

PRICE CONTROL DEVICES IN NRA CODES

By

GEORGE TERBORGH



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By
GEORGE TERBORGH

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DIRECTOR'S PREFACE

This is the third of a series of NRA studies undertaken by the Institute of Economics under the immediate direction of Leverett S. Lyon. This monograph is limited in its scope to an examination of the more important price regulating devices which have appeared in the first 250 codes approved.

The arrangements for the control of prices which have been developed by the Recovery Administration involve problems of administration as well as important issues of public policy. In this monograph the author has not dealt with issues of public policy. The purpose of the study is to present, at a time of widespread interest in the subject, an analysis of what has been done in price regulation in the codes thus far approved, together with a statement of certain of the more obvious difficulties of administration which will need to be resolved. It is believed that the study should prove valuable both to those whose most earnest efforts are devoted to the administration of the NRA and to the public who view the Recovery Act as an important part of the general recovery program.

The author wishes to acknowledge the assistance of Aaron V. Abramson, Robert T. Beall, and Hugo Bezdek, Jr. The members of the committee which co-operated with the author in preparing this study were Harold G. Moulton and Arnold Bennett Hall. We have also had the aid of an advisory committee of the Social Science Research Council.

EDWIN G. NOURSE

Director

Institute of Economics
February 1934

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CHAPTER I

INTRODUCTION

The National Industrial Recovery Act may prove to be the first general modification of the anti-trust laws since their enactment. It expressly exempts from their provisions any code or agreement effected under it, or any action taken in accordance with the terms of such code or agreement.¹

This exemption is qualified by two conditions stated in the Act. (1) Codes promulgated under it shall not permit monopolies or monopolistic practices.² (2) Nothing in the Act shall be construed to impair the powers of the Federal Trade Commission under the Federal Trade Commission Act, as amended.³ The precise significance of these qualifications is not clear, but in any event they have not deterred the NRA from approving codes containing a variety of arrangements for the control of prices and production, some of which appear to be definitely contrary to the anti-trust laws as heretofore interpreted by the courts.

Control of prices through the concerted action of competitors has long been impeded by these laws. The restraints imposed have run counter to the desire of many business groups to abate by common action what they are accustomed to characterize as "cut-throat" competition. For years these interests have supported

¹ Sec. 5.

² Sec. 3(a).

³ Sec. 3(b).

an agitation for the liberalization of the law, a movement which grew in force and insistence with the growing difficulties of business during the depression. The National Industrial Recovery Act seemed to most industrialists a sort of Magna Carta of business co-operation.

Under these circumstances it is not surprising that a great many proposed NRA codes carried schemes for the co-operative regulation of prices and production. An examination of the proposals discloses an astonishing armory of devices, limited in diversity only by the ingenuity of their proponents. In the process of code-making a number of them have been eliminated entirely while others have been granted only to some of the industries that originally requested them. In their early form these schemes are now significant merely as an indication of what the spokesmen of various industries wanted.

The present study is concerned not with what industry wanted but with what it has actually obtained. The following pages present the results of a survey of price and production control devices in the first 250 codes approved by the NRA. It should be clearly understood that no attempt is made to deal with the important questions of public policy involved in the official approval of these devices, or to appraise their practical effects as revealed in experience to date. Both of these tasks are reserved for a later study. Attention is centered here on the classification and description of the price-control arrangements covered, and on a consideration of some of the administrative problems inherent in their operation.

The center of interest is the individual price-control device itself, not the code or codes in which it appears.

Many codes contain several separate devices, the effect of which can only be considered in combination. Even if only one appears, its actual operation is colored by circumstances peculiar to the individual industry. The discussion that follows deals only with the general features of each device without reference to the peculiarities of its application in specific cases.

Even within this limitation, the survey makes no pretense to comprehensiveness. There is a large number of code provisions which in some degree modify or abridge the freedom of the individual member of an industry to control his own production and to make his own prices and terms of sale. We have attempted to discuss only four main types. (1) The fixing of minimum prices. (2) Prohibitions against selling below individual cost of production. (3) Open-price arrangements. (4) Limitation of production or productive capacity.

In discussing these forms of price control as they appear in the first 250 codes no implication is intended as to the probable permanency of the code provisions. It is well known that approved codes can be amended or modified at any time by administrative order. It is well known also that many of them were hastily considered and passed with the idea in view of possible revision. As originally ratified they represent merely a starting point.

CHAPTER II

PROVISIONS FOR THE FIXING OF MINIMUM PRICES OR MARK-UPS

A considerable number of approved codes provide machinery for the fixing of minimum prices or mark-ups that are uniform for all members of the industry selling the same goods in the same market.

These codes cover some of the largest and most important industries in the country, such as petroleum, bituminous coal, steel, and lumber, as well as others of distinctly minor significance like cigar containers, fire extinguishers, and excelsior. They govern not only the extraction of simple raw materials, but also the manufacturing of highly fabricated products. The diversity of these industries is noteworthy. An examination of the list fails to make clear the reasons why many of them were accorded a privilege of price fixing not generally granted to the ordinary run of businesses. The explanation of these apparent anomalies doubtless lies less in logic than in the exigencies of the code-making process.

While the codes for these industries apparently contemplate that uniform minimum prices shall govern all members selling the same goods in the same market, this principle is inapplicable in cases where the products to which the minimums relate are non-uniform as between competitors. It is obviously impracticable to enforce the same minimum prices on articles of varying design and quality. Allowances for such variations

must be made in the form of price differentials. The problem confronting the price-fixing agency may thus resolve itself into a determination of separate minimum prices for the products of each member of the industry.

Although many of the industries subject to minimum price fixing produce a variety of non-uniform and unstandardized goods, very few of their codes appear to recognize the complications introduced by this factor. In most cases the price-fixing scheme seems to be based on the assumption that a single minimum price can be made applicable to a group of competitors. This point should be kept in mind in connection with the following discussion of price-fixing devices and formulas.

With a single important exception (the fixing of dealers' resale prices by individual manufacturers) the minimum price-fixing devices covered in this survey provide that some body representing the industry shall make the initial decision as to what the minimum prices shall be.¹ In the majority of cases this body is the code authority. Codes differ as to whether the decision must be affirmatively approved by the NRA Administrator before it can become effective, but in all cases he retains the power to veto or suspend any prices to which he takes exception.²

In contrast to the comparative uniformity in the character of the price-fixing agency, we find a considerable variety in the character of the formulas by which prices are supposed to be fixed. The principles and administrative techniques which they outline seem

¹ This statement is not strictly true of the petroleum code, which authorizes the President to fix the price of gasoline. The administrative set-up in this industry is unique.

² There are some codes which do not expressly provide for a review of price fixing by the Administrator, but this omission in no way impairs his right to set aside price schedules deemed objectionable.

of sufficient interest to warrant a classification of the codes in this division in accordance with the price-fixing formula contained. Such a classification follows, accompanied by some comments on the definiteness and technical adequacy, from an administrative standpoint, of the several formulas presented.³

1. *Minimum prices shall be "fair and reasonable."* In this group fall a considerable number of codes that offer the price-fixing agency no other test of where minimum prices shall be fixed than some vague injunction of slight administrative value, like the mandate that they shall be "fair and reasonable."

