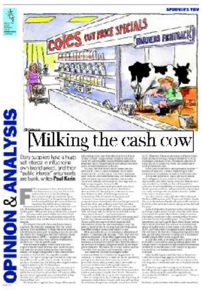

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Milking the cash cow

Dairy suppliers have a huge self-interest in influencing own-brand prices, and their "public interest" arguments are bunk, writes **Paul Kerin**.

FEW commentators have criticised Coles more than me in recent years. But recent criticism levied at Coles for offering discounts on staple grocery items is just plain ludicrous. It is disappointing that the media and politicians give such credence to assertions levelled by vested interests.

No matter what they do, Coles and Woolworths can't win. If they raise prices, they're accused of abusing market power. If they lower prices, they're also accused of . . . abusing market power. Politicians want it both ways. They rave on about cost-of-living increases, but then dump on Coles and Woolies for doing something about it.

The biggest critics of Coles's retail price cuts are suppliers. That's hardly surprising. They are vested interests. They would love to dictate the retail prices at which their products (and competing products) are sold. That's why our competition laws have outlawed resale price maintenance (RPM) — suppliers using their influence to keep retail prices of their own branded products up — for the past 40 years.

Milk processors supply retailers with their own supplier-branded milk (such as Paul's and Pura) and with milk that retailers sell under their own retailer brands. It is illegal for suppliers to try to influence the retail prices of even their own supplier-branded products. Yet they're trying to go even further than that and influence the retail prices of retailer-branded products. Because Coles isn't doing what suppliers want, suppliers paint it as the devil incarnate.

Whenever suppliers want to get the government to help them, they always couch their arguments in the public interest. It's never about their self-interest. Milk processors are apparently only concerned about big retailers' poor old customers, small retailers and farmers. Bless 'em!

The fact is that suppliers have a huge self-interest in influencing Coles's own-brand retail prices and their "public interest" arguments are complete and utter bunk. Yet politicians like Senator Nick Xenophon have swallowed them completely and are making outlandish policy recommendations on the run.

At Coles, two-litre bottles of full-cream milk are priced at $1 a litre (Coles's own brand), $1.50 a litre (Paul's) and $1.72 a litre (Pura). The recent discounts apply only to Coles's own-brand milk. The real reason milk processors are concerned is that lower retailer-brand milk will take sales away from their high-priced, high-margin supplier-branded milk.

The claim that lower retail prices will drive dairy farmers out of business is nonsense. Retail price discounts haven't changed prices to farmers, nor are they likely to. In 2008, the federal government commissioned the Australian Competition and Consumer Commission to report on the competitiveness of retail prices for standard groceries. It found that farm-gate milk prices are "set by market forces of supply and demand" and that "because milk products are internationally traded, the prices domestic milk processors offer [to farmers] are primarily set by international factors" — not by retail prices.

Only 23 per cent of milk bought from farmers is used for drinking. Most is used to make milk products like cheese and butter, much of which is exported. If international prices rise, processors divert more raw milk to export products, causing their wholesale prices for milk to retailers (hence retail prices) to rise.

More generally, the ACCC investigated why prices of staples — including milk and eggs — have risen over the previous five years. It found that big retailers had very little to do with it: "At most, roughly one-20th of the increases in food prices could be directly attributable to the increase in the gross margins achieved by the major grocery players." Much was due to other factors, such as "increased international food commodity prices".

The claim that price discounting will make consumers worse off — despite the big gains they're enjoying — is a big stretch. It relies on the old "predatory pricing" yarn that vested interests often spin to governments but, when pressed, they're never able to point to a credible real-world example of where predatory pricing has worked. This yarn is based on assertions that price cuts are meant to eliminate smaller retailers and supplier brands. Once they're eliminated, Coles will suddenly whack up its own-brand prices.

But our competition laws outlaw predatory pricing. If processors really believe Coles is predatory pricing, they should follow due process and make a complaint to the

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ACCC. However, if I were a processor and knew it's not really predatory pricing, I wouldn't want the ACCC to investigate and show it's not. I'd instead make lots of noise and try to delude the public and politicians to exert pressure on Coles.

Coles's price reduction is hardly massive anyway — less than 10 per cent. If it was really trying to drive everyone out of business, it could do better than that.

In any case, processors' highly profitable brands won't disappear. They account for about half of supermarket milk sales. Many customers will still want supermarkets to stock them. Even if demand for processor-branded milk falls somewhat and processors divert more raw milk into milk products for export, they can easily switch production back to branded milk if Coles tries to increase prices.

And does anyone seriously believe that Coles and Woolies will lift prices by 50-72 per cent? Unless they do, the fact is that retailer-brand milk prices will continue to be far less than what we've been paying for branded milk for years.

Coles and Woolies are painted as big nasty retailers with huge market power. I would certainly prefer a less concentrated supermarket industry. But just because they're big doesn't mean that every time they change a price they're abusing market power. They might be sometimes, but that's hardly likely when they're cutting their own retail prices. The best way to guard against abuse of market power is to increase competition. The ACCC and Productivity Commission have argued that the best way to do that is to change planning and zoning laws and decision processes to given new entrants and smaller players fairer access to good sites.

In any case, is the pot calling the kettle black? Take a look at the concentration among milk suppliers. Two foreign-owned companies supply the processor brands stocked by Coles: National Foods (owned by Japanese brewer Kirin) and Italian multinational Parmalat.

I also think it's great that Coles has cut the price of Coles-brand free-range eggs by 20 per cent. Because supplier-branded eggs have been far too expensive for too long, many consumers have had to buy and bear the guilt.

It's hard to argue that cutting prices of animal-friendly products is against the public interest. But, of course, lobby group the Australian Egg Industry Association has labelled it — you guessed it — "abuse of market power".

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