MARKETS -- MANAGED OR FREE?

ADDRESS BY

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FEDERAL TRADE COMMISSION

TO THE MEETING OF

PURCHASING AGENTS' ASSOCIATION OF DENVER

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It has been suggested that your organization would be interested in a discussion of recent Federal Trade Commission activities affecting pricing methods, particularly as these activities might relate to the economy of the inter-mountain territory.

At the outset it should be emphasized that the Federal Trade Commission is not seeking to enforce arbitrary methods of pricing, and is suggesting no formulae to replace any of the pricing practices, the legality of which has been questioned. Thus statements that the Commission seeks to enforce universal f.o.b. mill pricing or to set up local monopolies are simply without foundation.

The Commission has questioned the legality of a number of pricing systems in recent years -- not on any new or strange legal theories, but because either they were the result of a combination to fix and maintain prices or were discriminatory under the Clayton Act, and its Robinson-Patman amendments.

The law is well settled that any combination or conspiracy to fix or maintain prices is illegal. This is no new or strange theory. Under the ancient common law free markets in which the buyers participated in the price-making process were set up and obstructions to freedom of the market were prohibited. Whether physical or monopolistic in nature, such obstructions were forbidden.

Thus it was a public offense to forestall the market by purchasing commodities before they reached the market in order to resell them at higher prices in the free, open and legitimate market.

It may interest you to know that, reflecting this traditional view, public markets at which produce is sold by farmers directly to consumers, frequently bear signs prohibiting "price-fixing" and stating that violations will be punished by fines as high as $50.00. It was a public offense also to engross, or in modern parlance, to "corner," a commodity in the market because this was regarded as an attempt to enhance prices and as a denial of equality between buyers and sellers. For similar reasons it was regarded as a public offense for a middleman to regrate or pyramid the cost between producer and consumer, the modern counterpart of which we have in our present so-called "grey markets."

The rule was also developed at common law that a seller who entered business to serve the public generally must serve all comers at a reasonable price and without discrimination. The Clayton Anti-discrimination Act is a Federal recognition and restoration of that ancient common law rule modified

somewhat to meet modern conditions. Our other anti-trust statutes 1/ are also designed to reach practices which have been recognized for centuries as inimical to the integrity of a free competitive market.

I wish to point out to you some of the cases of interest which the Commission has acted on in recent years. An order was entered against a group of manufacturers of crepe paper requiring them to cease and desist from employing by agreement a method of pricing which involved dividing the country into three large zones, within each of which customers of the same class paid the same delivered prices, irrespective of the differing freight costs to customers. The Circuit Court of Appeals sustained the Commission's order, saying:

> "One glance at the three zone map for bulk crepe will show the artificiality of the zone structure and the intention to obviate any natural advantage of location from price determination.
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> "We think the artificiality and arbitrariness of the zone structure is so apparent it can not withstand the inference of agreement. The Commission evidently could not believe that Wisconsin companies would deprive themselves of the natural benefit of location in the midwest, and proximity to the west, over eastern competitors, were it not agreed that they would have equal chance for the eastern business, where most of the crepe paper manufacturers were located."2/

Note particularly that the order of the Commission and the decision of the court were based squarely upon an agreement to employ the zone system of selling, and further that the court was impressed by the regional discrimination against the west inherent in the scheme.

In another recent case, the Commission entered an order requiring the manufacturers of milk and ice cream cans to cease and desist from an agreement to employ what has been characterized as a freight equalization system of pricing. By this method, each producer quoted an f.o.b. price at his factory and calculated delivered prices by adding the rail freight to destination. Where use of his own f.o.b. price, plus freight, amounted to more than the f.o.b. price of a competitor, plus freight to customer from the competitor's plant, the latter formula was used in quoting. In sustaining the Commission's order against collusive use of this practice, Judge Major of the Seventh Circuit Court of Appeals said:

> "It is argued, perhaps correctly, that such a freight system had long been employed by industry so that members thereof might deliver their product at the same price. ...Such being the case, the fact still remains that it was employed by petitioners for the purpose of fixing the delivered price of their product and by such use price competition was eliminated, or at any rate seriously impaired. On the face of the situation, it taxes our credulity to believe, as argued, that petitioners employed this system without any agreement or plan among themselves."3/

1/cf. Sec. 4, F.T.C. Act, 52 Stat. 111, for definition of anti-trust acts.
2/Fort Howard Paper Co., et al v. F.T.C., 156 Fed. (2d) 899.
3/Milk and Ice Cream Can Institute, et al v. F. T. C., 152 Fed. (2d) 478.