These codes fall into two sub-groups distinguished by certain differences in administrative arrangements. In one of these the price-fixing agency is empowered to promulgate blanket minimum prices for the industry.⁴ In the other, minimum prices may be fixed by the piecemeal process of overruling particular price quotations filed by members of the industry and deemed by the authority unfair.⁵

"Fair and reasonable" prices are variously described. The bituminous coal code defines a fair market price as one necessary "to carry out the purposes of the National Recovery Act, to pay the minimum [wage] rates herein

³ It should be noted that in some of the codes cited below the fixing of prices is permitted, but not required; also that in some cases the price fixing is by districts, and may be done in the first instance by some trade body having only a regional jurisdiction. Since the interest here is in the formula rather than in the individual code, no effort is made to indicate specific instances in which these arrangements obtain.

⁴ Bituminous coal; cleaning and dyeing; domestic freight forwarding.

⁵ Iron and steel; paper and pulp; reinforcing materials; compressed air; heat exchange; pump manufacturing.

The authorities for some of these codes cannot compel an overruled price to be raised above the current price of the next lowest competitor, but since there is apparently nothing to prevent them from overruling this next lowest price, and the price above that, they should be able in this way to establish effective minimums—by elimination rather than by proclamation.

established, and to furnish employment for labor." It is added that it shall be proper to take into consideration the competition of other fuels or forms of energy. The cleaning and dyeing code describes fair and reasonable prices as those "sufficient for carrying out the purposes of the Act, to be consistent with the maintenance of minimum standards of quality prescribed by the code authority, to enable the trade to maintain the payment of at least minimum wages herein established, and other wages properly based thereon, the furnishing of stable employment necessary to maintain the trade, and other considerations reasonably pertinent thereto." The code authority for the iron and steel industry may overrule a member's posted price if, "having regard to the cost of manufacturing the product," it holds that the price may result in unfair competition in the industry.

It is apparent that none of these elaborations of the notion of "fair and reasonable" prices offers anything remotely approaching a definite formula. The price-fixing agencies in these industries are virtually given *carte blanche*.

2. *Minimum prices shall equal the "lowest reasonable cost of production."* This mandate, like the one just discussed, offers little of definite guidance to the administrative authorities. They can of course collect data on the costs of individual members of their industries but no method is set forth by which they can judge whose cost is the "lowest reasonable cost."⁶ In most cases they will have a wide range of individual costs to

⁶ This statement must be qualified by a reference to the merchandise warehousing code, which specifies that minimum charges "shall not be less than the lowest reasonable cost of the most efficient and lowest-cost operator in the locality."

choose from, and their selection can be no more exact than their notion of reasonableness.⁷

3. *Minimum prices shall equal the cost of the "lowest-cost representative firm."* From an administrative standpoint, this formula appears to differ little from the preceding ones. It substitutes the notion of a "representative" concern in place of the idea of "fairness" or "reasonableness."

A few of the codes in which this formula appears have something to say as to the meaning of the term "representative."⁸ That of the fire extinguishing appliance industry describes a "representative member" as "one who manufactures within his own plant a representative line of products of the industry, who maintains research and development departments for the improvement of the art of fire extinguishment, and who through educational publicity and sales promotion broadens the market and develops business for all members of the industry." The refractories code, although containing no definition, states that in no event shall a representative member be "construed in such a manner as to exclude from such classification more than 10 per cent of the total manufacturers of any particular product in

⁷ The following codes provide for the fixing of minimum prices at "lowest reasonable cost": merchandise warehousing; fur dressing and dyeing; millinery and dress trimming braid. The malleable iron code sets the minimum at "fair and reasonable" costs. A limited form of price fixing on the basis of "lowest reasonable cost" may be found in the silverware code.

A number of codes prohibit selling below the "reasonable cost of production," without making it quite clear whether the reasonable cost referred to is that of the individual member of the industry or that of the industry as a whole. If it is the latter, the formula of course constitutes a device for the establishment of a uniform minimum price. See the codes for the following industries: automatic sprinklers; cast-iron soil pipe; fishing tackle; ship-building; macaroni.

⁸ The formula occurs in the following codes: excelsior; motor vehicle storage; fire extinguishing appliances; refractories; rubber (automobile fabrics, rainwear, and mechanical rubber goods divisions); feldspar (mining).

any competitive district." The basic rubber code provides negatively that the term representative member "shall be deemed to exclude any member of the industry whose actual capital costs are unduly low due to the acquisition of plant at less than fair appraisal value, or to other exceptional circumstances out of the course of normal business." A representative producer of crude feldspar is described in the code for that business as "a member of the industry regularly engaged in the mining of feldspar and maintaining a permanent organization for conducting these operations."

The level of minimum prices fixed under these provisions depends partly on the cost-accounting systems used and partly on the number and character of concerns excluded from consideration as non-representative. Under the first of the definitions quoted a firm is classed as non-representative because it manufactures an incomplete line, has no research department, and does not support an advertising budget. This formula might be so applied as to prevent small concerns from competing on a price basis. The second definition makes it possible to class as non-representative that 10 per cent of the firms in any district who produce at the lowest cost, without limitation on the percentage of the volume of production covered. With any of the foregoing definitions, or with no definition at all, the code authority has wide latitude of decision, and the minimum price fixed may vary accordingly within wide limits.

4. *Minimum prices shall be "compensatory."* We have here another word comparable to "fair," "reasonable," and "representative." The idea of adequate compensation appears to control the fixing of fees and service charges contemplated under the banking code. Minimum fees for trust services are to be determined

“on the basis of the cost of the service rendered and the responsibilities assumed.” Other service charges are to be fixed “in accordance with the practice now in effect whereby services rendered by banks shall be compensated for either by adequate balances carried or by a scale of charges.”

In the absence of any statement as to how the cost of rendering a service shall be computed, or any indication of whose cost shall determine the fixing of fees when costs differ among the institutions subject to a uniform fee schedule, we may class this formula with the preceding ones.

5. *Minimum prices shall equal the “weighted average cost” of production.* Unlike the four so-called formulas just discussed, this one does embody a fairly definite, quantitative test. It contemplates that the price-fixing agency shall compile weighted averages of the individual costs of production reported by members of the industry and fix minimum prices to coincide with these averages.⁹

This arrangement appears to reduce to a minimum the discretionary element in price fixing. It results, however, in a rigid and inflexible pattern of minimum prices for the various products of an industry which is almost certain to prove impossible of application when and if the minimums are effective. Such a pattern of prices ignores not only the conditions of competition between the different items and products sold by the industry, but the competition of these products with those of other industries.

One of the codes containing this formula, that of the

⁹ The arrangement appears in the following codes: lumber; lime; cigar container. The code for the slate industry provides for the use of average, rather than weighted average, cost. An interesting feature of this code is a stipulation that in computing the average the costs of at least 40 per cent of the members of the industry having the highest costs shall be excluded.

lumber industry, attempts to avoid such an impossible freezing of relative prices by providing that it is "the weighted average minimum price" of all the items and classifications of products derived from a single species which shall be related to the weighted average cost of production, leaving to the discretion of the price-fixing agency the minimum price to be set for each separate item. The relative prices of different species are further made flexible by the proviso that "such minimum prices shall be established with due regard to the maintenance of free competition among species, divisions, and subdivisions, and with the products of other industries and other countries, and to the encouragement of the use of said products." To this is added an arrangement by which weighted average costs of production may be figured in two different ways, leaving it discretionary with the price-fixing agency to use any figure falling between the results of these two methods. These various qualifications are effective in securing flexibility, but they raise a doubt as to what is left of the formula. It appears that most of the decisions of the administering authority must be made without reference to it, and with no guidance from it.

