

## BOOK REVIEWS

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**The Basing-point System.** By Fritz Machlup. Philadelphia: Blakiston Co., 1949. Pp. vii, 275. \$5.00.

The Supreme Court of the United States in deciding *Federal Trade Commission v. The Cement Institute, et al.*<sup>1</sup> found that the pricing system utilized in the cement industry was unlawful. Under this system, called a basing-point system, the delivered price of a product at any destination is so calculated as to be identical no matter where the product is produced or from what point it is shipped. The calculations are simple. Published and readily available transportation charges are added to published posted prices for selected base points (usually but not necessarily major producing centers); the lowest combination of the two factors—base price and transportation price from a base—is then the delivered price, quoted by all the participants in a basing-point system.

Since the passage of the Sherman Act in 1890, agreements, understandings or arrangements to fix prices have come to be illegal in the United States. Yet basing-point systems have continued to be widely used in this country for approximately fifty years. Not until 1948 did a majority of the Supreme Court explicitly find an industry-wide basing-point system illegal. At that time Mr. Justice Black held that use by competitors of a uniform pricing formula, with knowledge that concerted action was contemplated and invited, constitutes a combination to fix prices.<sup>2</sup> Essentially that is the cement case.<sup>3</sup>

The reverberations of the decision are still being felt. The Senate of the United States has held extensive hearings,<sup>4</sup> trade publications, commercial papers, and professional journals are filled with analyses and speculations about “delivered pricing,” “meeting competition,” “candy bars that sell for a nickel the country over,” “the danger of ghost towns” and “usurpation of the legislative function by the courts.” Professor Fritz Machlup has published the first full-length book on the subject of the basing-point system since the cement case.

In his timely book Professor Machlup has put the basing-point system on trial. In Machlup’s “economic court” the ruling of the Supreme Court is both confirmed and extended. The complaint before “Judge Machlup” contains six broad counts—price fixing, price discrimination, wastes of distribution, concentration of control,

<sup>1</sup> *Federal Trade Commission v. Cement Institute, et al.*, 333 U.S. 683 (1948).

<sup>2</sup> *Ibid.*

<sup>3</sup> Much of the furor about the Cement case arises from Justice Black’s comments concerning producers as individuals (i.e., not in concert) with respect to price discrimination. This involves departures from competition not covered by Section 1 of the Sherman Act. It should be emphasized that it is *not* necessary that Section 5 of the Federal Trade Commission Act have any broader scope than Section 1 of the Sherman Act to outlaw an industry-wide basing-point system.

<sup>4</sup> Study of Pricing Methods, Hearings before a Senate Subcommittee of the Committee on Interstate and Foreign Commerce on S.R. 241, 80th Cong. 2d Sess. (1948).

retardation of growth, and distortion in location of capacity. He finds the defendant, the basing-point system, guilty on all six counts. On the basis of his findings Professor Machlup decrees that equitable relief is afforded by requiring participants in the system so to price their products that the net returns to any mill on all sales of like products made at the same time are uniform. In other words, his decree requires that there shall be compulsory uniform f.o.b. pricing.

"The bulk of this book," says Professor Machlup, "is devoted to the economic analysis of the basing-point system."<sup>5</sup> And on the following page, "To relate the various facts and understand the significance of their interrelationships we must rely on a logical analysis of the system in all its ramifications."

Unfortunately these commendable objectives are not realized. A "logical analysis of the system" by an economist might be expected to throw some light on the question why and under what circumstances a basing-point system rather than some alternative form of price cartel<sup>6</sup> is adopted. Such analysis is conspicuously absent. Chapter 4, *The Monopolistic Nature of Basing-point Pricing*, points up significant departures from competitive behavior. It does not afford so much as a clue to the essential differences between a basing-point system and other departures from competition. In fact, the case that is made in this chapter does not vary greatly from the government's position in the *Cement* case, although Machlup uses more care in distinguishing the case of the single monopolist from the price cartel. Machlup's finding that the basing-point system is "collusive" rests heavily on the kind of evidence which lawyers traditionally present to courts in anti-trust cases: thus on page 135, "correspondence . . . between officers of companies in industries using the basing-point system . . . referred to base price and extras to be charged," and "oligopoly positions were shown to have resulted from corporate mergers"; and on page 128, "Bitter complaints were directed to trade associations if a competitor by mistake or otherwise failed to use the published freight factor in calculating the delivered price and, thus, quoted a lower price"; or on page 126, "the open price association is, as the Supreme Court once said, 'simply an expansion of the gentlemen's agreement of former days, skillfully devised to evade the law and 'to procure . . . concerted action.'"

