REVIEWS

THE BASING-POINT SYSTEM. By Fritz Machlup. Philadelphia: The Blakiston Company, 1949. Pp. vii, 275. $5.00.

OF the many paradoxes posed by the attempt to enforce competition, none is more exasperating than the riddle of basing-point pricing. Here is a system which is capable of precise exposition and graphic delineation, as has been ably demonstrated by Professor Machlup in his timely monograph. Yet the effects are controversial, and the remedies baffling. It is like a game of checkers in its geometric nicety; but the onlookers, and perhaps the players, are blindfolded.

Readers of the YALE LAW JOURNAL are presumably acquainted with the economic arguments for and against geographic price systems, lucidly set down in a recent Comment,[1] and with the political implications, etched by Professor Latham.[2] Such readers may well inquire why we must have a whole book on basing-points at this time, especially one which, in the author's own apt characterization, "is rich in economic theory and poor in statistical material." [3]

The first and not the slightest reason is that Professor Machlup just happened to have it in his pocket at this critical moment. Designed as part of a larger work on *The Economics of Price Discrimination*, the basing-point chapters were amputated as a sacrifice, and a worthy one, to the current fray.

The second excuse for his using so many words is the opportunity that space gives for clarification by patient definition and analysis. Thus, the ghostly twins, phantom freight and freight absorption, are given substance by working through every example to the real twins, net price to the seller and delivered price to the buyer. It is frequently asserted, for example, that injury to buyers near a non-base mill results from the "phantom freight" added to the base price of a more distant base mill. Machlup demonstrates what seems absurdly simple once it has been explained, that the same consequences can be obtained by manipulating base prices. Take a hypothetical situation based on the *Corn Products* case. This example is intended to focus on the plight of candy manufacturers buying glucose in the Kansas City area, where the defendant's mill constructed its prices on a Chicago base. Suppose the Chicago price is $50, and freight is $10 to Kansas City. The delivered price in Kansas City is then $60, and $60 is the mill net for the Kansas City seller. This sum is commonly said to include

1. *Price Systems and Competition: The Basing-Point Issues*, 58 YALE L. J. 426 (1949).

2. *Giantism and Basing-Points: A Political Analysis*, 58 YALE L. J. 383 (1949).

3. P.v. The illustrations are drawn, with regrets for their incompleteness, from steel, cement, and corn products. Professor Fetter's THE MASQUERADE OF MONOPOLY (1931) was, with a larger theme, more pungent and varied in its materials, and also more argumentative and impassioned.

$10 phantom freight, and everyone from the Supreme Court to Senator Capehart is outraged. Very well; Kansas City is made a base, and the base price is set at $60. The phantom freight evaporates. Similarly, on a sale $4 (freightwise) toward Chicago, Kansas City, which formerly collected $2 in phantom freight from the delivered price of $56, now is said to absorb $4 freight in meeting the same delivered price, which is still controlled by the lower Chicago base. To those who believe in freight absorption as a magic sponge which soaks up all stains of collusion, this is practically an act of charity.

But I would not like to have to explain the difference between the old and new pricing to a disgruntled candy manufacturer. Only lawyers and economists who have been long schooled in the craft of meeting competition where no competition exists can appreciate such a sleight-of-hand.

The example given is perhaps an uncommon one (though it demolishes the notion that freight absorption is good and phantom freight bad); and it would not do to infer from it that the whole basing point problem is a phantom. Professor Machlup slogs through monopoly theory to establish that, while perfected basing-point systems are an outgrowth of essentially anti-competitive industries, they are also powerful devices to keep competition from breaking out. He then weaves through the maze of discrimination inherent in the systems, and again demonstrates that even the beneficiaries of discrimination are in fact the victims of a wasteful process which makes prices to all higher than they might otherwise be.