The code for the cigar-container industry appears to recognize the difficulty of price rigidity inherent in the formula, but the solution of the problem is uncertain. After authorizing the code authority to establish minimum prices for the various types of containers manufactured by the industry it stipulates that "such minimum prices shall be established with due regard to the maintenance of free competition among the various types of containers, with the products of other industries, and to the encouragement of the use of said products; and shall be not more nor less than the

weighted average costs determined as provided in this article and under such rules and regulations as the authority may from time to time adopt and issue." Nothing in the article referred to sheds any light on how the inflexibility of a weighted average cost system of price fixing may be relaxed.

The only other modifying provision in codes employing this formula occurs in the slate code, which permits certain inventory liquidation.

6. *Minimum mark-ups shall equal the "modal" cost of handling and selling.* This is another mathematical formula similar to the one just discussed. It occurs in two mercantile codes.¹⁰ Members of the trade are forbidden to sell merchandise at less than its actual cost to them plus a mark-up equal to the modal selling and delivery expense for the trade as a whole. This modal expense is determined by the trade authority from reports on individual costs submitted by members of the trade and computed in accordance with an accounting system which it prescribes.

The determination of modal costs may be easy or nearly impossible, depending upon the character of the data. A frequency distribution of reported individual costs may show no clearly defined mode. There may be more than one modal area. In such cases the code authority is called upon to make some very arbitrary decisions. Even if the mode is clearly distinguished, it may lie almost anywhere in the range of individual costs and the result may be more a statistical accident than anything else. If the determination of modal selling costs is carried out separately for the various items of merchandise dealt in there is no assurance that the resultant pattern of minimum mark-ups will not be

¹⁰ Retail lumber and builders' supplies.

practically unworkable. It may add to the rigidity noted in the case of a weighted average cost system of price fixing this further handicap of eccentricity, making necessary a degree of administrative modification that amounts to a virtual scrapping of the formula.

The foregoing price-fixing formulas fall quite definitely into two classes—the non-mathematical and the mathematical. The former in general do very little to qualify the free discretion of the administrative authorities. The latter, if faithfully executed, are likely to lead to an impossible rigidity of the price structure which must be relaxed by methods which involve the abandonment of arithmetic. Once the arithmetic is left behind, the price-fixing agency may be as much at sea as if it had merely a formula of the first type to work from.¹¹

The truth appears to be that price fixing necessarily requires the exercise of a large degree of discretionary authority. Administration must deal not only with the problem of setting minimum price schedules that will keep goods moving against the competition of other goods or industries, preserve something like the existing balance of competitive opportunity, and satisfy the members of the industry well enough to make enforcement possible; it must deal also with innumerable special and individual exceptions to the minimum prices fixed, such as limited exemptions for close-outs, seasonal liquidations, and the sale of seconds, damaged goods, and the like. Flexibility is essential.

In view of the number and complexity of these ad-

¹¹ A couple of codes that do not fall readily into the preceding classification may be mentioned at this point. The petroleum code authorizes minimum price fixing but contains no formula. The code for the bedding manufacturing industry empowers the authority to adopt a system for determining "standard costs."

ministrative problems, it is a fair question whether more than a fraction of the specific decisions of the price-fixing agency can be effectively reviewed by the Administrator or his representatives. Even where complaints are reviewed, there remains the question whether the tests and standards for proper price fixing are in the general run of cases sufficiently definite to permit of other than essentially political decisions between conflicting interests.

Even after such decisions are arrived at, there remains the problem of getting them observed. While the task of enforcing a system of fixed minimum prices is not likely to be entirely easy anywhere, in some industries it promises to be exceedingly difficult. Many of the industries covered by the devices just discussed have a numerous and widely scattered membership. Others produce a great diversity of products. Some present both characteristics. The number of separate minimum prices to be fixed and enforced by the administrative authority in a single industry may run into the thousands.

The task of policing such an arrangement is likely to be aggravated in many cases by the fact that the price fixing is prejudicial to the interests of some sections of the industry, the active resistance of which is added to the other difficulties confronting the code authority. The evasions and concealments available to dissenters who are determined to avoid the scheme are as numerous and varied as they are elusive.¹² Only experience can tell how successfully such unfavorable conditions can be dealt with.

The foregoing discussion has concerned the fixing of minimum prices or mark-ups by trade agencies, subject

¹² Some of them are discussed in Chap. IV of this study.

to the veto of the NRA Administrator. Another type of price fixing appears in a number of approved codes, the maintenance of dealers' resale prices as prescribed by manufacturers. This has the effect of fixing uniform mark-ups for all dealers who buy their goods on the same terms and uniform prices for all dealers irrespective of the terms of purchase.

Resale price maintenance is of interest here only in so far as the codes authorize or compel its observance by the concurrent action of manufacturers or dealers. Several codes for dealers make it mandatory.¹³ In manufacturing codes, provisions for the enforcement of resale price maintenance by dealers necessarily take the form of some arrangement for the boycotting of dealers who violate, or do not agree to observe, the established resale prices. Such boycotting is made compulsory in a number of codes, while in others the manufacturers are authorized but not compelled to boycott.¹⁴

This completes the presentation of devices for the fixing of minimum prices or mark-ups. A much more numerous category of arrangements remains to be considered, namely, those which aim at preventing the sale of goods at prices below the cost of production of the individual producers who offer them on the market. This group of devices is discussed in the following chapter.

¹³ Machine-tool and equipment distributing; motor-vehicle retailing (for parts and accessories); automobile wholesaling.

¹⁴ Codes in which boycotting is compulsory: asbestos; buff and polishing wheel; rock crusher; warm-air furnace; saddlery. The saddlery code contemplates the fixing of standard terms for resale by the trade body. Codes in which boycotting is authorized but not required: petroleum; copper and brass mill products; gasoline pump (amended).

CHAPTER III

PROVISIONS AGAINST SELLING BELOW INDIVIDUAL COST OF PRODUCTION

Prohibitions against selling an article below its cost of production constitute the most common price-control device to be found in the 250 approved codes reviewed in this study. They appear in more than half of these codes.

Unlike arrangements for fixing a single minimum price that is uniform for all members of an industry selling the same article in the same market, this device appears to call for a multiplicity of minimum prices even in the case of identical competitive goods. Since each producer is forbidden to sell below his own individual cost of production, that cost constitutes his own minimum price. There may be as many minimum prices for an article as there are producers.

The probable effects of such an arrangement are obvious. All producers whose cost exceeds the current market price for an article are left without the possibility of lawfully carrying on business. There are probably few industries in which there are not at all times a few and sometimes many producers who are unable, at market prices, to recoup their costs. This condition may be temporary for particular concerns, or it may relate only to certain items of their production; but while it continues, and for the items concerned, the prohibition against selling below cost is a prohibition against selling at all.

It is difficult to believe that codes of fair competition were intended to accomplish this result. Nor is it easier to believe that the relevant provisions of the codes could be enforced in cases where they operate to exclude from the market any significant number of producers. To obviate the difficulties inherent in this situation, somewhat more than half of the codes with no-selling-below-cost provisions contain a saving clause permitting a member to sell below his cost where necessary to meet the competition of another member whose cost is lower.¹

It seems likely that the saving clause will be administratively read into codes in which it does not appear, thus eliminating the anomaly of multiple minimum prices on the same goods in the same market. In the following discussion we shall proceed on the assumption that the absence of the clause is a matter of no practical significance, and that all codes will be so interpreted as to allow high-cost producers to meet competition.