It may well be, as the author points out, that "[l]egal minds sometimes show an astounding slowness in grasping economic arguments."<sup>7</sup> Perhaps this would be less so if they received more economics and less legal reasoning from economists. Machlup's case that basing-point systems are "price-fixing" arrangements principally involves a lawyer-like demolition of the arguments of basing-point advocates.

"Attempting to prove a basing-point system 'competitive' is trying to prove what can't be proved," says Machlup. Either through "hypocrisy" or "sincere ignorance" mutually inconsistent positions are taken, according to the author. Essentially these are:

1) The identity of delivered prices is evidence of effective competition, because competition must result in price uniformity.<sup>8</sup>

<sup>5</sup> P. 51.

<sup>6</sup> The pricing practice involved in the use of an industry-wide basing-point system is characterized by Machlup as a price cartel (page 18).

<sup>7</sup> P. 91.

<sup>8</sup> Mutual inconsistency of the statements is mild criticism indeed of such argument. If cats have tails, is a dog a cat because it has a tail?

2) The system is a method of increasing competition through interpenetration of regional markets which without the system would become domains of local monopolies.

3) The system brings more order into markets, but does not eliminate or reduce competition, which continues to operate effectively (a) through adding bases and changing prices at existing basing points, and (b) through selling at prices deviating from the rules.

4) The system has reduced the degree of competition, but it is the result of the natural evolution of competitive forces under the economic conditions prevailing in certain industries, and a prohibition of the system could not increase the degree of competition effective in these industries.

Professor Machlup analyzes the arguments with thoroughness and patience. On page 96 seven reasons are listed why delivered price uniformity of the basing-point system is not evidence of competition. The argument that intermarket penetration is evidence of competition is disposed of by showing that no pecuniary benefits accrue to consumers.<sup>9</sup> The local monopoly prices alleged to derive from f.o.b. pricing are then shown to be lower than those which would be charged under the basing-point system.<sup>10</sup>

Unlike points 1 and 2 above, points 3 and 4, according to Professor Machlup, are based on valid theorizing and their significance has to be tested by factual evidence. The evidence is found wanting.

Prices under the system, it is said, are not lower at new basing points even though "[a] producer does not realize his freight advantage by charging a high price at which he can sell very little, where he could sell a great deal more at a somewhat lower price."<sup>11</sup> Machlup believes the price would not be lowered with a basing-point system "guided by financially powerful firms," because they can easily afford to keep up and even increase their shipments into the territory of the new base mill since they need not lower prices in other territory. Does this conclusion derive from the basing-point system or from the existence of "financially powerful firms"? Essentially this is an argument against discrimination and provides the principal argument for compulsory uniform f.o.b. pricing. Machlup does not establish that there is anything inherent in the use of a basing-point system which prevents either an increase in the number of basing points or changes in base prices if such course of action should prove to be beneficial to the participants. How did it come about that Luken Steel and Worth Steel at Coatesville, Pennsylvania, and Claymont, Delaware were basing points for steel plates, or that Granite City, Illinois was a basing point for tin-plate? It is not unknown in cartel practice for concessions to be made to small producers in order to carry out the purposes of the organization.<sup>12</sup> If the basing-point system is a collusive price-fixing device, is it not immaterial whether prices can be lowered a little under the system so long as they are fixed by concert to avoid competitive levels?