Still another similar proceeding involved what is known as the single basing-point method of pricing, whereby everyone in the industry quoted a price at a single point, and added freight to the customer's location. The Commission entered an order requiring the producers of malt to cease and desist from continuing this method by agreement, and, with Judge Major again writing the opinion, the Circuit Court sustained the Commission's order, saying:

> "We are of the view that the Commission's findings that a price fixing agreement existed must be accepted. Any other conclusion would do violence to common sense and the realities of the situation. The fact that petitioners utilized a system which enabled them to deliver malt at every point of destination at exactly the same price is a persuasive circumstance in itself."4/

All of the above cases have been plain, old-fashioned price-fixing cases. In another series of cases, the Commission and the courts have considered the legality of the so-called single-basing point system under the Clayton Act and without reference to conspiracy or agreement.

The producers of corn syrup employed a method of pricing known as "Chicago plus," whereby a producer in Kansas City, for instance, sold to his customers in Kansas City by adding to the prevailing Chicago price the rail freight rate from Chicago to Kansas City. Thus all bulk corn syrup was priced on the fiction that it was produced in and shipped from Chicago. The Supreme Court of the United States upheld the Commission's orders in these cases, saying:

> "In none of the markets in which respondents had a freight advantage over their Chicago competitors did respondents reduce their prices below those of their competitors. Instead they met and followed their competitors' prices by prices rendered artificially high, by the inclusion of unearned freight proportioned to the amount by which their competitors' delivered costs exceeded their own.
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> "We cannot say that a seller acts in good faith when it chooses to adopt such a clearly discriminatory pricing system, at least where it has never attempted to set up a non-discriminatory system, giving to purchasers who have the natural advantage of proximity to its plant, the price advantages which they are entitled to expect over purchasers at a distance."5/

To the extent that these orders may result in the elimination of "phantom freight" and reflection of territorial advantages to buyers located near factories remote from the old Chicago base, important savings to large geographical areas may be expected.

It is common knowledge that certain areas in the west and south have suffered from discriminations of the type I have mentioned, due to pricing of goods on the fiction that they have been produced and shipped from some eastern industrial center. It is not in my province to discuss the details of such matters which have not been investigated and considered by the

4/U. S. Maltsters Ass'n., et al v. F.T.C., 152 Fed. (2d) 161.
5/Corn Products Refining Co., et al v. F.T.C., 324 U. S. 726.

Commission, so I cannot elaborate on this situation as it may affect Denver and the inter-mountain territory. But to illustrate the manner in which such artificial and discriminatory pricing methods may adversely affect the industrial development of a community, I would like to recall a situation which was developed in our investigations in the corn syrup industry. The largest producer in the industry had a plant at Chicago and another in Kansas City. Prices in Kansas City, even though they involved no actual freight charges, were calculated on the Chicago price, plus freight to Kansas City. A number of manufacturers of candy were located in and around Kansas City, and corn syrup constituted one of their principal raw materials. As far as price was concerned it made no difference whether they purchased from the plant in Kansas City, a plant in St. Louis, a plant in Chicago or a plant in Iowa. In any case, the price was Chicago plus freight. As was stated by the Supreme Court in affirming the Commission's order, the "phantom freight" differential in favor of the Chicago candy manufacturers placed them in a more favorable position, and several of the Kansas City manufacturers moved their factories to Chicago.

As a matter of interest to you, it was found in the corn product industry that shipments from Kansas City to Denver or Salt Lake involved 10 cents per hundred pounds of unearned or "phantom freight," this being the difference by which the actual shipping charge from Kansas City was lower than the freight rate from Chicago used in computing the Denver price.

To recapitulate: these proceedings which have involved the legality of methods of pricing have been squarely based on price-fixing conspiracy or upon price discriminations which injure competition and which cannot be justified by legitimate differences in the cost of manufacturing, selling or shipping. No new or strange theories of law or economics have determined or affected these proceedings. The Commission is not seeking to confine industry to local territories or to prevent national distribution by any concern which can achieve such distribution without either entering an agreement on prices with its competitors or resorting to unjustifiable discrimination.

On this subject, I have recently read several speeches by a colleague of mine which constitute ringing defenses of what he calls "administered prices," and in which he decries proceedings of the Anti-Trust Division of the Department of Justice and the Commission as part of a game of "cops and robbers." He has proposed as a substitute for present methods of enforcement of the anti-trust laws new legislation which in effect would grant immunity from action under the anti-trust laws to industries which would get together and draw up a set of trade practice rules under the auspices of the Federal Trade Commission. There has been some favorable comment in the trade journals on this legislative proposal.

