Press Release
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The Public Interest and Private Economic Power:
A Case Study of the Northeast Dairy Compact*

Leading supermarket chains and dairy processors in New England use their dominant market positions to elevate retail milk prices well beyond levels justified by the Northeast Dairy Compact, according to a new study being released today by the Food Marketing Policy Center at the University of Connecticut.

The study shows that nearly $50 million of the $130 million increase in the milk bill paid by New England consumers at supermarkets over a three-year period (from July 1997 through July 2000) is due to increased profits by supermarket retailers and dairy processors.

"The public interest is being subverted by private economic power," says Ronald Cotterill, director of the Food Marketing Policy Center and lead author of the study. "Higher retail prices and related consumer losses have been entirely attributed by many observers to the Compact's operation and other cost increases. This clearly is not the case."

Debate has surrounded the Northeast Dairy Compact since it was created in 1997 to provide participating states a minimum milk price for dairy farmers and thus protect dairy farms from going out of business. The Compact is set to expire this fall unless it is re-authorized by Congress. It faces vigorous opposition from the milk industry, among others.

"It is particularly egregious that industry spokespersons routinely cite higher retail prices as a reason for discontinuing the Compact, when, in fact, industry profit taking and cost increases not related to the Compact are responsible for 84 percent of the increase in retail prices in New England during the 3 years after Compact implementation," says Cotterill.

Mindful that the study results are likely to inflame the debate over the Compact, Cotterill emphatically insists that the UConn Food Marketing Policy Center's report is independent research and "was not commissioned or supported by the Northeast Dairy Compact Commission, any government antitrust enforcement agency, any private firm, foundation or lobbying group."

Since the Compact's creation, retail milk prices have increased. Key questions addressed by the study are: How much have the prices consumers paid increased? How much of the increase in price is due to the Compact? How much is due to other factors? and, What are those factors?

Retail prices for leading brands of milk sold at supermarkets in New England increased from an average $2.49 per gallon just prior to the Compact to an average $2.78 per gallon in the three years after the Compact, according to the study. It demonstrates that increased profits by dairy processors and supermarkets account for 11 cents of the 29-cent retail price increase during the three-year period. In comparison the Compact increase was 4.5 cents, which amounts to only a 1.8 percent increase over pre-Compact levels. (See Report Table 14 for details and breakdowns by major metro areas.)

Further, the study contends that in order to generate the 11 cent per gallon overcharge for all of New England, the leading supermarket chains would have to "condone and fully participate in any power pricing game." For example, examining the concentration of milk sales in Boston, the study shows that while four firms accounted for 75 percent of milk sales by supermarkets in 1996, by last year just three – Stop & Shop, Shaws with its acquisition of Star markets, and DeMoulas – captured 85 percent of supermarket milk sales.

Higher retail prices are also likely due to the exercise of market power by dairy processors, the study maintains. Since its entry into the New England market in 1997, the Dallas-based dairy processing giant

* The full report and related documents can be downloaded, free of charge, from the Food Marketing Policy Center website: http://www.uconn.edu/fmktc.html.

Suiza Foods Corp., "has closed, or caused the closure and dismantling of several milk processing plants in the region," the study says. It adds that Suiza now controls 80 to 90 percent of the supermarket milk business in Boston and Providence, having acquired Garelick farms in 1997, West Lynn Creamery and Cumberland Farms in 1998, and Stop & Shop's milk business in 2000 as well as Nature's Best Dairy in Rhode Island and New England Dairies in Connecticut. All but Garelick and West Lynn plants are now closed.

"Suiza has provided no public information that documents this was a cost effective move. Moreover, even if processing costs per gallon are lower in their huge plant in Franklin, Massachusetts, none of the savings have been passed forward to consumers in the form of lower prices."

"Virtually all Boston, Providence and most of Connecticut's supermarket and convenience store milk comes from that one huge plant" Cotterill notes. If your milk container has plant number 25-100 stamped on it, it is from Suiza's Franklin plant. Brands include Garelick, Sealtest, and the store brands of Wal-Mart and nearly all supermarkets except Big Y and Shoprite.

This report estimates that the Compact increased dairy farm income 128.5 million dollars in the July 1997 to July 2000 period. Fifty one million dollars came from supermarkets. Since supermarket consumers paid only 19 million dollars more due to the Compact-induced higher farm prices, where does the rest come from? It comes from the Dairy Compact's price support feature. Shielding farmers from farm price drops was far more important for protecting their income than was retail price elevation.

The study suggests that a major policy issue now facing New England milk consumers is not the Northeast Dairy Compact, but the exercise of market power by the region's leading retailers and dominant milk processor.

This issue is also a national problem. "With the recent trend towards very few, very large firms in many regional milk processing and local food retailing markets, private firms are capturing the ability to price off the market demand curve," the study concludes. "Private economic power exercised for private interests is replacing public milk pricing based on the public interest. This transfer of power does not bode well for consumers and farmers. Consumer milk prices will be higher and farm prices will be lower."

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NOTE:

The University of Connecticut study is over 100 pages in length. It contains a one-page bullet point summary and an executive summary as well as the main text and many tables and charts for each market area. The full report is available and can be downloaded from the Food Marketing Policy Center website at www.are.uconn.edu/fmktc.html.

The charts visually document the pricing strategies of individual brands and individual chains in individual markets.

The study uses Information Resources Inc. (IRI) supermarket scanner data and other data to analyze pricing in each of the four major IRI market areas that collectively cover 95 percent of New England: Boston, Providence, Hartford/Springfield, and Northern New England.