Considerable space is given by Professor Machlup to point 4, the natural evolution point. Inasmuch as he takes pains to distinguish basing-point pricing practice

<sup>9</sup> P. 100. A qualification on page 103, however, states that in certain situations market interpenetration may promote competition.

<sup>10</sup> P. 104.

<sup>11</sup> P. 112.

<sup>12</sup> Elsewhere Machlup quotes Professor Fetter with approval: "[A]ccomplices may be in a measure victims, and fear may be mingled with rewards to enforce cooperation." P. 133.

from less formalized open-pricing or price leadership examples, an impression is created that equally noncompetitive results are possibly less "collusive" than when less direct means and methods are utilized. The space given to this kind of argument hardly seems consistent with the approval with which Machlup quotes the Supreme Court in the *Masonite* case on this very point: "The fixing of prices by one member of a group, pursuant to express delegation, acquiescence, or understanding, is just as illegal as fixing prices by direct joint action."<sup>13</sup> Similarly, he quotes the *Cement Institute* case: "It is enough to warrant a finding of a combination within the meaning of the Sherman Act, if there is evidence that persons, with knowledge that concerted action was contemplated and invited, give adherence to and then participate in a scheme."<sup>14</sup>

The author concludes, "The courts have now seen the truth." But the truth the courts see need not rest on the overt actions which Machlup details. For even if other systems are devised which do not fit the means or methods tests which Machlup outlines, or even if the basing-point system can be shown to be a much more logical collusive device for maximizing gains than it appears to be under Machlup's description (and therefore, perhaps, more susceptible to the leadership principle) does not the conclusion still follow that there is "collusion," not only in the legal sense but also in the economic sense which Professor Machlup gives the term?<sup>15</sup> In any event, there is small and declining impartial dissent from the proposition that a basing-point system is a price-controlling device. Machlup concludes as did the Supreme Court, and as did Professor Frank A. Fetter long before either, that a basing-point system "is in restraint of trade," "is a price cartel," or "is a masquerade of monopoly." The elegance of the variation should not hide the uniformity of the economic conclusion.

For those who, like Machlup, believe "that a truly competitive order . . . [is] the most efficient mechanism for the allocation of resources . . ." the case against the basing-point system (or any other pricing system) should be conclusive upon showing of collusion without resort to proof of the additional points in his indictment—that is, price discrimination, waste of distribution, concentration of control, retardation of growth, and distortion of location of capacity. Much of the findings with respect to these latter charges rest not only on facts which are in dispute but also upon assumptions the credibility of which for collusive purposes is subject to considerable doubt. They seem to have achieved a status of authority in no small part due to the frequency of their repetition, not only as a part of the specious and conflicting claims of basing-point advocates, but also in statements of the students of the problem who could safely be characterized as "disinterested." A specific reference is "cross-hauling."

Intermarket penetration (cross-hauling) has long been said to characterize the basing-point system. Machlup accepts cross-hauling as a fact almost without reservation. But he does not cite reliable empirical evidence that true cross-hauling is quantitatively important; indeed, he points out that there is a dearth of reliable information on the extent of true cross-hauling. In the absence of direct evidence it might be reasonable to suppose extensive cross-hauling to exist if it could be shown

<sup>13</sup> *United States v. Masonite Corporation*, 316 U.S. 265, 276 (1942).

<sup>14</sup> *Federal Trade Commission v. Cement Institute, et al.*, 333 U.S. 683, 716 (1948).

<sup>15</sup> That is, "collusive" not only as a mere or minor departure from theoretical or pure competition, but as a significant departure from the effective competition which could otherwise be achieved.

that sellers characterized by Machlup as "cartelists," would benefit thereby. Yet Professor Machlup argues that cross-hauling is irrational for both monopolists and cartelists. On page 94, for example: "A single monopolist would *not* use a basing-point system for his plants"; and for a group of sellers, on page 102: "The end-effect is that as a group producers gain no business at all. Each of them finds his mill net price reduced, the reduction being due *entirely to higher selling costs and freight involved in the increased cross-hauling*, i.e., in the increased intermarket penetration."<sup>16</sup> The little firms are oppressed by the system, but don't cry out in protest from ignorance. "First of all, most of them do not understand the situation."<sup>17</sup> Under these circumstances, it is hard to understand Machlup's acceptance of cross-hauling, except as evidence of the power of reiteration. This question is significant, not only for its implication about the depth of his analysis, but even more because many of Machlup's charges about concentration of control, or mal-location of capacity, for example, would require modification if it were established that cross-hauling was insignificant.