I appreciate that business men generally are the staunchest defenders of the system of freedom of economic enterprise under which this country has reached its present high standards. Yet for some reason they frequently fall for a proposal to "manage" that system, or the part of it in which they are most immediately concerned, through group action. Thus a group of wholesalers may become intensely irritated by what they feel to be the unfair practice on the part of manufacturers in selling direct to certain retailers, by-passing the wholesaler. The natural urge is to do something about it.

The Commission has had numerous cases of this sort in the past, where such groups have gotten together to pool their strength to "do something about it" by way of organized pressure on manufacturers to cease selling direct to retailers. I have no doubt that the men involved in these matters have been firm advocates of free competition and that it would have been impossible for most of them to have built up their businesses without resort to real competition. They would be the first to resent any organized group which tried to enforce rules of conduct upon them, yet apparently feel no inconsistency in maintaining a "black-list" of manufacturers with whom they will not deal as the result of some real or fancied wrong.

The competition of the free market is in many respects a ruthless thing. A man may build a costly plant near his raw materials but distant from his markets. Discovery of raw materials nearer the market may ruin him unless the discoverer can be persuaded to price his product so that his advantageous location is equalized. This same thing may occur where any of the other factors, including new machinery or processes, research, or just plain American ingenuity throw an industry out of balance for a time, and give some producer advantages not enjoyed by others. From the standpoint of the business man, the easiest thing to do is reach some understanding whereby the status quo is preserved and the man with the advantage forbears from translating it into lowered prices.

The temptation to soften the effects of competition is ever present in business -- it is perfectly understandable that a man might resort to agreement with competitors to avoid failure. Perhaps you gentlemen are familiar with individual instances of such coerced or desperation agreements which you consider to be justified morally, ethically and legally. However, can you visualize the remarkable industrial growth of this country under any system of private or governmental controls which would have removed the harsh realities of free and vigorous competition? Can you visualize the growth and development of our present automobile industry if it had been organized and run to keep in business the badly located, badly run or uneconomic producers whose bones lie along the trail?

What are the alternatives to free and fair competition? Only two present themselves to my mind. One is a system of industrial controls by business itself. The other is a similar system in which the responsibility is shared both by business and the government. Now, to be realistic for a moment, do you gentlemen who are in industries in which for example, lumber, brick, cement, steel or copper is a basic raw material really feel that you could substitute the absolute decision and judgment of a group of producers of such basic materials for the forces of a free competitive market? Do you feel, at heart, that any group in such an industry is wise enough and unselfish enough to run the industry in the public interest so that it could be removed from the operations of the anti-trust laws or other control? Without meaning to cast any reflection upon the ability or the integrity of the basic material producers, I doubt seriously that you feel that they could be entrusted with such a responsibility, and, probably, you believe that in any case the end result of such assignment of responsibility must be to place some sort of check upon their actions, so that when their primary interest in the welfare of their stockholders might conflict with the larger public interest, the public will not suffer. The only check which can be used for this purpose is the government itself, so that such a course

must lead to divided responsibility for management of industry between industry and the government, much as has been developed in the field of public utility regulation.

When I spoke of the two alternatives above I was referring to the short range prospects. It does not require any great stretch of the imagination to foresee, in the long run, that managed markets, either by business men themselves or by business men under government supervision, must lead ultimately to a disappearance of any lines of demarcation between business and government and the development of the super state which will tell us all the whats, whens, whys and hows of everything we do. It may seem strange to you that I should oppose a proposal which no doubt would convert the Commission from an agency with less than six hundred employees to one of many thousands of high-powered accountants, economists, lawyers, investigators, consultants and Lord only knows what else.

We had some experience with substitution for competition of government-regulated industry controls during the N. R. A. period. Entry into certain fields was restricted, as were additions to plant facilities. Production controls were formulated. Nearly every conceivable control to alleviate the distress of competition was tinkered with in one or the other of the codes. Pants pressers, filling station operators, and even manufacturers who refused to conform to the rules laid down were hauled before the courts. A seller who deviated from the prices, terms or conditions of sale filed with the code authority in order to secure a choice piece of business was a "chiseler." What had in other times been normal individual rights and legitimate business practices suddenly became illegal.

I refuse to believe that American business men want to return to such a system of management and controls as a permanent, peace-time proposition, in spite of their grumbling at the imperfections of the free market in operation.

