketing, 1991-current.

The Milkweed, The Farmer's Milk Marketing Report, Oct 2000-current.

Contact Adam Rabinowitz (860) 486-2823 for a complete listing of data and reference works available.

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The FMPC Has a New Web Address

The Food Marketing Policy Center can now be found at: <http://www.fmpc.uconn.edu>. Please update your bookmarks/favorites to reflect this change.

Food Marketing Policy Center Publications Catalog

We have updated the list of the publications that are available through the Center. Call (860) 486-1927, write for a copy, or print it from our Home Page: <http://www.fmpc.uconn.edu>

FMPC Research Reports and Issue Papers

The entire research report series and issue paper series was recently archived in electronic (pdf) format. You may download any of these papers at our new web address.

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Recent Publications and Papers

Bonanno, Alessandro. "Retail Configuration and Milk Prices." M.S. paper, University of Connecticut. Rigoberto Lopez, advisor. May 2003.

Caswell, Julie A., Yumei Ning, Fang Liu, and Eliza M. Mojduszka. In Press. The Impact of New Labeling Regulations on the Use of Voluntary Nutrient Content and Health Claims by Food Manufacturers. *Journal of Public Policy and Marketing*.

Caswell, Julie A. In Press. Food Safety. In *The Encyclopedia of Globalization*, ed. Ashish Vaidya. Santa Barbara, CA:ABC-CLIO Publishers.

Caswell, Julie A. 2003. Trends in Food Safety Standards and Regulation: Implications for Less Developed Countries. Collection of Policy Briefs: Food Safety in Food Security and Food Trade. Laurian Unnevehr, editor. Washington, DC: International Food Policy Research Institute (IFPRI).

Cotterill, Ronald W. "Supermarket Milk Prices Need to Come Down." *The Hartford Courant* opinion piece. Food Marketing Policy Center Issue Paper No. 31, November 2002.

Cotterill, Ronald W. "Supermarkets, Stop the Gouging—Milk Prices Should Tumble \$1." *The Providence Journal* opinion piece. Food Marketing Policy Center Issue Paper No. 32, November 2002.

Cotterill, Ronald W. and Adam N. Rabinowitz. "An Old and New Cooperative Alternative: Integration by Farmers Into Fluid Processing to Develop Local Brands to Capture Some of the Channel Margin." Food Marketing Policy Center Issue Paper No. 33, March 2003.

Cotterill, Ronald W. "Comments on the Food Marketing Institutes' Submission to FTC Workshop titled, 'Supermarket Merger Investigations and Remedies.'" August 2002. Posted at <http://www.ftc.gov/bc/bestpractices/index.htm>.

Cotterill, Ronald W. "Fair Pricing Mechanics." Food Marketing Policy Center Issue Paper No. 34, March 2003.

Cotterill, Ronald W. "Explanation of Farmer Benefits of the Proposed Connecticut Milk Pricing Laws." Food Marketing Policy Center Issue Paper No. 35, April 2003.

Cotterill, Ronald W. "Drafting of Connecticut Fair Milk Pricing Law: Further Thoughts on the Retail Price Collar." Food Marketing Policy Center Issue Paper No. 36, April 2003.

Cotterill, Ronald W. "Answers to Questions that Often Surface When Discussing the Proposed Connecticut Fair Pricing Milk Law." Food Marketing Policy Center Issue Paper No. 37, May 2003.

Cotterill, Ronald W. "Drafting a Connecticut Fair Milk Pricing Law: A Meeting the Competition Clause that Enhances the Competitive Position of Connecticut Processors and A Small Account Rule that Recognizes the Higher Cost of Supplying Such Accounts." Food Marketing Policy Center Issue Paper No. 38, May 2003.

Cotterill, Ronald W. "An Act Concerning the Fair Pricing of Milk." Food Marketing Policy Center Issue Paper No. 39, May 2003.

Cotterill, Ronald W., Adam N. Rabinowitz, and Li Tian. "Milk Prices in New England and

Neighboring Areas of New York: A Prologue to Action?" University of Connecticut Food Marketing Policy Center Research Report No. 73, November 2002.

Cotterill, Ronald W. and Tirtha Dhar. "Oligopoly Pricing with Differentiated Products: The Boston Fluid Milk Market Channel." University of Connecticut Food Marketing Policy Center Research Report No. 74, February 2003.

Cotterill, Ronald W. "Perspectives on Global Concentration and Public Policy." University of Connecticut Food Marketing Policy Center Research Report No. 75, February 2003.

Cotterill, Ronald W. "Dairy Policy for New England: Options at the State and Regional Level." University of Connecticut Food Marketing Policy Center Research Report No. 76, February 2003.

Cotterill, Ronald W. "The Impact of the Northeast Dairy Compact on New England Consumers: A Report from the Milk Policy Wars." University of Connecticut Food Marketing Policy Center, Research Report No. 77, 2002.

Cotterill, Ronald W., Adam N. Rabinowitz, and Li Tian. "A Law to Promote Efficient and Fair Pricing of Milk in Connecticut." University of Connecticut Food Marketing Policy Center Research Report No. 78, April 2003.

Dhar, Tirtha P., Jean-Paul Chavas, and Ronald W. Cotterill. "An Economic Analysis of Product Differentiation Under Latent Separability." 25th Marketing Science Conference Proceedings, University of Maryland, June 15, 2003.

Lopez, Rigoberto A. and Elena Lopez. "The Impact of Imports on Price-Cost Margins." *Empirical Economics* 28(April 2003):403-416.

Lopez, Rigoberto A. and Charles Kabambi. "The Cassava Market of the Democratic Republic of Congo: A Stakeholders Analysis." A report for

SECID/USAID, contract No. LAG-00-93-00042-00, January 31, 2003, 45 pages.

Nevo, Aviv. “New Products, Quality Changes, and Welfare Measures Computed from Estimated Demand Systems.” *The Review of Economics and Statistics*, May 2003.

Salay, Elisabete, Julie A. Caswell, and Tanya Roberts. 2003. Survey Instrument for Case Studies of Food Safety Innovation. Working Paper 2003-06, Department of Resource Economics, University of Massachusetts, Amherst.

Teisl, Mario F. and Julie A. Caswell. 2003. Information Policy and Genetically Modified Food: Weighing the Benefits and Costs. Working Paper 2003-01, Department of Resource Economics, University of Massachusetts, Amherst.

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University of Connecticut
Food Marketing Policy Center
Agricultural and Resource Economics
U-21, 1376 Storrs Road
Storrs, CT 06269-4021

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