A particularly flagrant example of Machlup's acceptance as realistic of highly irrational behavior by "cartelists" is provided on page 161, an example which is designed to show that the power of the large firm to oppress the small under the basing-point system is due neither to technological inferiority and high production cost of the small mill nor to the small mill's not being a basing point. Machlup's conclusion that the small producer is oppressed by the larger rests squarely upon the continuance of a practice against the interests of both participants. The assumptions of Machlup's illustration are as follows:

1) Eighteen consuming points (A to R) each consume 200 units daily. All are located on the same railway and the freight rate from any one point to the next is \$3. The long-haul rate is the sum of the short-haul rates.

2) This market is supplied by two producers, one at D, the other at I. Both mills have the same unit costs when capacities are utilized to the same extent.

3) Of the total supply for the 18 consuming points (18 × 200 units per day, 3600 units) the mill at D supplies 1200 units, the mill at I 2400 units, each at an average production cost of \$47 per unit at those outputs. Both mills operate under constant average variable costs and under decreasing average total unit costs.

4) Both mills are basing points. Base price at each point is \$50. Delivered prices exceed base prices by the amount of the freight rate from the nearest basing point.

Under these assumptions it is immaterial (pricewise) to any consumer from which supplier he purchases. It is not immaterial, however, to either supplier to which consumers he sells. The following table shows clearly that under the above assumptions, returns for mills at both D and I are maximized only when the mill at D serves consumers at A, B, C, D, E, and F, and the mill at I serves all others. Then and only then are mill net returns for both mills maximized at \$50 on all sales (see table).

If both mills serve their "natural"<sup>18</sup> markets (and maximize their returns under the assumptions given) mill D will be selling 1200 units per day, receiving a mill net of \$50 each, or \$60,000. Total cost is \$47 per unit, or \$56,400, and a net profit of \$3 per unit provides \$3,600. The mill at I will be operating at the same unit rate with twice the sales or \$120,000, at a cost of \$112,800 and a net profit of \$7200.

<sup>16</sup> Italics added.

<sup>17</sup> P. 168 n.

<sup>18</sup> The markets in which a mill has a comparative cost advantage.

So far there has been no departure from Machlup's own example. Machlup now assumes that the mill at I will attempt to expand sales into D's (the small mill) territory. Mill I succeeds in taking half of the business at consuming points E and F. Presumably the mill at I has excess capacity so that the initial action, at least, does not necessitate a patently absurd assumption like trading \$10 bills for \$5's. In any event, it costs Mill I \$1200 more ( $\$3 \times 100$  at F plus  $\$9 \times 100$  at E) to handle this business than it would mill D. But notice what follows: Machlup says, "*The mill at D will now try to make up for the lost volume by sales to customers at G and H.*"

Assuming at this point, as Machlup does, that the mill at D gets half the business at G and H, it is supplying these new customers at a cost \$1200 per day higher than the mill at I. Machlup's ingenious cartelists are now donating \$2400 daily, something more than 20 per cent of their prior combined profits, to the railroad. Are they satisfied? Indeed not! The mill at I does not even attempt to take additional business at

(IN UNIT SALES)

Sales to Consuming Point	Governing Basing Point	Freight Rate from D	Freight Rate from I	Mill Net to D	Mill Net to I	Advantage
A B C or D....	D	\$9 \$6 \$3 or \$0	\$23 \$21 \$18 \$15	\$50	\$35	To D \$15
E.....	D	\$3	\$12	50	41	To D \$9
F.....	D	6	9	50	47	To D \$3
G.....	I	9	6	47	50	To I \$3
H.....	I	12	3	41	50	To I \$9
I J K... R....	I	\$15 \$18 \$21 ... \$42	\$0, \$3 \$6 ... \$27	35	50	To I \$15

F and E, where its relative disadvantage is but \$3 and \$9, but moves into territory A... D where its disadvantage is \$15 per unit. And D, surprisingly enough, retaliates by taking a like share of I... R at a similar disadvantage. Rigid adherence to this system of self-inflicted punishment, involving equally matched losses, obviously exhausts the smaller revenues of the small mill before it does the larger. Thus "the large concern can dominate the smaller competitor on account of size alone."