Such findings should now be familiar, and my busy reader may still ask why they need most of a book to develop, even with refinements and qualifications. In defense I would now point to the great unsettlement that still prevails among economists over the alternatives to basing-points. Their leading trade journal, the *American Economic Review*, has recently published three articles by distinguished authorities;[4] they are not wholly in accord. Professor Frank A. Fetter, who has since died at the pinnacle of triumph after a thirty years' war against basing-points, nails up twenty-two theses in favor of his old love, compulsory f.o.b. mill pricing. Dr. Corwin Edwards of the FTC hints as broadly as he can that the industrialists who have unwillingly cast off their chains should use their freedom in sporadic chiselling, the nearest an oligopoly is likely to come to meaningful price competition. Professor J. M. Clark, first to expound the uses of unsystematic discrimination,[5] is now more cautious. He perceives the need for an area of uncertainty in the pricing of such products as steel and cement, but he raises the spectre of cutthroat competition, and is affrighted by it.

Professor Machlup explores all these contentions. Unimpressed by the

4. Fetter, *Exit Basing Point Pricing*, 38 AM. ECON. REV. 815 (1948); Edwards, *Basing Point Decisions and Business Practices*, 38 AM. ECON. REV. 828 (1948); Clark, *The Law and Economics of Basing Points*, 39 AM. ECON. REV. 430 (1949).

5. In his ECONOMICS OF OVERHEAD COST 416–33 (1923).

likelihood that an industry with powerful leaders will destroy itself, he is receptive to any plan that will diminish the waste and rigidity of systematic interpenetration of markets. But he makes a telling objection to the assumption that a healthy anarchy will follow the dethroning of basing points.

> "It would be possible for an industry to give up the basing-point system and adopt price-making policies that do not constitute a collective system, but rather consist of individual and independent ways of going after the desired business without regard to price maintenance. But is it likely that sellers who for many years have respected their own price lists as well as those of their competitors will suddenly forget all they have learned and will start doing what they have come to regard as unethical? If I am correct in assuming that this is very unlikely, then at least a period of psychological reconditioning is necessary before an industry can acquire the proper 'propensity to compete.' This is particularly necessary in industries dominated by large firms, where the small firms have become conditioned to follow the leaders, and the leaders can use discriminatory methods of imposing their will upon unwilling followers. It is doubtful, to say the least, that collusive price making can be eliminated in such an industry as long as its dominant members can practice price discrimination." [6]

He is thus driven to the conclusion that, in industries with a high concentration of control, uniform f.o.b. mill pricing is the only practical alternative to formal regulation. To be sure, the Federal Trade Commission disavows having the power to order f.o.b. pricing, and its interpretations of the *Cement* case boil down to the formula, "Do what you like, as long as it is not collusive." Machlup thinks this can be read, "Do what you like, as long as it is f.o.b. mill pricing." [7] I hasten to add that he is not uncritical of f.o.b. In it he properly finds weaknesses that reflect the brute fact of domination by large firms in the industries concerned.

The final reason why Professor Machlup had to write a book was to dispel some of the vast nonsense that has accumulated since the *Cement* case. Witness the notion that the shift to f.o.b. in steel and cement required an increase in mill net prices. Witness the skillful appeal of the smaller companies in the corn products industry to the Federal Trade Commission to save them from the perils of competition. Witness the tendentious hearings of the Capehart Committee. And what is one to say of the gyrations of Commissioner Lowell Mason, the Don Quixote of the Trade Commission?

Lawyers may take some comfort from the apparent fact that the law of geographic pricing systems is, at the moment, more settled than their economics. Professor Machlup, as well as some of his economist colleagues I have cited, is able to lay down positive prohibitions derived from recent

6. P. 250.
7. P. 251.

cases, and to draw distinctions that would do credit to a budding Blackstone. To be sure, the proponents of competitive discrimination have a considerable chore to distinguish away the ominous perils of the Robinson-Patman Act. Spokesmen for the Federal Trade Commission may suggest that it can draw a line between good and bad discrimination; but that is not likely to be entirely satisfying to the businessman whose counsellors are startling him with interpretations of *Standard Oil Co. v. Federal Trade Commission*.[8]

Professor Machlup, I should note in conclusion, wears his economic theory easily; and his book is remarkably intelligible to anyone interested in following him across the checkerboard. Will it be convincing? That depends, I suspect, on the extent to which one shares the author's "old-fashioned . . . belief that a truly competitive order is not only the best guarantee for the preservation of freedom but also the best mechanism for the allocation of economic resources." [9]

RALPH S. BROWN, JR.†

LEGAL PHILOSOPHY FROM PLATO TO HEGEL. By Huntington Cairns. Baltimore: The Johns Hopkins Press, 1949. Pp. xv, 583.

