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Willard L. Thorp

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BY WILLARD L. THORP

The proper behavior of prices is one of the essential requirements for the operation of our economic system as it is now constituted. With production and distribution carried on by thousands of different business men under no direct controls, our reliance for balancing supply and demand is placed in the market. By the simple device of upward or downward price movements, the producer is encouraged or discouraged and the consumer is attracted to or kept from the market. It is not surprising that public policy in the economic field presumably has had as a basic purpose the preservation of competitive markets and the free movement of prices.

The first great threat to this desired price behavior came soon after the Civil War, when sellers in various industries discovered that they could improve their economic position by acting in concert. Gentlemen's agreements, pools, trusts and outright combinations all began to appear. When it became apparent that this monopolistic trend was threatening the public by raising prices, various states passed anti-trust laws, and the Sherman act was finally enacted in 1890 to bring the forces of the Federal government to play on the problem.

The trouble here was essentially that prices were raised abnormally as the result of agreement or combination among the sellers. Obviously all that was necessary to bring such situations under control was to make certain that there were some free actors in the market who would not join in the conspiracy to maintain high prices. A few such independents could force the conspiring group to lower prices, through the simple process of threatening to take over the market at lower levels, but still high enough to be profitable to them.

The Robinson-Patman act is an attempt to deal with another alleged threat to the proper determination of competitive prices. In this case, the disturbing force comes primarily from the buyer's side of the market. It is not that prices are too high, but rather that certain prices are too low. In specific terms, it is that price discrimination has developed in many markets, such that certain large buyers with strong bargaining power are able to demand and obtain price concessions which are not given to their lesser competitors. Enforcing competition, the simple solution used to meet the threat of unnaturally high prices, is of no assistance here, unless there is some way to equalize the bargaining power of the different competitors. This would, of course, mean a complete reconstruction of the economic system, eliminating the disparity in size of enterprises. The problem is not so much absence of competition as inequality of bargaining power.

The Patman act meets this problem by establishing two basic principles as limiting the discriminations which sellers can make between different competitive buyers. Disregarding the many controversial details which arise from the obscurity of some of the law's phrases, as well as the complexity of the economic situation to which it is intended to apply, we can easily perceive the general character of the approach to the problem.

The first principle is that, with respect to those elements in a transaction which involve the cash payment for the commodity, the price differences established by a seller among his customers may be no greater than those which "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the different methods or quantities in which such commodities are to such purchasers sold or delivered." In other words, the first test for an allowable differential is a demonstrable difference in cost on the part of the seller. This may take the form of economies arising from either quantity or from method of operation.

The second principle relates to discrimination arising in connection with the various services, allowances and facilities which frequently are a part of the considerations involved in the purchase and sale of goods. As far as such items are concerned, the cost test is difficult or impossible to apply. Discrimination is permitted when the seller makes these services and facilities available on a proportionately equal basis to all competing buyers. While the law has still other elements, I am concerned at the moment in raising only some of the issues having to do with the problem of determining the propriety of price discrimination by the cost test.

The committees both of the House and of the Senate discussed in their reports, in a general way, the concept of cost which they had in mind in considering this act. The point of most significance is that they seemed determined that general overhead should be allocated on a per-unit basis, and that pricing in terms of the additional cost or increment involved in a particular order should not be permitted as justification for price discrimination. Already a number of competent authorities have expressed themselves on the problem of the proper definition of costs for these purposes, so the question need merely be mentioned here.

In the cost test, there is one issue deserving special mention. The proviso permits differences "resulting from the different methods or quantities in which such commodities are to such purchasers sold or delivered." "Such commodities" refers back to the phrase "commodites of like grade and quality." "Such purchasers" refers back to the phrase defining the interstate character of the purchaser. To what extent must the costs be the costs relating to the specific transactions involved in the complaint, or may they be more general costs relating to the type of transaction?

In applying the cost test, there are three general bases which might be used: First, the cost of the specific transactions under examination; second, the cost customarily experienced by the particular manufacturer involved for the type of transaction; third, general costs established for the industry for the type of transaction. Not only does this choice have definite implications for accounting, but also for fixing the burden of the law upon the business man.

The first basis, costs as determined on every separate transaction, involves of course the most meticulous sort of record-keeping. It implies an ability to forecast costs in specific situations as a basis for pricing far beyond the actual ability of any business man or accountant. On no basis of economic theory should price correspond to transaction-costs. Other conditions being equal, prices should presumably be uniform in a given market, regardless of differences in costs which have gone before in the production of the specific goods. If by chance, a machine breaks down so that the cost of producing a particular lot is extremely high, that can hardly justify a higher price for the transaction involved. Any such basis for testing price discriminations seems fairly absurd as a working principle. It would presumably result in price differentials far below those technically justified, in order to provide a sufficient margin of safety for every individual transaction.

At the other end of the scale would be the development of standard cost items for an entire industry. This would be by far the easiest and least expensive approach to the problem, but it is doubtful if it would be entirely satisfactory. Even within industries, the processes of production are not sufficiently standardized so that given quantity differences, for example, would yield the same economies to all producers. Where there was marked standardization, as, for example, in an item such as an allowance for cotton rather than burlap bags, one could more easily defend a general industry standard.

Even if we had a complete record of costs for a given industry, how might they be applied—by an average, by the extreme, or by some figure regarded as "reasonable"? For example, suppose the average savings in an industry for car-load lots was 10 per cent., the maximum economy by any producer was 18 per cent., while 90 per cent. of the operators saved less than 15 per cent.

If the principle is accepted that one may always meet a competitor's legitimate price, then 18 per cent. should be permissible for all (assuming that the producer takes full advantage of his economy in his pricing). But the more vigorous advocates of the Patman act would resist such an interpretation most vehemently. Practically speaking, it has the difficulty of requiring information on the costs for all members of the industry in order to establish such permissible maxima. And the result would be a price structure built up piecemeal from the records of one man in one element and a second in another, etc. The simple industry average would be simpler, but of doubtful application as an exact guide to individuals. Costs vary too much for such a test.

Perhaps the most reasonable solution to this problem may be the middle ground—the measurement of costs according to the experience of the individual business man with the type of transaction under scrutiny. His price structure should not be related to some single transaction, but must have more permanence and breadth. By this approach, the purposes of the law would be served, since persistent discrimination in excess of cost differences would be outlawed. The practical values of greater knowledge, which may be the greatest benefit of the act, would be realized. And, of considerable importance, the burdens placed on industry by the law would not be excessive.

The above discussion has greatly oversimplified the possible answers to the problem. In fact, the evolutionary processes of interpretation may lead eventually to a combination of all three approaches, according to the nature of the specific problem. This article is intended to outline the problem rather than give the final answer. In the last analysis, that must come from the Federal Trade Commission and its courts.