Suppose, however, that the smaller mill can somehow be endowed with a modicum of enlightened self-interest. Why cannot the mill at D be expected to exercise its retaliation where it has a cost advantage? It is clear that if the mill at D retaliates a move by the mill I to take customers at F, E or A... D in those same areas, then at any price a cost advantage of \$3, \$9 or \$15 per unit respectively can be exerted over the mill at I. In this event the mill at I would drive itself to the wall, not mill D. Moreover, the folly of the plant at I attempting to secure business in D's natural area (or for that matter D in I's territory), if rational behavior can be expected, seems apparent even in the absence of overt agreement. As a basic feature of a cartel agreement (basing-point system?) it enters the realm of cuckooland.

This same kind of dilemma (the apparent folly of the system) arises not only in the case of domination due to size, but also in the other cases the explanation of which depends upon cross-hauling. Must cross-hauling be considered an essential part of the system, especially since, as is generally agreed, the confirming empirical evidence is so unsatisfactory? One economist, at least, has seriously questioned its importance.

Professor George Stigler of Columbia University is currently working on an explanation of a basing-point cartel which does not depend upon irrational behavior.<sup>19</sup> He has suggested that the system is rational as a form for "price collusion" where production is widely dispersed, where demand is geographically unstable,<sup>20</sup> where sizable storage of product is impracticable, and where transportation cost is a major component of delivered price. It is generally recognized that price-fixing schemes are most workable when prices can be stabilized over substantial periods of time. "Price chiseling" can then be more easily detected and properly provided for. If a price-fixing scheme must depend upon wide and frequent variations in price the problems of adherence and compliance often become insuperable. The need of this stability by a price cartel, according to Professor Stigler, coupled with geographically unstable demand gives rise to the need for delivered pricing schemes (of which the basing-point system is an example). Without geographically unstable demand an f.o.b. price agreement with territorial division would seem to be a more effective pricing arrangement than a delivered pricing scheme, and it would not require substantial shipments from far away producers to markets more economically served by adjacent producers. But an f.o.b. scheme without this geographic stability would be effective only as the diversely situated suppliers varied their prices significantly as demand shifted in order to maximize returns.

If, unlike the previous example (illustrated by the table on page 9), the demand were not assumed to be geographically stable, but rather in one month concentrated in the natural market of a mill situated as the one at D, and in another month in the territory of the mill such as the one at I, then in the absence of the basing-point system, the mill located at D would rationally raise its prices when demand concentrated in its area. The mill at I would participate insofar as the D mill could not handle the additional business. A similar result would follow when demand was concentrated in the natural market of the mill at I, with the mill at I having the advantage. This kind of price adjustment, says Stigler, is obviated by a basing-point system. Base prices are established which define the "natural" markets for the participating firms, located for example in the foregoing table for mills A and D.<sup>21</sup> As demand shifts from D's territory to I's territory then and only then will mill D indulge in so-called "freight absorption," and even then penetration is limited by the increasing cost of going too far into I's market. It is important to note, though, that mill I will not at the same time be making substantial sales in D's territory.<sup>22</sup> Substantial cross-haul is excluded.

<sup>19</sup> At the time this review was written, Professor Stigler had not published his analysis of the basing-point system. What is herein referred to as "Stigler's theory" results from this reviewer's interpretation of his position as presented in a roundtable session at the University of Chicago. Consequently, any errors or omissions are the responsibility of this reviewer. Essentially, however, Stigler is to be credited with rationalizing delivered-pricing by correlating it with geographically unstable demand conditions.