THIS book, the third in a series which is to be completed by a fourth on the Elements of Legal Theory, is designed by Dr. Cairns to treat the law from the point of view of philosophy in the same way that the preceding volumes have adopted the standpoint of the social sciences, of logic, and of the empirical sciences respectively. There are chapters on Plato, Aristotle, Cicero, Aquinas, Bacon, Hobbes, Spinoza, Leibniz, Locke, Hume, Kant, Fichte and Hegel. As far as possible Dr. Cairns has allowed each to speak in his own words, without attempting the hopeless task of reconciling differences or of proving the superiority of one over another. The result is a number of pleasantly discursive accounts of what these thinkers have to say about the nature of law, its relation to the state and society, and the problems of legal interpretation, with a few final paragraphs to each chapter summing up the results.

Although Plato is linked up with Bentham, Bacon with Dewey, and Leibniz with Russell, the book is mainly concerned with philosophies about the law rather than philosophies immanent in or arising out of legal systems. Readers who already have some acquaintance with the work of any one philosopher may not learn much from the pages given to him, but the student of Jurisprudence seeking an introduction to this or that thinker will find this book as useful as most. Dr. Cairns has no illusions about the imperfections of a

8. 173 F.2d 210 (7th Cir. 1949).
9. P. 50.
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book of this sort. He knows that Plato and Aristotle do not exhaust the whole of Greek legal thought, any more than Cicero sums up that of Rome or Aquinas that of medieval Europe. And if we are to judge from his first chapter on Philosophy as Jurisprudence and his last on Jurisprudence as Philosophy, his final volume, which he tells us is on the way to publication, should be an interesting and valuable contribution to legal theory, in which the material collected in the earlier ones will be put to good use.

The practical lawyer who is reluctant to open any book which combines the words law and philosophy on its title page, if he dips into this volume will find some instructive remarks on such matters as the use of preambles to statutes and some valuable illustrations on the often unconscious hypotheses which condition opinions of the justices of the Supreme Court. And when he thinks of the time which has been given to such questions as the nature of juristic personality, his heart will warm to a writer on legal theory who is prepared to discover that many of the problems with which the student of Jurisprudence has been concerned in the past may turn out to be "pseudo-problems," and who, while recognizing the need for philosophy as a preliminary to the practical systematization and reform of the law, frankly faces the possibility that in the end philosophy may have taught us nothing about the nature of law.

J. WALTER JONES†

PUBLIC ORGANIZATION OF ELECTRIC POWER. By John Bauer and Peter Costello. New York: Harper & Brothers, 1948. Pp. xvi, 263. $4.00.

THERE has long been common agreement that electric utilities should not be allowed to exploit their monopoly position independent of public regulation. There is also a growing realization that existing methods of regulation are both wasteful and ineffective. This book argues persuasively that public ownership and operation offer the best escape from the dilemma.

The authors raise a number of complaints against the existing organization of the industry. As a system, it is uncoordinated and wasteful. Individual companies incur excessive operating costs through the use of obsolete plant and incur excessive overhead charges through public relations activities and managerial magnificence. Capital structures are inflated and commissions allow an excessive percentage return on the watered assets. The authors hold that these elements of cost and exploitation reflect necessary inadequacies in regulatory procedure and that outright public ownership affords the only practical remedy.

This line of argument is not new, but the authors have attempted to give it further substance by calculating the savings which public ownership could provide. They have analyzed revenues, costs, and capitalization in 1942 for the 123 cities with populations exceeding 50,000. They compute total plant

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account at $456 per customer, while they estimate that the average fair value of plant at original cost less proper depreciation should not have exceeded $250 per customer. Similarly, annual overhead expenses were $10.68 per customer, whereas $6.50 should have been adequate for all legitimate functions. It is usual for commissions to allow a return of 6% on the rate base, while interest charges on a publicly owned plant would amount to no more than 3%. Finally, in 1942, these companies paid $268.8 million in federal taxes, which would not have been necessary for publicly owned enterprises. And in the long run, additional savings could be achieved through replacing obsolete plant and through the better integration of a basically chaotic industrial pattern.