I. THE FORMULA AS A PRICE-CONTROL DEVICE

Let us consider the prohibition against selling below individual cost, plus the saving clause, as a device for price control. Its prevalence in codes in all probability results from the notion that it puts some kind of a "bottom" under prices, that it sets a limit below which "cut-throat competition" will not be permitted to go. What is the lower limit of prices under this plan? If the formula is applied in strict accordance with its terms, prices may possibly decline until they equal the cost of the lowest-cost producer in the market. Until

¹ A common statement of the saving clause permits selling below cost to meet the price of a competitor on an identical or substantially similar article when the competitor is not selling below his own cost.

this point is reached it does not preclude further price cutting.

While the formula theoretically puts under prices no absolute bottom higher than the cost of the lowest-cost producer, it may in practice reduce price cutting by limiting the number of competitors who are entitled to initiate price reductions. While the so-called saving clause, as indicated, permits selling below cost when necessary to meet competition, it does not authorize a concern to initiate reductions that bring its prices below its own costs. The producer who is selling below cost can follow prices down, but cannot force them down. The initiative must come from those who can cut without violating their costs.

This statement on the character of the price control involved in the formula is purely theoretical. The effects of its application in practice depend on the administration given it. As a price-control device the scheme is novel and untried and its enforcement involves the exercise of the widest sort of administrative discretion. What code authorities will try to make of it depends in considerable degree on what they want it to accomplish. If it is desired merely to prevent price cutting by high-cost concerns which are selling below their own costs, a fairly strict and literal interpretation of the formula may be satisfactory. If, on the other hand, it is desired to abate the competition of strong producers whose low costs enable them to make money while selling at prices that are unprofitable to their weaker competitors, a strict interpretation would be of little effect. The formula does not protect a market against this type of competition.

There is reason to believe that the formula was written into many codes with but slight understanding

of its significance on the part of the industry affected. In many cases the proponents of a code have assumed that it affords quite a different sort of "price protection" than its terms justify. In other cases they have accepted the formula as the only one that the NRA was prepared to grant them. An industry whose membership is determined to prevent price cutting by high-cost and low-cost producers alike may be acutely dissatisfied with a weapon aimed only at concerns whose costs are above the market price. This dissatisfaction, it hardly need be said, is an unfavorable background for a strict and literal enforcement of the formula.

II. ADMINISTRATION OF THE FORMULA

Since the actual effects of a prohibition against selling below cost must depend so largely on the decisions of the administrative authorities, it is desirable to give some attention to the nature of the administrative problems involved in the enforcement of the prohibition. Only by some understanding of these problems is it possible to forecast the probable drift of enforcement policy.

1. *The general administrative set-up.* The typical arrangement in codes with no-selling-below-cost provisions may be briefly described as follows. The code authority is instructed to prepare, or to have prepared for it, a cost-accounting system deemed suitable to the industry. After this system is approved by the Administrator it must be installed by the members of the industry.² Thereafter no member may sell below cost of production as computed by the approved accounting

² A few codes permit members to use their own systems if they are satisfactory to the code authority, and a considerable number permit the use of a system "as detailed and complete" as the official system.

formula, except as permitted to meet competition.³ The code authority may proceed, either on complaint or on its own motion, to investigate suspected violations of this provision. It then decides whether there has been selling below cost and if so whether it was permissible as a legitimate meeting of competition. If it holds that the code has been violated, it initiates proceedings to terminate the practice.⁴

The difficulties arising in the various stages of this administrative process are legion. We shall make no attempt to deal with them comprehensively, but shall confine discussion to only two general problems peculiar to the enforcement of a no-selling-below-cost formula: (1) Ascertaining "cost of production"; and (2) deciding what is a legitimate "meeting of competition."

2. *Ascertaining "cost of production."* The code authority must be able at any time to determine the cost of production of every article separately quoted and sold by every member of the industry. The number of different items in many cases runs into the hundreds and thousands. Anyone even slightly familiar with the intricacies of cost accounting will be impressed by the appalling difficulties of this task. Almost every

³ Many codes permit the authority to make certain exemptions in the case of close-outs, seconds, damaged goods, seasonal liquidations of stocks, and the like. The difficulty of administering these provisions may be very considerable.

⁴ Most codes contain no special provisions relating to procedure in case of suspected violations of no-selling-below-cost provisions. The steps outlined are typical of the provisions of codes which do set out a special procedure. Provisions differ considerably as to disciplinary measures in cases of proved violations. Some codes go no further than a provision for "investigation and report." Some provide for declaring an offending price to be "null and void." Others require the code authority to report the case to the Administrator for prosecution. A number empower the authority to void an offending price and to require the filing of a new price which shall be "fair" or otherwise acceptable.

instance involves the thorny problem of allocating overhead among different items of production, and many cases present the necessity of allocating joint labor or material costs as well.⁵ To these problems of allocation must be added those arising from the variability of direct and overhead costs with changes in the rate of plant utilization, and from numerous other factors.⁶

Although cost accounting when properly adjusted to the conditions of the individual business establishment may be a valuable aid to intelligent management, a great many industries whose codes make the practice of cost accounting mandatory have heretofore made but slight use of it. The installation and operation of a reasonably uniform system in such cases is likely to present a great deal of difficulty. It involves not only the solution of the technical problems, which may be

⁵ Most codes contain no definition of cost of production, merely leaving the formulation of a costing system to the code authority. There are enough which offer definitions, however, to give a fairly good idea of what is covered. The enumerations of elements included in cost vary considerably in comprehensiveness, and are not uniformly consistent as to all items, but it is reasonably clear that the general conception of cost is a broad one. Definitions uniformly include some overhead as well as all direct costs. Many cover virtually complete overhead. Upon a survey of overhead items, the inclusion of which has been repeatedly approved by the NRA, one reaches the conclusion that few are definitely barred. The line does appear to be drawn, however, between overhead costs (including charges for depreciation, depletion, and obsolescence) on the one hand and return on investment (including interest on borrowed capital) on the other. The latter is almost uniformly excluded.

⁶ Some students have observed that since theoretically it is only the cost of the lowest-cost producer in a market which constitutes a final barrier to price cutting, it should not be necessary to compute costs of production for higher-cost producers. This view ignores not only the mandate of the codes, which impose cost accounting on all members of the industry where they impose it at all, but also the provision that no competitor can initiate price reductions below his own cost of production. This provision requires the general observance of cost accounting.

very intricate, but the imposition of considerable expense upon the members of the industry.⁷

The difficulty of this task constitutes a strong reason for the adoption of as many artificial simplifications as possible in the cost-accounting procedures employed. Although it may seem that from a theoretical standpoint the determination of whether a certain producer is selling below his cost should rest on a comparison of his net realization from the sale of a given item and his actual cost of producing it, the measurement of the actual cost would require an appraisal of all the special circumstances attending its production and sale, a task that is for practical purposes unmanageable. For administrative reasons costs must be figured by the use of conventional and more or less arbitrary assumptions which obscure the effects of special circumstances and result in a computed cost that may differ widely from the actual current cost at the time a particular item is produced.

As a consequence of the practical necessities of accounting procedure, there is likely to be a tendency toward an unrealistic stability and uniformity in costs as computed for code purposes. Unreal stability may characterize the computed costs of a single producer over a period of time.⁸ Unreal uniformity may appear in the costs of different producers computed for the same time.

Since accounting rules or assumptions that obscure

⁷ The burden of expense is likely to fall with special severity on small concerns with simple bookkeeping methods.