<sup>20</sup> Also conceivable under conditions of geographic fluctuations in supply: for example, production affected by weather changes.

<sup>21</sup> Strictly, the hypothetical limitations imposed in the Machlup example do not provide an apt situation for a good "Stigler case." The assumed price and cost conditions in this particular example preclude substantial penetration of mill D's market by mill I, or mill I's market by mill D irrespective of geographic shifts in demand, because marginal costs for either mill will exceed delivered-price after only limited penetration.

<sup>22</sup> Minor exceptions for time lags or the cost of moving salesmen are recognized.

In summary the basing-point system has rational advantages under certain assumed conditions. It allows for stability of price, making unnecessary numerous price changes; it allows mills to concentrate on the most profitable business, placing penalties in the form of transportation costs on business uneconomically supplied, and thereby substantially eliminates wasteful cross-haul; and it minimizes the necessity of wide fluctuations in output of various mills in the absence of price change.

The extent of the empirical evidence to support the assumed demand characteristics which Stigler ascribes to basing-point industries must await further study. Readily available examples should be expected, however, especially in the industries supplying building and construction. Professor Machlup has a partial list of products sold in conformance with basing-point systems on page 17. Of these, cement, rigid steel conduit, soil pipe, structural steel, oak flooring, and other lumber products might be expected to fall into an unstable demand group. On the other hand, such products as sugar, glucose, corn syrup, and certain steel products as tin plate and automotive sheets probably exhibit much less variation in regional demand.

There may well be rational explanations for inclusion in a list like Professor Machlup's of products that are not subject to large regional variations in demand. The existence of anti-trust laws in the United States and the earlier court decisions under them at least made the legality of basing-point systems much less subject to doubt than less camouflaged price-fixing schemes. If the system provided a haven for cartel minded oligopolists then it is probable that the form of the system might have been adopted even though in actual practice pricing closely approximates what would occur under an f.o.b. price agreement. (When production is concentrated in a small area, a basing-point agreement involves no substantial cross-haul irrespective of the geographic characteristics of demand.) The production of both hardwood flooring, and plywood, although included as basing-point examples, is geographically concentrated. (An interesting test of this speculation about the form of the agreement would involve contrasting pricing forms in this country with those for similar products abroad where no anti-trust laws exist.)

The contrast between the more traditional description of basing-point systems involving extensive cross-hauling adopted by Professor Machlup and the "rational cartel" model portrayed by Professor Stigler has interesting implications concerning the much discussed subject of uneconomic location of productive facilities due to basing-point practice. Machlup points out, "In general the most economic locations for the installation of productive capacity for a particular product are those at which the sum of 'procurement cost,' 'processing cost,' and 'distribution cost' is least." He might have added that this generalization is equally true of competition, oligopoly, or monopoly. The theory of mal-location under the basing-point system, apart from the not insignificant effect of any departure from competition in eliminating an automatic mistake corrector, arises because of the irrationality of the distribution pattern. As Machlup says on page 233, "The mere fact that the basing-point system has important effects upon *distribution cost* suggests that it also may have effects upon the location of productive capacity in the industries that have practiced this system as well as in the industries that have used the products sold under the system."

But what becomes of this conclusion if it is assumed that the system has minor or insignificant effects upon the distribution costs of the producers? Certainly rational producers do not locate their plants just anywhere because they can to some degree

fix prices. The reasons Machlup gives for expecting mal-location rest on statements of previous writers on the problem, including Professors Arthur R. Burns, Frank A. Fetter, Edgar M. Hoover, and Melvin de Chazeau. At most, their statements suggest possible delays in economic adjustment of the kind that might arise from any cartel-like departure from competition; they do not point to any mal-location attributable specifically to the use of a basing-point pricing system. Both Professor Machlup's analysis and his historical data seem singularly unconvincing, especially since not a single reason is listed which explains *why* any producer would locate a plant differently when he is a participant in a basing-point system from when he is a vigorous competitor.

