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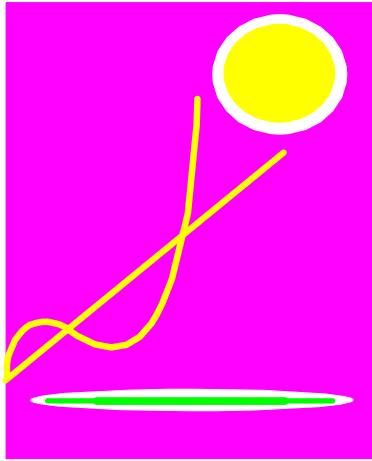
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# **Food Marketing Policy**

## **Issue Paper**

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### **Fair Pricing Mechanics**

**by**

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# **Fair Pricing Mechanics**

**by**

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**March 19, 2003**

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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¢ 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—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 ¢	(The milk Commission will need to measure these.)
Guida	55 ¢	
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.

<u>Initial Raw Price</u>	<u>Target Margin/.4</u>	<u>Raw Price Needed to Comply</u>	<u>Over Order Premium</u>	<u>Wholesale Price</u>
Hood \$1.00	$\frac{.60}{.4} =$	\$1.50	\$ .50	\$2.10
Guida \$1.00	$\frac{.55}{.4} =$	\$1.375	\$ .375	\$1.925
Garelick \$1.00	$\frac{.50}{.4} =$	\$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.