⁸ One example occurs in the provisions of several codes to the effect that overhead shall be computed on the basis of a fixed rate of plant utilization rather than on the actual rate. Electrotyping and stereotyping; paint and varnish; cement; waterproofing materials; concrete; road machinery (optional). The dental laboratory code prescribes that all costs shall be computed on the basis of "normal operations." Another example occurs

differences in the costs of competitors may be used in connection with no-selling-below-cost provisions to further the establishment of uniform minimum prices, it may be well to mention rules of this character appearing in approved codes. (1) A trade body shall average the overhead costs of members of the industry and the average shall be used thereafter by each member instead of his own overhead.⁹ (2) All members of the industry are to account the cost of raw materials at their current market value, regardless of when or at what prices they were actually bought.¹⁰ (3) Members of the industry who both produce the raw material and fabricate it must charge themselves as fabricators the market price for the raw material (the detailed provisions differ somewhat).¹¹ (4) The code authority or the Administrator shall fix a uniform allowance for the wages of labor.¹² (5) The code authority shall compute average transportation cost for the members of each division of the industry, which cost shall thereafter be used by each member instead of his own.¹³

Rules of this kind tend to give every producer the same cost as every other producer on items subject to their operation. The degree to which they make total costs uniform depends, of course, on the relative im-

in the crushed stone and asphalt shingle codes, which provide for the calculation of overhead costs per unit as a fixed percentage of direct costs. A third type of rule provides that a producer's cost for some previous period, rather than his current cost, shall determine whether he is violating the no-selling-below-cost provision. Paper and pulp; paper bag; paper stationery and tablet; canning and packing machinery (optional).

⁹ Vitrified clay; sewer pipe; and structural clay products.

¹⁰ Paint and varnish; electric storage battery; motion-picture laboratory; textile bag; paper bag; smelting and refining of secondary metals; corrugated and solid fibre shipping containers.

¹¹ Limestone; feldspar; corrugated and solid fibre shipping containers.

¹² This rule appears in most of the codes governing retail and wholesale trades.

¹³ Paper bag.

portance of the affected items. In so far as they operate to raise fictitiously the computed costs of the low-cost producers in an industry, they raise whatever "bottom" is put under prices by the no-selling-below-cost formula.

We have already stated that comparatively few codes contain even definitions of cost, much less cost-accounting systems. The fragmentary nature of the data precludes even a conjecture as to how far the NRA will eventually go in sanctioning accounting rules that operate to impose standard or uniform costs for code purposes. A great deal will depend upon developments along this line.

3. *Deciding what is a legitimate "meeting of competition."* The foregoing discussion of the administrative difficulties involved in determining cost of production leads to another set of problems that may prove on occasion quite as thorny. These have to do with the administration of the saving clause permitting selling below cost to meet competition.¹⁴

When some member of an industry invokes the saving clause to justify prices below his cost of production, the usual requirement is that he must inform the code authority (or other trade body having jurisdiction) as to the particular producers and products whose competition he is meeting. The authority must then decide (1) whether the products cited are sufficiently competitive with his to entitle him to the benefits of the saving clause, and (2) whether his prices constitute a proper "meeting" of the competition of these products.

These decisions may be relatively easy in the case of

¹⁴ In providing only for selling below cost to meet competition by other members of the same industry, the codes ignore the fact that it may frequently be necessary to sell below cost to meet the competition of substitute products turned out by other industries.

industries producing standardized or identical goods, but they may be exceedingly difficult when the industry in question produces non-uniform goods of varying design and quality. In this type of industry the degrees to which different products are competitive with each other may vary within a wide range. Even if the code authority can decide what degree of competition is necessary to justify invoking the saving clause, it may be unable in a particular case to determine whether that degree is present. If it does make this determination it is confronted with the further problem of deciding what pattern of relative prices for the competitive goods constitutes a "meeting" of competition.¹⁵

We refer here to a "pattern of relative prices" for the reason that when competitive articles differ in character and quality a meeting of prices is clearly not a meeting of competition. Competition can be met on even terms only by unequal prices. It is not easy to see how code authorities charged with administering the saving clause in an industry of this type can avoid ruling on price differentials between competitive goods. If they begin doing this, it is a fair question whether they can stop short of a widespread extension of the practice. The set-up seems logically to tend toward general price fixing by code authorities for products sold below cost by virtue of the saving clause. The administrative difficulties inherent in such an undertaking are obvious.

The foregoing discussion of cost determination and the operation of the saving clause is brief and sketchy, but it is sufficient at least to suggest the problems that must be dealt with if a no-selling-below-cost scheme is

¹⁵ It should not be supposed that this situation will occur infrequently. The very large majority of codes carrying no-selling-below-cost provisions are for industries in which the products of different members are non-identical.

to be successfully administered.¹⁶ The difficulties encountered in installing and policing the system are certain to vary widely from one industry to another, depending on the character of the products, the number of competitors, the marketing arrangements, the accounting practices, and many other factors.

In view of the seriousness of the administrative problems involved, it seems likely that many if not most industries will find it impracticable to execute the scheme in anything like an exact and literal manner.¹⁷ The authorities in such cases must face the alternative of letting the relevant provisions of the code go unenforced entirely, or of enforcing them in some rough and ready fashion designed to assist in such price control as the members of the industry desire. The less possible it is to administer the formula in strict accordance with its terms the greater the temptation to use it irregularly as a pretext for actions which it does not really support. We may repeat here the observation made in connection with cost accounting—that what is done with a formula in actual practice will be largely determined by what the industry wants to accomplish, and by the character of the control exercised by the NRA authorities. To this we may add a third factor, the ability of the trade authorities to enforce upon dissenters such price control as they desire and the NRA does not prevent.

¹⁶ Further administrative problems common to this and other price-control devices are discussed in the following chapter.

¹⁷ We have not mentioned one administrative problem that seems likely in many cases to add to the difficulties already described. It frequently happens that several different codes are in effect in the same establishment. Where this occurs the management may be faced with the problem of operating as many different cost-accounting systems as there are codes to which it is subject.

CHAPTER IV

OPEN-PRICE PROVISIONS

Nearly half of the approved codes covered in this study contain provisions for some kind of an open-price system. The arrangements, although similar in essentials, differ so widely in details that we shall attempt only a generalized description of their principal features.

Codes with open-price plans typically require that within a specified period after the effective date the members of the industry must file with the code authority or some other designated body and publish to the trade the prices, discounts, and terms of sale on which they are transacting business. Thereafter, until revisions of these schedules have been duly put into effect, the members are forbidden to carry on business, except in some cases with express permission, at prices or on terms other than those filed.¹

With few exceptions the codes require that revisions of price schedules must be filed and published for a prescribed period of time before they can become effective. A ten-day waiting period is specified in nearly 60 per cent of the codes, a five-day period in about 20 per cent,

¹ Copies of filed schedules are usually sent out to the members of the industry as a matter of routine, or, less frequently, the original schedules are open to inspection at the central offices. Only about 20 per cent of the open-price arrangements examined provide that the central filing body shall make the schedules available to others than members, although members themselves are nearly always required to make public their own lists.

and periods in excess of ten days in nearly 10 per cent.² An exemption from the compulsory waiting period is usually granted to the competitors of a member who has filed notice of a revision, by virtue of which they are permitted to announce revisions effective on the same date as the one first announced. In most cases they cannot claim this exception, however, if they announce revised net prices lower than those announced by the member initiating the revision.³

I. OPEN-PRICE SYSTEMS AND PRICE CONTROL

Open-price reporting may be considered either as an administrative aid to the enforcement of types of price control discussed in the preceding chapters or as a separate and independent price-control device.