Does the location of the purchasers of the products sold under the basing-point system present a case for uneconomic location? Prices to fabricators or consumers will certainly be different under the "basing-point cartel" from pricing in its absence. But it is not enough to establish that prices are generally higher. Mal-location could arise only from geographic discrimination.<sup>23</sup> Geographic discrimination is certainly characteristic of basing-point systems described by both Stigler and Machlup, as has been previously indicated. But is this discrimination consistently in favor of particular locations? If there were persistent discrimination in favor of one area it would be reasonable to expect that this might lead to the establishment of users or fabricators which the elimination of the system would displace. But the very reason for Stigler's rational basing-point system is *changing* geographic demand. No particular location under this hypothesis has to be favored in such manner as to change the economies of plant location by customers. This is apparent when principal producing areas are basing points, if it can be assumed that changing from base prices to f.o.b. prices does not involve greater relative charge at one base than at another averaged over a span of time long enough to account for shifts in demand. But it has already been indicated that the producer participants can be properly and rationally located under the system. If a switch to f.o.b. pricing makes for relatively greater price change for one producer than another it merely signifies that the basing-point prices were not rationally adjusted in the first place. It is not required that prices at all bases be uniform under a basing-point system.

A case of retarded industrial expansion is usually made for areas not contiguous to basing points. Professor Machlup, for example, quotes Professor de Chazeau with approval that the system "would obstruct the extensive development of capacity for tonnage steel at locations other than those contiguous to basing-points."<sup>24</sup> And Machlup's own theoretical conclusion is "that the basing-point system in general tends to retard the decentralization of the industry in which it is employed."<sup>25</sup> And from this "it follows logically that the fabricating industry had an incentive to locate close to the large and old centers of supply [basing-points?] rather than near the peripheral supplies and markets."<sup>26</sup> But Professor Machlup goes on to point out that "this is no less true under a uniform f.o.b. mill pricing system than under the basing-point system." "The distinctive influence of the basing-point system upon the location of fabricators," he says, "results (1) from the retardation or prevention of the establishment of a local source of supply under the system, and (2) from the maintenance of a high price differential between center and region even after a regional source of

<sup>23</sup> Assuming producers are properly located.

<sup>24</sup> P. 236.

<sup>25</sup> P. 237.

<sup>26</sup> P. 241.

supply has come into existence . . . under the basing-point system the regional fabricator has to pay transportation cost even when none is incurred.<sup>27</sup>

Point (1) in the preceding excerpt rests on the proposition that plant location under the system is irrational. The point is one that has already been discussed. Essentially the same reasoning is involved as in the previous example of mills A and D and the 18 consuming centers. The introduction of a far-away non-base mill does not essentially change the conclusion. Point (2), of course, implies "phantom freight" advantage for non-base mills, and irrational practice by distant sellers. It is not material that the distant mill is a non-base mill. The distant mill can become a base rather than a non-base mill without changing its economic situation in the slightest by simply announcing a base price which is higher than that of the nearest base by the freight rate from the closest basing point. Moreover, the distant mill can exert any economic advantage it possesses by lowering this base price under the system. It hardly seems reasonable to assume that the elimination of the system would entail foregoing any advantage that exists. And if the advantage does exist it can be exerted under the system. Certainly, f.o.b. pricing does not require the same price at all points of production, any more than a basing-point system requires uniform base prices.

If we suppose logical and rational behavior on the part of basing-point participants, it follows that mal-location of both producers and consumers is limited to delay occasioned by the lack of corrective pressure resulting from the lack of competition, and can not be regarded as a consequence uniquely attributable to a basing-point system. Significant departures from rational behavior are of course possible on the part of participants in basing-point systems, or for that matter, other systems. But to confine economic analysis to speculation concerning irrational motives is to rob it of its merit and to deny its very meaning.

Interestingly enough, if a rational model of basing-point behavior could be assumed, Machlup's conclusion concerning relief in the form of compulsory f.o.b. pricing seems to be strengthened rather than weakened. The author's chief doubt about the advisability of this pricing form is that he believes it might entail substantial industrial relocation.