It also examines pricing for New England's leading supermarket chains, the leading source of distribution for fluid milk, accounting for nearly 40 percent of total fluid milk sales in the region. These include Stop & Shop, Hannaford Shop N Save, Shaws, DeMoulas, and Star markets, and for the leading brands of milk, Hood, Garelick, private label (supermarket's own brand), Guida, Oakhurst, Weeks, and Booth.

The data are for four-week periods (13 a year). They commence in February 1996 and continue through July 2000 period, thus allowing the study to examine price conduct in 18 before-Compact periods (February 1996 through June 1997) and 40 after-Compact periods (July 1997 through July 2000).

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Executive Summary

KEY POINTS

- Contrary to the economic theory of a competitive market and prior studies, processor-retailer margins increased when farm level fluid milk prices were stabilized by the Compact.

- Investigation indicates no transmission of farm level price changes to the retail level in the before compact period, creating a serious resource allocation and farm income problem, and invalidating prior studies of the Compact's impact that rely upon farm-to-retail price transmission models.

  Marketing channel firms used Compact implementation to lock in wide margins

  A dramatic shift in retail pricing strategy occurs at Compact implementation and subsequently.

- Brand level analysis corroborates the earlier finding that Garelick and private label retail prices increased more than Hood retail prices.

- Suiza's rise to dominance in New England fluid milk processing is related to rising Garelick and private label prices.

- Increasing retail concentration and the dominance of Stop & Shop and Hannaford is related to rising retail milk prices.

- Chain level analysis of branded milk sales establishes that Shaws, DeMoulas, Hood, and Guida were price mavericks for a short period after Compact implementation.

- Estimation of market and brand level elasticities documents that the exercise of market power is a source of wider margins and higher retail prices in the post-Compact period.

- In the supermarket channel in New England, estimated loss to consumers due to the Dairy Compact are 19 million dollars, and consumer loss due to the exercise of market power are 49.4 million dollars.

- The Dairy Compact increased farm income 128.5 million dollars; but only 51.5 million came from the supermarket channel and of that only 19 million dollars came from consumers with the rest coming from the Compact's price support feature.

- Decomposing retail prices into payments for factors of production and profits documents how meager the Compact's contribution to higher prices is in comparison to the increase in profit by channel firms. In a before and after model centered on Compact Implementation in July 1997 for all New England, retail prices increase 29 cents per gallon to $2.78 per gallon. The Compact accounts for only 4.5 cents of this increase. Increased profits by channel firms accounts for 11 cents. The remaining 13.5 cents is due to increases in costs other than milk and increases in the farm price above the Compact minimum due to fleeting strength in the raw milk market.

- The exercise of market power by channel firms shifts the industry to a more elastic region of the fluid milk market demand curve thereby reducing the effectiveness of the Federal Milk Market Order system and Compacts.

Table 14. Who Gained from the Retail Milk Price Hikes: July 1997 to July 2000

	Before the Compact	After the Compact		Change per gallon
All New England				
1 Average Farm Price	$1.40	$1.51		0.11
Increase due to Compact			0.045	
Increase due to Strong Raw Milk Market			0.065	
2 Increase due to non Milk inputs				0.07
3 Total Cost Increase (1+2)				0.18
4 Retail Price	$2.49	$2.78		0.29
Increase in Profits (4-3)				0.11
Boston				
1 Average Farm Price	$1.40	$1.51		0.11
Increase due to Compact			0.045	
Increase due to Strong Raw Milk Market			0.065	
2 Increase due to non Milk inputs				0.06
3 Total Cost Increase (1+2)				0.17
4 Retail Price	$2.43	$2.73		0.30
Increase in Profits (4-3)				0.13
Hartford-Springfield				
1 Average Farm Price	$1.40	$1.51		0.11
Increase due to Compact			0.045	
Increase due to Strong Raw Milk Market			0.065	
2 Increase due to non Milk inputs				0.08
3 Total Cost Increase (1+2)				0.19
4 Retail Price	$2.60	$2.94		0.34
Increase in Profits (4-3)				0.15
Providence				
1 Average Farm Price	$1.40	$1.51		0.11
Increase due to Compact			0.045	
Increase due to Strong Raw Milk Market			0.065	
2 Increase due to non Milk inputs				0.07
3 Total Cost Increase (1+2)				0.18
4 Retail Price	$2.54	$2.87		0.33
Increase in Profits (4-3)				0.15
Northern New England				
1 Average Farm Price	$1.40	$1.51		0.11
Increase due to Compact			0.045	
Increase due to Strong Raw Milk Market			0.065	
2 Increase due to non Milk inputs				0.06
3 Total Cost Increase (1+2)				0.17
4 Retail Price	$2.47	$2.71		0.24
Increase in Profits (4-3)				0.07

Brief Biosketch of Author

Ronald W. Cotterill is Professor of Agricultural Economics, and Director of the Food Marketing Policy Center at the University of Connecticut. He has a joint Ph.D. in economics and agricultural economics from the University of Wisconsin, Madison. Professor Cotterill is an internationally known expert on the organization and performance of food industries. He is editor of *Agribusiness*, a leading research journal, has written more than 50 scholarly articles, coauthored or edited 12 books, testified before Congress on food industry issues, and served as expert economist on over 20 antitrust matters for private firms and agencies including the Federal Trade Commission; the Attorneys General of Massachusetts, Connecticut, Rhode Island, New York, Tennessee and Arkansas; Royal Ahold (the parent of Stop & Shop); ShopRite Supermarkets; Vons Supermarkets; Waremart Supermarkets; Pueblo Supermarkets; the New York/New Jersey milk workers union; and the New York Farm Bureau. His research on industrial organization and antitrust policy in food markets addresses issues of market power, price transmission, differentiated product pricing, cooperatives, mergers, price fixing, and monopolization.