1. Open pricing as an aid to other forms of price control. Prohibitions against selling below a fixed minimum price or below individual cost of production are unenforceable when the administrative authority does not know, or cannot readily ascertain, at what prices the members of the industry are selling their products. It must know not only the nominal prices but the actual net realization after all discounts, rebates, allowances, and adjustments. This is by no means a simple matter. The devices which have been developed in industry and trade for the purpose of selling goods

² An NRA administrative order dated Jan. 27, 1934 stayed the operation of waiting periods provided in codes subsequently approved. This order affects about 15 of the 250 codes surveyed here.

³ The provision permitting competitors of a member posting a revision to revise their own prices effective on the same date raises administrative problems somewhat similar to those discussed in connection with selling below cost to meet competition. When notice of a price revision on certain articles is filed the administrative body must be prepared to decide what products of other members are sufficiently competitive with these articles to entitle them to price revisions simultaneously effective. The language of the codes on this point is exceedingly vague.

below their standard or nominal prices are almost infinitely numerous and varied.⁴ They are frequently extremely elusive.

Such devices have been developed in the absence of any legal barriers to overt price cutting. Their purpose generally has been to conceal price cutting from competitors, to entice customers with special bargaining, or to cut below a self-imposed standard price while nominally maintaining it. To these prevalent motives many NRA codes add another: the desire to evade restrictions on price cutting. When code prohibitions against selling below fixed minimum prices or below individual cost of production prevent a member of an industry from making desired price reductions he is given a strong inducement to make his selling price appear to be higher than it really is.

Open-price systems make a direct attack on price concealing practices by requiring sellers to adhere to price schedules and terms of sale on file in some central place and known to competitors and customers. In so far as this operates to keep the administrative body correctly and continuously informed of what the members of an industry are getting for their goods, it supplies one of the indispensable requirements for successful price control. The probable efficacy of open-price systems for this purpose can best be estimated after a consideration of the administrative difficulties involved in their enforcement, a subject to which we shall refer later.

2. *Open pricing as an independent price-control device.*
In form, open-price systems appear to be entirely

⁴For extensive studies of two of these devices, see Leverett S. Lyon, *The Economics of Free Deals*, recently presented as the first of the series of NRA publications of the Brookings Institution, and *Advertising Allowances* by the same author.

innocuous. Unless they are tied in with some other arrangement which itself constitutes price control, they put no bottom under prices and interpose no barrier to price cutting other than the prescribed waiting period. If the mere availability of information on prices that members of an industry are currently charging and on contemplated changes in these prices results in price control, it is because the information gives an opportunity for collusive agreements among competitors and for the exercise of "moral suasion" and duress to prevent a member of an industry from putting into effect, or maintaining, prices deemed objectionable by his fellow members.

No one familiar with the forms of pressure that have been used in certain cases to force recalcitrant members of an industry into line can fail to appreciate the possibilities inherent in such informal methods of price control. Yet it is certainly a mistake to assume that such collusive activities are a necessary result of the mere availability of information as to what competitors are charging. There are a great many industries in which the prices and terms of each member are generally known without the formalities of open-price reporting but which are nevertheless free from concerted control over prices.

Collusive price control is not only absent from many lines of business in which price information is available; it is impracticable in many cases, by the purely informal methods we are discussing, irrespective of such information. The number of competitors may be too large, the products too heterogeneous, the *esprit de corps* of the membership too weak. There may be no consensus of opinion on the desirability of such control, or a few important dissenters may checkmate the majority. It

is doubtful if there are many industries in which conditions are suitable for this type of price control and in which the members have been prevented from carrying it out merely because of the lack of a formal open-price system.

These considerations do not alter the fact that open-price reporting, especially if accompanied by the compulsory waiting period previously cited, may, when other conditions are favorable, prove of material assistance in the maintenance of collusive price control. The filing requirements may, for example, effect a compulsory standardization of discounts and terms of sales which facilitates a comparison of competitive prices and simplifies the enforcement of understandings and agreements.⁵ Even in the absence of such standardization, the requirement that sellers must adhere to their own terms of sale as filed may, if successfully enforced, obviate the use of secret practices and special selling arrangements which are inimical to the accomplishment of price control, even of an informal character. The publicity provisions may serve to abolish secret competitive bidding on contracts. In these and other ways an open-price system can facilitate collusion in price making where the desire for collusion is present and where the industrial setting is otherwise favorable.

⁵ A few of the open-price codes authorize the administrative agency to draw up and enforce standard forms of sales contracts for the industry. A considerable number either fix, or authorize the agency to fix, uniform time, trade, and quantity discounts. Uniform classifications of customers, or permission for the code authority to make such classifications, occur in about a fifth or a quarter of these codes. In the majority of cases, however, the individual member of the industry is apparently free to decide on his own discounts, customer classification, and terms of sale subject only to the requirement that he file and publish them in accordance with the terms of the open-price arrangement.

It seems likely that the amount of price control effected under an open-price scheme will depend in any given case more upon the psychological and industrial background than upon the precise terms of the scheme itself. If the products and marketing arrangements are suitable, and if there exists among the members of the industry a strong sentiment in favor of some form of collusive action, it may be doubted if minor alterations in the open-price set-up (such, for example, as the elimination of the waiting period) will materially change the situation. Informal price control through "gentlemen's agreements," "follow-the-leader" policies, and similar arrangements is apt to be not only elusive but highly variable. Because it depends so largely on psychological factors it may be comparatively independent of the formal mechanism of the open-price system.⁶

II. SOME ADMINISTRATIVE PROBLEMS IN THE OPERATION OF OPEN-PRICE SYSTEMS

Whether an open-price system is used as an independent price-control device or as an adjunct to the enforcement of minimum-price-fixing or no-selling-below-cost provisions, it should serve to disclose to the administering authorities just what the members of an industry are getting for the goods they sell. For this purpose it is necessary not only that the members abide by the terms of sale filed with the authorities, but also that the terms as filed include every material feature of a transaction effected under them. Otherwise, terms

⁶ It is a fair question whether the organization, the co-operative activity, and the personal contacts developed in many industries through the process of obtaining and administering NRA codes may not prove to be far more important in furthering informal price control than any open-pricing mechanisms which the codes provide.

not covered by the open-price schedules may be so modified and varied as to conceal effectively the seller's actual realization from a transaction. It is the actual net realizations of different sellers, not their nominal prices, which are important for code purposes. Unless the prices and terms filed enable the code authority and the members of a trade satisfactorily to compare these realizations, the open-price scheme fails of its purpose.

To secure the filing of prices and terms of sale that will make possible such a comparison is in many cases a difficult undertaking. We have already alluded to the multiplicity of devices that have been developed for selling goods below their nominal prices. Such devices, unless expressly forbidden, may be conveniently employed to sell goods below the prices filed under open-price arrangements.

By way of giving some idea of the number and variety of expedients that may be used for obscuring sellers' realizations, we have prepared the following classified list of so-called "unfair" marketing practices forbidden in the codes under review. Each of the practices cited appears in at least one of these codes.⁷

Collateral transactions with customers. (1) Contributions to customer's advertising costs; (2) purchase of his receivables; (3) payment of excessive rentals for use of a part of his premises; (4) loans to or endorsements for him; (5) purchase from him of patents, stocks of

⁷ It should not be inferred that these practices were forbidden primarily to facilitate the operation of open-price or similar schemes. Generally speaking, the code-makers were less concerned with trying to anticipate possible new devices for evading code regulations on prices than with eliminating "unfair trade practices" already afflicting the industry. The devices cited below constitute only one of several types of "unfair trade practices" forbidden in the codes.

competitors' materials, or other articles; (6) offering him products not subject to the code at abnormally low prices; (7) purchase of capital stock or other interest in his business.