The mere existence of wastes of this magnitude in the electric power industry and the possibility that public ownership could eliminate them would not by themselves indicate that public ownership is the best policy. Sufficiently vigorous and alert regulations should reduce capitalization and overhead for existing private companies and could encourage both the replacement of obsolete plant and the construction of efficiently integrated systems. The authors deny, however, that such effective regulation is possible. The past history of the industry, the power and continuing interest of the companies, and the weakness of regulating bodies indicate that the elimination of water is unlikely. Moreover, the freezing of overcapitalization, as securities divested under the Public Utilities Holding Company Act are sold at prices capitalizing prospective earnings at existing rates, makes more difficult the future reduction of the rate base. They also argue that conflicting interests among private utilities will prevent suitable integration and consolidation of an entire network. In contrast, the purchase of the existing plants by government bodies would allow the issue of valuation to be decided once for all and would eliminate thereafter the conflict of interest between the companies and regulating commissions which would otherwise persist.

In addition to their general argument for public ownership, the authors present a detailed proposal for the organization of electric power on a national scale. Federal hydro and steam plants would supply base and main load power through a national grid. States would add peak power and transmit the whole to municipal distribution systems. For some purposes and regions, they prefer regional authorities on the TVA model.

The core of the argument, however, relates to public ownership rather than to the savings from a better organized grid. The authors estimate that main load power can be supplied by the federal network at 4.5 mills per kilowatt hour or can be independently generated by the states at 6 mills and by large cities at 7 or 8 mills. There would thus be less than .5¢ per kilowatt hour difference between the generating costs of a nationwide public system and the costs which a city could attain by independent municipalization. The latter would have available all of the savings from lower capitalization, overhead, and interest and from tax avoidance discussed above.

Several comments may be made on this argument. The measures of exist-

ing waste depend on the authors' calculations, and I have made no attempt to go behind them. From what we know of the past history of the industry and the way in which earnings regulation distorts profit incentives, it seems likely that extensive overcapitalization and excessive overhead exist and that obsolete plant imposes further burdens on the economy. Lower interest and tax avoidance, however, do not appear to be valid measures either of existing wastes or of useful savings which public ownership could yield.

Tax savings are not a net benefit to the economy. The authors place heavy emphasis upon the unequal treatment given different regions, according to whether they secure power from tax-free public sources or from private sources which must pay federal taxes. Such regional advantages may indeed distort the pattern of economic location, and the argument might well be made that public projects should be subject to federal tax equivalents or that private utilities should be tax exempt. Since such measures are politically unlikely, the authors urge that the unequal treatment should be removed by extending public ownership to the entire industry, thus avoiding all federal taxes. Two objections may be raised to this position. First, as a matter of political practicality, it may be doubted whether the socialization of electricity is more feasible than the imposition of tax equivalents on public projects. Second, regional dislocations are not the only dislocations which can arise from tax exemption. Not only do regions compete with each other, but also, in conditions of full employment, electric power production competes for resources which would otherwise be used elsewhere. The extension of electric power by marginal investments which just pay their own way without taxes involves an economic loss if it takes resources away from employments where they are sufficiently useful to return tax payments as well as other costs. The possibility of avoiding taxes is an incentive for any region to desire public ownership. For the economy as a whole, however, it not only sacrifices tax revenue but may lead to a disproportionate extension of electric power investments.

For similar reasons, it is not proper to count among the advantages of public ownership the low rates of interest at which government can borrow. Low interest may make possible low electric rates, but the question remains whether this reflects a real reduction in cost or a mere shift in incidence. Government units can borrow cheaply from the public because of the near certainty of repayment, but this does not mean that the government's receipts from a power project are equally reliable. With fixed electric rates, power revenues will change with the business cycle, and it seems that the government bears much the same sorts of entrepreneurial risk as does private enterprise. At present, the stocks and bonds of leading operating utilities are so priced that total earnings amount to 5% to 6% of the market value of all securities. This is the return which private investors now require to compensate for non-liquidity and risk in electric power investments. When power is privately financed, electric rates carry a premium for risk, while if government uses its general credit to finance power projects at low inter-

est rates, this means that the government has itself decided to bear the risk burden.