Is Professor Machlup's remedy actually better than he thinks? This question poses complicated problems that cannot be dealt with thoroughly here. The question goes beyond the use of basing-point pricing as a system. The system depends upon cooperative action by competitors. The requirement of mandatory f.o.b. pricing means more than eliminating a cooperative system. It must also be thought necessary to guard against sporadic, non-systematic, non-collusive price discrimination including prices to meet an equally low price of a competitor. (This would in effect eliminate the qualifying clause in Section 2(b) of the Clayton Act as amended by the Robinson-Patman Act.)<sup>28</sup> Those who oppose compulsory f.o.b. pricing contend that the elimination of the basing-point system does not automatically make for enough sellers to achieve the kind of competition in which uniform mill net pricing is automatic.

When the number of sellers is limited, tacit price agreement is simplified. Because price discrimination is a principal vehicle for breaking fixed prices and forcing price competition it is urged that compulsory f.o.b. pricing may make for less rather than

<sup>27</sup> P. 242.

<sup>28</sup> 49 Stat. 1526 (1936), 15 U.S.C.A. § 13 (1941).

more competition.<sup>29</sup> On the other hand, as Professor Machlup stresses, there is the danger that price discrimination can lead to systematic dumping for the purpose of eliminating competitors. Discrimination, for such a purpose, however, is at present in violation of anti-trust law. Presumably Professor Machlup, unlike Professor J. M. Clark,<sup>30</sup> feels that the practical difficulty of establishing "purpose" is so great as to require administrative ruling of what must be done rather than the usual anti-trust method of only attempting to set out what can *not* be done.

Irrespective of the merits of compulsory f.o.b. pricing there seems to be legal and economic concurrence that basing-point systems should be outlawed. There can be no *system* of basing points meeting current standards of anti-trust law so long as it is held that "[i]t is enough to warrant a finding of a 'combination' within the meaning of the Sherman Act, if there is evidence that persons with knowledge that concerted action was contemplated and invited, give adherence to and then participate in a scheme."<sup>31</sup> Consequently, regardless what the verdict turns out to be about the rationality of the system, the cross-hauling of freight, the economics of location, or the oppression of the small by the large, advocates of systematic formula pricing are not likely to receive comfort from current economic analysis of the subject.

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**Labor Law: Cases, Materials and Comments.** By Charles O. Gregory and Harold A. Katz. Charlottesville: Michie Casebook Corp., 1948. Pp. xxi, 1324. \$9.50.

Unusual thought, discussion, and other energy have been devoted since the war to the content of law school courses in labor relations. The old content is widely deemed unsatisfactory for a number of reasons. Except for its concern with the National Labor Relations Act, it concentrates almost wholly on labor war, that is, the use of economic weapons—strikes, boycotts, picketing, and the like. And even the major portion of its concern with the National Labor Relations Act is directed to labor war, the unfair labor practices designed to discourage unionization. Practically no attention is paid to the relations of employees and unions for the greater periods of time in which they bargain collectively and adjust their differences without resort to the economic weapons. The materials, almost wholly judicial opinions, have not adequately expounded the real problems involved in the cases, nor the wider economic and social problems of which the cases are symptomatic; nor have the materials explored the possible methods of solution.<sup>1</sup>

While this casebook by Gregory and Katz is on the whole the best of the Labor Law

<sup>29</sup> A recent article by J. M. Clark, *Law and Economics of Basing-Points*, 39 *Am. Econ. Rev.* 430 (1949), develops this position at length.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Federal Trade Commission v. Cement Institute, et al.*, 333 U.S. 683 (1948).

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<sup>1</sup> The dissatisfaction was stated most effectively by Professor Wirtz in an address which led to the 1947 Conference on Training of Law Students in Labor Relations. Wirtz, *On Teaching Labor Law*, 42 *Ill. L. Rev.* 1 (1947). I do not mean to detract from the quality or the truth of his criticism by suggesting that Wirtz's talents would produce similar criticism of a goodly number of other courses in the law school curriculum.