

Professor Stephen King (appearing as a witness 11-11:45am by teleconference)

Milk headlines

March 9, 2011 | 5 Comments | Stephen King

Given the debate on low retail milk prices and dairy farmers I thought I would help out our main stream media colleagues with some headlines they might like to use:

Coles threatens farmers. "We'll sell more milk"

Farmers plead: "Dont sell more of our product"

Increasing milk sales to hurt dairy farmers

They all sound a bit silly don't they. But this is the other side of the Coles retail milk debate. Low retail prices will increase retail sales, both overall and from Coles. This will hurt Coles competitors, particularly the dairy companies who market branded milk in competition with Coles' home-brand product. But low prices and increased retail sales will help producers who supply the inputs. For milk, the main producers are the dairy farmers. There will be more milk sold and that means retailers have to convince farmers to supply more milk. You cannot do that by harming the farmers.

Don't believe me? Well, let's take another example that is close to home. China is booming by selling a lot of manufactured goods cheaply. Those goods use inputs like iron ore and coal (through power and smelting). China's 'low price' policy has been a huge boon to those input producers like BHPB and Rio. It has been a huge benefit to the countries that produce the inputs – like Australia. It has hurt China's competitors but helped their suppliers.

Now Coles ain't China. And maybe Coles will not be able to maintain the low price for the long term, particularly as the farm gate price of milk starts to move higher as the quantity of milk sold at the retail level increases. But if the low price is maintained, then our dairy farmers will benefit.

<http://economics.com.au/?p=6796>

Milkonomics

February 27, 2011 | 12 Comments | Stephen King

Sam has already commented on the milk price debate [here](#). As background, Coles started a price war on home-brand (or own label) milk. The argument is that this will hurt farmers. Sam refers to an AFR article that points out that it is the export market that sets the milk price at the farm gate as the 'marginal' milk in Australia is exported. I have noted this [before](#). Milk in Australia is a (big) export industry.

But even without exports, a little bit of economics shows that the 'farmers will be ruined' story is complete nonsense. As Coles drops the price of home-brand milk, total retail

sales of milk in Australia are very unlikely to drop. Indeed, sales will probably rise. So Coles (and the other outlets that have matched Coles' price) need at least as much milk as before. Which means that they need to encourage dairy farmers to produce more milk. Over the longer term, this can only happen if the price of milk at the farm gate does not fall. At worst it will stay the same (a likely result as the price is set by exports) or it may rise. So selling more milk in Australia will not hurt (and will probably help) dairy farmers.

Who loses? Not the customer. They get cheaper milk. Not the farmer – as explained above.

The losers are the dairy processors. They face stronger competition against their branded milk. This is more profitable for the processors than the home-brand milk. But for those of you who buy branded milk, I hate to tell you, but it comes out of the same cow as the home-brand stuff.

What we are really seeing is another step in cheap home-brand milk driving out the branded milk. This happens in industries where there is little product differentiation so that 'brands' are more about perception than real added-value. Eggs provide another good example.

The effect of the Coles move will mean that the processors have to be more innovative in their branding and marketing – or give up the branded milk. So expect to see lots of innovation but lower processor profits. Of course, this may hurt dairy farmers through the back door. Some processors remain farmer cooperatives so the farmers may get more for their milk but less as their share of processor profits.

<http://economics.com.au/?p=6756>