Excessive services to customers. (1) Providing unusual and excessive maintenance or servicing of goods sold; (2) furnishing uncustomary free storage for a customer's goods; (3) excessive furnishing of demonstrators; (4) making unusual estimates or surveys free of charge; (5) giving uncustomary free installation service; (6) offering excessive guarantees or warranties; (7) furnishing special containers or formulas without adequate charge.

Exceptional adjustments and allowances. (1) Excessive returns of merchandise; (2) excessive adjustments for "defective" merchandise or alleged "shortages"; (3) excessive trade-in allowances, such as the taking of "seconds" as "firsts"; (4) improper settlement of old accounts at less than the full amount; (5) permitting improper deductions when buyer remits.

Improper use of commissions and gratuities. (1) Commercial bribery; (2) excessive use of entertainment, "gifts," and the like; (3) splitting commissions with the buyer's agent; (4) contributing to the salary or commissions of the buyer's agent; (5) payment of dealer's or agent's commissions to persons other than dealers or agents.

Special transportation favors. (1) Uncontracted reimbursement of buyers for transportation charges; (2) furnishing cartage outside the normal city delivery area; (3) allowing freight at other than the lowest rate effective on the date of shipment; (4) assumption of freight charges for some but not all buyers; (5) false classification of goods to give the customer a lower

freight rate; (6) giving other uncustomary transportation services without special compensation.

Special discount arrangements. (1) Selling S. D. B. L. and then waiving payment of cash; (2) selling on time, consignment, or open bill of lading at S. D. B. L. prices; (3) making small deliveries on large orders at large-order prices; (4) pooling orders of several buyers to give each a better price; (5) sale of an indefinite quantity at a certain price; (6) increasing the discount on a product in consideration of large purchases of another product; (7) price discrimination between buyers of the same quantity; (8) selling to buyers of one class at discounts for buyers of another class; (9) price discrimination between buyers of the same class; (10) failure to observe published discount schedules.

Bonus and penalty clauses in contracts. (1) Accepting contracts subject to unreasonable penalty provisions; (2) making contracts providing for liquidated damages; (3) deducting from the price anticipated, bonuses to be earned on a contract; (4) agreement with buyers that certain clauses of contracts will not be enforced.

Miscellaneous practices. (1) Selling for a certain share of the goods produced with an article; (2) sale of a combination of articles for less than the sum of the separate prices; (3) selling on consignment; (4) shipping goods to a buyer without an order; (5) selling goods with a repurchase agreement; (6) giving overweights; (7) billing for a grade of goods lower than the grade shipped; (8) giving of prizes, premiums, and free deals; (9) improper sales as "dropped lines," "surplus stocks," or "seconds"; (10) reducing the price of a new appliance under the pretense that it is a demonstrator; (11) false invoicing; (12) false marking or advertising to conceal prices; (13) improper continuance or extension of old

contracts more favorable to the buyer than the current published prices.

The mere enumeration of these marketing practices is sufficient to indicate the extraordinary difficulty of setting up a system of open-price reporting that will preclude the use of devices to make the seller's actual realization other than it appears to be. Many of the practices listed are generally considered legitimate if used in a customary manner. The test of improper use is not defined beyond the meaning of such vague terms as "excessive," "exceptional," "unusual," or "uncustomary." In such cases the power of the code authority to stipulate what "terms of sale" shall be filed may be of little use. A clear-cut standard is impossible. Even apart from this difficulty, the exhaustive detail with which terms of sale may have to be reported to forestall the use of this impressive armory of practices presents a major problem in setting up and policing the system.⁸

The NRA codes have prescribed open pricing for scores of industries that have never employed it before. Many of these appear to be poorly adapted to its use. The test of its administrability in these cases will be whether the authorities can enforce its provisions on dissenters and "chiselers" who have resort to evasions of the kind we have presented.

If devices for concealing the seller's net realization from a transaction can bedevil an open-price scheme, they can bedevil also a scheme to fix minimum prices, or to prohibit selling below cost of production. It is a prerequisite to the successful enforcement of all of these arrangements that the administrative authority know

⁸ The enumeration of these practices should not be taken to imply that all of them can conceivably be used in a single industry.

what the members of the industry are really getting on their sales, not merely what they appear to be getting. For industries in which the prices and terms of sale of the members are not generally known to their competitors and to the code authority, some sort of price reporting seems to be necessary to the operation of any form of price control. If in such cases an open-price system proves unworkable it is difficult to see how minimum-price-fixing or no-selling-below-cost devices can be successfully enforced.

CHAPTER V

CONTROL OF PRODUCTION AND PRODUCTIVE CAPACITY

The control of prices may be attempted directly, by such devices as those just discussed, or indirectly, through the control of the supply of goods coming on the market. The indirect method appears in code provisions for concerted action to restrict production or productive capacity. Such provisions occur in a considerable number of codes covering a wide variety of industries.

I. THE CONTROL OF PRODUCTION

Production control schemes set forth in approved codes fall into two main types, those which depend upon the allotment of production quotas to individual members of the industry, and those which rely upon uniform limitations on machine hours.¹

1. The quota system. The operation of a quota system involves two principal problems, (1) the determination of the aggregate production to be allowed, and (2) the distribution of the aggregate among the various divisions and members of the industry entitled to share in it. From the standpoint of price control it is the first of these problems that is of principal interest.

¹ Several codes which contain no production control formula provide that the code authority or some similar body may develop a scheme of control for ratification by the Administrator.

The code for the solid fibre shipping container industry authorizes members to form "voluntary agreements" for the sharing of their business.

All of the codes with quota systems provide that the aggregate production allowed the industry, or its several divisions, shall be determined on the basis of estimates of expected consumption during a forthcoming period.² No method for making these estimates is set forth.

A general mandate that allowable production shall be based on anticipated consumption does not of itself constitute an adequate administrative standard for production control. It fails to take into account the fact that consumption cannot properly be estimated without reference to the prices that are to be charged. If the estimates are based on a relatively high level of prices for the products of an industry, the production control scheme may turn out to be nothing more than a device to prop up this price level by cutting down production to match the curtailed demand. The claim that the device is used in such cases to prevent "over-production" is, to say the least, misleading. An adequate set of standards for production control must include some criteria of proper prices.

The system of allotment used to distribute the predetermined aggregate production of any article among different regions and individuals may or may not make a difference in the price, depending on circumstances. If the quotas are so allocated that some of them are not completely executed, owing to high production costs or for other reasons, the aggregate output placed on the market may be less than planned, and the price may be higher than if the quotas had been otherwise distributed.³ If, however, all quotas are fully produced and

² Petroleum; lumber; glass container.

³ The question arises whether production quotas can be transferred from one producer to another. The lumber code specifies that allotments "shall not be transferable except as between operations under the same ownership within the same division or subdivision." The other two codes with quota

sold, it may make comparatively little difference who gets them.⁴ In such a case, the price is largely controlled by the size of the aggregate production allotted.

Although it may for the moment make little difference, given a certain aggregate production, whether one allotment system is followed rather than another, in the long run different systems may have quite diverse effects upon the capacity and efficiency of an industry. If low-cost producers get no advantage over high-cost producers in the assignment of quotas, their conquest of the industry is retarded. In the end the consumer is likely to pay higher prices because of the technological retardation of the industry.