It is possible that risk would be somewhat reduced for a public enterprise. Some of the hesitancy which investors now show toward utility securities reflects uneasiness over future government policy, and this is not a risk which would affect government itself. This saving, however, is not measured by the simple difference between the rate of return allowed by regulators and the low interest at which government can borrow. Much of the "advantage" of low interest rates would reflect a mere shift in risk burdens, and the consequent reduction in electric rates would be offset by increased taxes. Moreover, to the extent that the risk cost of power investment is underestimated, overinvestment in the industry is encouraged.

If we exclude tax avoidance and interest savings from the table given above, there remain potential savings of $292.4 million from eliminating overcapitalization and excess overhead. These would still have allowed a reduction of 13.3% in 1942 operating revenues.

It should be noted, however, that while severe fault may be found with the present industry, public ownership may develop its own weaknesses. Partisans of private utilities generally object to the supposed inefficiencies of public management. While these inefficiencies may be overestimated, the difficulty of maintaining minimum costs in the absence of strong market pressures, particularly if power production and politics are not adequately separated, would constitute at least a partial offset to the inherent inefficiencies of the present system. This is especially so with municipal ownership, for while some of the larger plants have enjoyed outstanding success, a complex industrial undertaking presents serious management problems to a small political unit, and it is in such units that power and politics are least easily separated. Municipal policy like that of Jacksonville, Florida, where high rates are used to support the general budget, is of doubtful desirability. Moreover, it is probable that in a practical program of public ownership existing overcapitalization would be reflected in the purchase price of private plants. Thus the potential savings from eliminating water would not be fully realized.

Despite these reservations, the case for public ownership seems strong. Regulation has not proved satisfactory, and public ownership would at least not be subject to the same vices. Efficiency in government may be difficult to secure, but a public enterprise would not have the same positive incentives to inefficiency which confront a regulated utility. And even if a public enterprise did not eliminate overcapitalization, it would at least not have to return 6% on the water.

The authors devote relatively little attention to the pricing and investment decisions which should be followed after the establishment of public ownership. They prefer that projects be self-liquidating, yet approve of savings in taxes and interest payments which would encourage the expansion of electric power beyond the limits which profit incentives would set to efficiently regulated private activity. There is thus an element of implicit subsidization in

their program, and while this may be justifiable, one would like to see it explicitly defended and the magnitude indicated. It is doubtful, however, that the authors even see this as a problem. As enthusiastic advocates both of public ownership and of the expansion of electric power itself, they believe that:

> "The government can hardly build too many plants which can generate electric energy at 4.0 mills per kilowatt hour and transmit it at 0.5 mills to the state areas for distribution. With such unified power supplies and with increasing efficiency there is virtually no limit to attainable future production and welfare."[1]

But to all good things, even electric power, there is a limit, and some general controls must be found to fit power production within the general economic system. At present, electric power investments and output are directed by the incentives of the pricing system as distorted by unequal incomes, monopoly power, and public regulation. Bauer and Costello propose to give public authorities control of investment decisions without much consideration of the criteria for the exercise of that control.

There are thus a number of faults of omission and commission to be found in this book. It is not the definitive work on electric power, but it is a stimulating and useful contribution to a controversy which is growing in importance.

RICHARD B. TENNANT†

REVENUE ACT OF 1948, LEGISLATIVE HISTORY SERIES. Edited by Paul Wolkin and Marcus Manoff. New York and Albany: Matthew Bender & Company, Inc., 1948. Pp. xxiii, 667. $10.00.

THE use of legislative history in construing federal enactments has become of primary importance not only in court battles but in the day-to-day process of administering a law or advising a client. For tax practitioners the Revenue Act of 1948 is a particularly pertinent example of the importance of legislative history since the committee reports, especially the Senate Finance Committee's Supplementary Report,[1] are, together with the new Treasury Regulations, to date the only official interpretation of the amendments to the estate and gift taxes.[2] But despite its importance, legislative history has been difficult for most private practitioners and even many courts to use because of its inaccessibility. The present volume, edited by two members of the Penn-

1. P. 131.

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1. SEN. REP. No. 1013, pt. 2, 80th Cong., 2d Sess. (1948).