The sponsors of legislation to substitute a "rule of law" in industry, and to supplant the present anti-trust policy by one of self-imposed rules of conduct, deny that they propose a return to anything like the N. R. A. codes. They urge that the proposals would not interfere with the Sherman Act and the Federal Trade Commission and Clayton Acts, and would instead serve as a cooperative means of enforcing the law without the necessity of prosecutions and orders to cease and desist. If this is really true, why then is it stated to be necessary to suspend the anti-trust laws for those industries which meet and formulate **rules?** Present procedures of the Federal Trade Commission encourage any industry group to come in and draw a set of trade practice rules to eliminate unfair or deceptive practices which may be present, and to promote ethical and moral standards of conduct above and beyond the minimum standards necessary to "get by." The Commission has always avoided approving any rule which would promote conduct in violation of the anti-trust laws, and the trade practice rules as now drawn do not give anyone immunity from the anti-trust laws. Even the N. R. A. codes purported to give lip-service to the Sherman Act and exemptions from its operations were specific and narrow in scope under N. R. A.

I presume that under any such program as is proposed, trade practice rules would be concerned with the intimate details of industry operation.

Anything less would defeat its own purpose. I question whether proponents of such a plan have thought the matter through to its logical end product which can only be complete and thorough government regulation. I am a government official and I would be the first one to tell you that there is no single man or group of men in the government service, or likely to be in the government service within the next several hundred years, sufficiently wise and dispassionate to substitute his or their judgment for the "natural" regulation of a free market.

Furthermore, is it possible for us to maintain political freedom of action where our economic affairs are managed inside or outside the government? In many countries in Europe economic freedom has been practically eliminated. A man may not open a grocery store where he pleases, or operating a grocery store, may not sell what he pleases. A baker must not make and sell a cookie containing more than a fixed percentage of sugar -- a regulation no doubt inspired by the "righteous" ire of confectioners over inroads of bakers into their field. A host of similar "controls" could be cited. I doubt that a people subject to such minute regulation of their economic life can ever be said to be politically free. Our success in developing this nation to its present pinnacle of living standards and personal and intellectual freedom can be attributed to our liberal capitalist system and to our insistence, through the courts and the forum of public opinion, upon the principles of the free market and the right of every man, subject to the basic rules of fair play, to risk his money or his time and effort in making a living.

The sum of the efforts of all of us is the free market, and it can never be controlled or managed successfully by any small group of men for more than an instant. Its rewards for success are munificent and its penalties for failure are harsh, but it is truly representative of all of us. The retail druggist in Kalamazoo, the wholesale grocer in Keokuk, the steel fabricator in Toledo -- all of them make up the market, and it is by the collective judgment and experience of all of them that business moves up and down and ebbs and flows. Ten, a hundred, a thousand businessmen may be wrong about a decision at any one time, and many may fail as a result, but the cumulative effect on the market may be very slight. On the other hand, consider the effect of such an error by a government official or a group of businessmen with the power of management of the market.

I would like to leave you with this one thought in parting: When you are urged to join in a movement to repeal the anti-trust laws, to support a program of self-regulation for industry, or to foster managed markets, stop and ask yourself whether the immediate advantages urged upon you outweigh the prospective paternalism of a controlled economy wherein government officials may have the responsibility for every important economic decision. Never forget that the American economic machine is the most unbelievably complicated organization that the world has ever seen -- that its continued functioning depends upon the automatically interrelated operation of hundreds of thousands of working parts, any of which can affect its efficiency. Even the relatively simple proposition of setting ceiling prices during the wartime emergency required an organization of thousands upon thousands of employees which could function very imperfectly since every action in setting a price at one point necessarily raised a host of other problems and complications at other points. During the N. R. A. and during the war we had

some experience with cooperative controls of the markets. We also have been able to observe the results of such controls in other countries. While some measures of control are doubtless necessary in periods of emergency, there is nothing in our experience with them which would make them attractive or recommend them to us as a steady diet.

The difficulty with controls is that no one has yet devised a system whereby the other fellow can be controlled to act one hundred percent of the time in our benefit and where we ourselves can retain freedom of action.

Do not let the irritations, the discomforts, and the imperfections which are so obvious in the free competitive enterprise system blind you to the fact that it is the foundation stone upon which is built our American way of life.

Above and beyond passively resisting attempts to enlist him in movements to vitiate the anti-trust laws, every citizen should work actively to preserve the American way of life and the free competitive system upon which it rests. You who are engaged directly and actively in business have even more of a direct stake than that of your citizenship, since the companies that you represent are the direct beneficiaries of the freedom of that system. Neither the Federal Trade Commission nor the Department of Justice would be able to enforce the anti-trust laws against the active resistance of an unwilling and unsympathetic populace. In the last analysis, the effectiveness of the enforcement of the anti-trust laws, or that of any other set of laws in our democracy, must depend upon your willingness to accept them as guiding principles in your daily actions, and to give them your active support in your daily business affairs.