Code formulas for the allotment of quotas to individual producers are vague indeed. The petroleum code has none at all. The glass container code specifies merely that allocations shall be "equitable." The formula for lumber is a cumbersome and complicated affair which in the last analysis leaves everything to the judgment of the administering authorities. In none of these is there any requirement that low-cost producers shall be specially favored in the distribution of quotas.⁵

2. Machine-hour limitations. Fixed limits on the

systems merely state generally that no one shall produce in excess of his allotment.

⁴ As a matter of abstract theory it should make no difference. However, dogmatic conclusions in a practical situation are apt to be misleading. The quota system may occasion dislocations of customary marketing arrangements, or involve additional cross-hauling of goods, the effect of which is to increase the cost to certain customers even though the aggregate quantity marketed remains the same.

⁵ Before leaving the discussion of quotas, we may mention an interesting provision to be found in the code for the advertising display and installation trade: "No trimmer shall be permitted . . . to install more than forty-five (45) window installations per week averaged over any consecutive twelve (12) weeks in any one (1) year."

number of hours per week during which machines can be operated may have much or little effect on production and prices, depending on circumstances. If all of the producers of a given article are crowding the limit, aggregate production may be severely restricted. If some of them are operating at the limit while others are below it, the restrictive effect may be at least partially offset by the shifting of business from the more active to the less active concerns. How far this "spread the work" arrangement can operate as a safety valve to prevent price increases resulting from the inability of the more active producers to expand their output, it is impossible to say in general. Certainly there are many cases when for one reason or another business can be shifted only at the cost of serious inconvenience. There are many other cases when the shifting would have to be from lower-cost to higher cost producers, with probably a higher price on the shifted work.

A considerable number of codes carry hour limitations for some or all of the machines which they govern.⁶ The exact limits set in the original codes are of slight importance, because of the facility with which they can be altered by the Administrator upon recommendation of the code authority. Already several temporary reductions in the code limits have been put into effect. This flexibility in maximum machine hours makes possible a continuous control of the volume of output similar to that effected under the quota system just described.

⁶ Cotton textile; cotton garment; wool textile; silk textile; textile processing; velvet; lace; hosiery; textile bag; throwing; knitted outerwear; underwear and allied products; rayon and silk dyeing and printing; upholstery and drapery; drapery and upholstery trimming; machined waste; slit fabric; wet mop; light sewing; medium and low-priced jewelry; envelope.

The two systems are, in fact, very much alike. Both make it possible to restrict the aggregate output of an industry within limits periodically revised. Both operate to spread the available work among the members of an industry in accordance with some predetermined scheme. If the allotments under a quota system are based on productive capacity the two systems may be similar in their effects on individual producers. Their effects in raising or supporting prices for the industry as a whole may be similar in any case.

From the standpoint of administrative simplicity, the device of blanket limitations on machine hours has distinct advantages. The principle of allocation is clear cut and definite. It has, however, the disadvantage that it precludes the favoring of efficient low-cost producers. The restrictions apply to strong and weak alike. Under a discretionary quota system there is at least a bare possibility that some way may be found to avoid diverting production from those best equipped to handle it.

II. THE LIMITATION OF PRODUCTIVE CAPACITY

The compulsory exclusion of new capacity from any industry or line of production may be said to constitute price control whenever the buyers of the products have to pay higher prices than they would have paid if the competition of the excluded capacity had been present.

Provisions for the limitation of new capacity appear in a considerable number of approved codes, and in a variety of forms.⁷ The arrangement can be described

⁷ Iron and steel; cement; glass container; motor-vehicle storage; refractories; structural clay products; floor and wall clay tiles; crushed stone; sand and gravel; pyrotechnic; feldspar; excelsior; glassware; ice; rayon; silk dyeing and printing; cotton textile (amended); silk (amended); lace (amended); throwing (amended).

A good many codes provide that the authority may recommend a system of capacity limitation to the Administrator, to be effective on his approval. This has already been successfully put to use.

generally by saying that no member of an industry may expand his present productive capacity, either by replacement of existing facilities or by the construction of new plant, without first obtaining the consent of the Administrator.⁸ Most codes provide expressly, and others by implication, that replacements may be made which do not have the effect of increasing capacity.

Provisions of this character, unlike direct restrictions of the volume of production, can usually be effective as a price-control device only after the lapse of a considerable time. The necessary period varies from one industry to another, depending on the length of time required to construct additional facilities and bring them into production, and on the readiness of the industry to undertake such construction. In the absence of any desire to build new capacity limitations on its creation are of course purely nominal.

Where such limitations are actually effective, it is difficult to see how they can fail to influence prices, their chief purpose and effect being to protect the market against new competition. The extent of their influence depends on the amount of the excluded facilities and their efficiency in comparison with the efficiency of the existing capacity in the industry.

It is essential to the proper administration of a capacity limitation scheme that the authorities empowered to pass upon applications for the construction of new facilities have some adequate method for determining whether in a given case the capacity of an industry is so excessive as to warrant the prohibition

⁸ The procedural arrangements are rather varied. In most cases the application proceeds to the Administrator after a review and recommendation (or decision) by the code authority. Registration of existing productive capacity is required in several instances.

of additional construction. No satisfactory method of arriving at such a decision is to be found in the codes.

The language of some codes seems to suggest that whenever the total capacity of an industry exceeds the probable consumption of its products the creation of additional facilities should be forbidden. This is obviously an extremely superficial view. By including all existing plant and equipment, whether obsolete, inefficient, or otherwise, a showing of excessive capacity could be made, by this test, for many if not for most industries. The existence of capacity in excess of probable market demand for the output may be due to a great variety of circumstances. To cite only one example, an industry may have undergone rapid changes in location or technology which have left in their wake a mass of facilities that are obsolete and on the way to extinction. The acceptance of the crude test just mentioned would in such cases merely protect the vested interests of inefficient establishments against the competition of new and superior facilities. Clearly, some further test of excessive capacity is indispensable to the rational application of the provisions we are discussing.

The four devices discussed in this and the preceding chapters by no means cover all of the forms of concerted price control authorized by NRA codes. We have not dealt with the varied regulations of time, trade, and quantity discounts, the fixing of maximum trade-in allowances, the control of rentals, and other arrangements of a similar character. It is apparent from the evidence that has been presented on these four devices, however, that fundamental questions of public policy are at issue, as well as intricate problems of administrative procedure.

We have deliberately postponed until a later occasion any general appraisal of these price-control devices from the standpoint of public policy. We shall merely observe that there seems little indication that the NRA, in the course of considering and approving the codes reviewed here, applied any clear-cut principles or standards of public policy in the matter of price control. A comparison of proposed and approved codes shows a number of instances in which a device was approved for some industries and denied to others of similar character. This apparent lack of consistency may be explainable by the haste of the codifying process, the confusion which accompanied it, especially in the early stages, and the bargaining character of that process. Regardless of the explanation, the problem remains of developing some reasonably consistent criteria of public policy in the matter of price control, and of revising the codes, where necessary, in conformity with them.

The need for more discrimination appears also when attention is directed to the administrative aspects of price-control devices in approved codes. A given device such as open pricing or a prohibition against selling below cost may have a good chance of successful enforcement in one type of industry and a very slight chance in another. Yet it is likely to appear in codes for all types. There is, consequently, a strong probability that in many cases the device will turn out to be almost if not quite non-administrable.

The development of workable standards of public policy and administration is of necessity a slow and halting process. In the field of price control, as in others, we shall doubtless find support for the old adage that experience is the best teacher.

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