2. Proposed regulations reflecting the estate and gift tax amendments were issued on November 6, 1948, and with minor variations were promulgated in T.D. 5699 and T.D. 5698, May 18, 1949, 14 FED. REG. 2623, 2637 (1949).

sylvania Bar, is designed to overcome this handicap in regard to the Revenue Act of 1948.

The editors have followed a plan somewhat similar to that used by Mr. Seidman in his well-known volume on legislative history to federal income tax laws.[3] In their book the enacting clause, each title, part, and sub-part heading, and each section, or smaller sub-division of the Act is set forth separately. Each of these divisions of the Act is followed by excerpts from the committee hearings, portions of the committee reports, selections from debates on the floor, versions of the appropriate part of *H. R. 4790* as it went through the legislative process, and some of the amendments proposed but not adopted.

The editors state that legislative material of a broad nature pertaining to a particular title, part, or sub-part appears under the heading to that title, part or sub-part, and that discussions pertaining to a particular section or sub-section are placed after that section or sub-section.

The present volume does not purport to be an exhaustive presentation of the legislative history of this Act. With some exceptions, to present a "rounded picture," most economic and budgetary motivations are omitted. The omissions have been most damaging to a clear concept of the opposing arguments and alternative proposals presented to the adopted amendments by minority leaders and the Administration.[4] The forceful testimony of Secretary Harriman concerning tax reduction and economic conditions is not even referred to.

Legislative history more commonly associated with interpreting statutory language has been more fully presented from both the majority and minority viewpoints. Secretary Snyder's statement in opposition to the estate and gift tax amendments loses much of its effectiveness, however, owing to the manner of its division under many sections. In comparison, the testimony and written statements of witnesses favoring repeal of the 1942 community property amendments and adoption of the 1948 amendments, although largely repetitious, are quoted much more extensively in a given place.

The above objection to the presentation of Mr. Snyder's statement points up a serious difficulty in the editors' method of presenting legislative history. The full meaning of a committee report or statement of a witness is often obscured if the statement is divided to fit under various parts of the Act. Of course, by reading the material under different sections the full statement may finally be pieced together. But this process is made difficult in the present volume owing to the lack of an index to the legislative material. Furthermore, if a comprehensive quotation is given in one place it is so divided by the editors' system of numbering that the reader is left in doubt as to whether the quotation is complete or merely a series of selections.

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3. SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861 (1938); see also SEIDMAN, LEGISLATIVE HISTORY OF EXCESS PROFITS TAX LAWS, 1946-1917 (1947).

4. A further difficulty is found in the editors' failure to note that page references to materials which are included from the *Congressional Record* are to the unbound edition of Volume 94 rather than to the later bound volume.

The three committee reports and presidential veto message pertaining to the Revenue Act of 1948 cover a total of 178 pages in their original form; the present volume consumes 690 pages, including introductory and explanatory material. It would seem that at least the committee reports and perhaps written statements of important committee witnesses could be fully quoted in one place. Even if it is advisable to place the remaining legislative history material (excerpts from hearings and debates, versions of the bill prior to final adoption, etc.) under the individual sections of the Act, adequate reference to pertinent parts of the committee reports and statements of witnesses could be made under each section. By such an arrangement the researcher could confidently utilize at least the committee reports and statements as source material.[5]

The editors and publishers announce their intention of publishing future similar histories on federal legislation of importance. They have made a good start in a much neglected field. It is to be hoped that in future volumes they will give a clearer picture of economic considerations, at least by reference or editorial statement; and set forth the committee reports and more important interpretative statements in a form more readily usable without reference to basic material.

FRANKLIN C. LATCHAM†

5. The difficulty of obtaining committee reports to federal tax legislation has diminished since 1939 when committee reports to tax legislation from 1913 to 1938 were collected in the Cumulative Bulletin for that year. 1939–1 CUM. BULL., Pt. 2. Subsequent Cumulative Bulletins have contained committee reports to revenue enactments since 1938.

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