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## Food Marketing Policy

## Issue Paper

# Fair Pricing Mechanics 

by

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# Fair Pricing Mechanics 

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## Fair Pricing Mechanics

## General Concept:

Let's look at a $200 \%$ price collar, that is the retail price can be no more than twice the raw fluid price paid to farmers. (Mass. Bill)

## Assume:

The retail price is $\$ 3.00$ and the raw price is $\$ 1.00$ per gallon (near today's situation).
To comply, the channel firms can:

1) Cut the retail price to $\$ 2.00$.

Note: This leaves them $\$ 1.00$ margin.
2) Raise the farm price to $\$ 1.50$ by paying a $50 \notin$ over order premium (O.O.P.) Note: This leaves them $\$ 1.50$ margin.

## Conclusion:

Under this policy processors and retailers will raise raw price by paying over-order premiums.

## Fair Pricing Mechanics

## Homogeneous Product Case

All processors sell milk as a commodity- $\underline{\underline{\text { No }}}$ brand premiums.
Now let's look at the Connecticut Bill's $140 \%$ price collar for processors.
The market has 3 major processors: Guida, Garelick and Hood. We assume that their processing costs per gallon are:

| Hood | $60 申$ | (The milk Commission |
| :--- | :--- | :--- |
| Guida | $55 申$ | will need to measure these.) |
| Garelick | $50 ¢$ |  |

We assume RAW PRICE = \$1.00

Now in the market place the wholesale price is set by the marginal (the high cost firm) and others capture rents.
$P_{\text {wsale }}=\$ 1.00+\$ .60=\$ 1.60$

Under the fair pricing bill these processors can charge no more than $140 \%$ of the raw price. At $\$ 1.60$ per gallon they are in violation.

To comply: The marginal processor must raise raw price to $\frac{.60}{.4}=\$ 1.50$ by paying farmers a $50 ¢$ O.O.P.

Wholesale prices move up to $\$ 1.50+.60=\$ 2.10$ for all firms. Each of the other firms captures $\$ .60$ and continues to do better than the marginal firm. They continue to earn rents.

NOTE: The two lower cost firms will not try to cut the O.O.P. If they did they would earn a lower dollar margin.

## Fair Pricing Mechanics

## Branded Milk Case

Now the firms sell brands, their costs include cost of branding, and their wholesale prices are different.

| Initial Raw |  | Target <br> Margin/. 4 | Raw Price <br> Needed to Comply | $\begin{aligned} & \text { Over Order } \\ & \text { Premium } \end{aligned}$ | $\begin{aligned} & \text { Wholesale } \\ & \underline{\text { Price }} \end{aligned}$ |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Hood | \$1.00 | $.60 / .4=$ | \$1.50 | \$ . 50 | \$2.10 |
| Guida | \$1.00 | $.55 / .4=$ | \$1.375 | \$ . 375 | \$1.925 |
| Garelic | \$1.00 | . $50 / .4=$ | \$1.25 | \$ . 25 | \$1.75 |

1) How do we pay farmers the O.O.P.?

* Market wide pool (if equal mkt. shares O.O.P. $=\$ .375$ ) and need to blend with manufacturing milk??
* Handler pools: Farmers that sell to a processor get his raw price.

Note 1: If pool breakers go to Hood then co-ops may be able to bargain for and get $\$ 1.50$ raw price (50¢ O.O.P.) from the other two.

Note 2: BUT also have manufacturing milk issue.

