

BOOK REVIEW

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

In this valuable book Professor Machlup gives us a comprehensive analysis—and a forceful condemnation—of the basing-point system of pricing in the United States, a system whose merits are today being disputed in Congress. This is no fly-by-night book; the material included is part of a large volume of material which Machlup has been gathering over a period of years for a forthcoming book on the general subject of price discrimination. The author with the cooperation of The Blakiston Company rushed the basing-point sections of the analysis into print so that the economist would have his day in court before and not after the legislative decision was reached.

At times one is sadly forced to conclude that jurists, legislators, lawyers, businessmen, editorial writers especially, and even economists do not make sense because they have no sure grasp of even the most elementary mechanics of the basing-point system. Machlup's first task is to set down the terminology and operating rules of the system. To this reviewer's knowledge Chapter I is the best currently available systematic explanation of these fundamentals.

Although Machlup recognizes and briefly treats the interplay of legal, business, economic, and political factors in the present controversy, he has argued his case mainly on the grounds of theoretical economic considerations. His first major concern is with the "monopolistic"¹ nature of the animal. He reviews the old errors which have made it possible in honest confusion to identify the price uniformity resulting from the basing-point system as evidence of competition. And he lays the boggy of "local monopoly," which the basing-point system is alleged to prevent.² He notes the significant inconsistency of industry statements that (1) the basing-point system is competitive and (2) frequent deviations from the fixed basing-point price in the form of "price-shading" introduce competitive elements into a seemingly rigid system.

Machlup's second major concern is with the "discriminatory" nature of the basing-point system. His simple test of non-discrimination is the lack of interest of a seller in the functional, geographic, racial, and other characteristics of the buyer. The seller under the basing-point system, of course, cannot meet this test since he is quite interested in the buyer's place of business and quotes delivered prices which do not equalize his mill net but which conform to the established basing-point price. As seen in footnote two above, the basing-point method of pricing *systematically* operates to discriminate against a consumer located near a non-base mill. Another type of discrimination is against consuming areas in which the substitute products of another industry are unavailable or consuming areas in which the expansion of capacity is not welcomed by the large producers. Suppose that a small Chicago producer in a basing-point industry dominated by a large Pittsburgh firm were to attempt to build up its volume by announcing a new, lower basing-point price at Chicago. Under the basing-point system

¹ Monopoly for him is the extent to which there is a oneness in decision-making in an industry, whether because of the dominance of one firm or because of the practice of forming decisions in the light of how other firms in the industry are expected to react.

² Crudely speaking, under the basing-point system a consumer located near a non-base mill is able to select among many sellers located at varying distances, all of whom charge the high, monopolistically established price, while under a uniform f.o.b. system he would be quoted many different prices and would presumably choose the low price of the near-by "local monopoly" seller.

the Pittsburgh producer would meet the new low delivered price by absorbing freight³ on shipments into the Chicago area, and would step up selling efforts or would resort to price-shading in order to punish the upstart. Even if the Pittsburgh firm took no punitive action, the working of the basing-point system would automatically lead to its accepting a lower mill net in sales to the Chicago area, a clear case of built-in local price discrimination concealed under the socially acceptable guise of "meeting competition in the Chicago market!" The average mill net of the Pittsburgh producer would be cut slightly, that of the Chicago firm greatly. Hence the Chicago firm will be induced to go along with the Pittsburgh basing-point price or a high Chicago basing-point price and to be content with its normal share of the industry's volume of business. And the Chicago customers of the industry will be discriminated against.

Secret price deals outside the basing-point framework are most often in recognition of the power of large buyers. This type of price discrimination is not a feature of the basing-point system per se.

Machlup's third major concern is with the waste of economic resources arising out of the basing-point system. The first of these wastes that usually comes to mind, "cross-hauling," involves many little byways of economic analysis that the author treats briefly. Other wastes considered are the uneconomic location of industry capacity and the uneconomic location of buyers' places of business.

A fourth major concern is the concentration of economic power under the basing-point system. Machlup demonstrates how small firms are encouraged to merge with large, how small firms are discouraged from expanding, how entry to the industry is made less attractive, and how "special" prices are likely to favor the larger buyers.

The author regards compulsory uniform f.o.b. pricing as the only desirable practical alternative to the basing-point system. He does not go into detail as to the methods and degrees of compulsion or uniformity.

One of the extremely interesting economic aspects of f.o.b. pricing is whether or not it would lead to "ruinous competition." First, it should be recognized that industrial monopoly and uniform f.o.b. pricing may exist together.⁴ The prevention of further merger and perhaps some fractionalization of industry presumably would be prescribed also if one went along with uniform f.o.b. pricing. These problems Machlup recognizes. He believes that the danger of "ruinous competition" is overrated. Among other things he points out that under a uniform f.o.b. system a firm which must cut prices on all near-by safe business in order to extend its market boundaries will hesitate taking the action, the more so if it may reasonably expect retaliatory price cuts by rival sellers.⁵

It is not to be expected that Machlup would present as complete an analysis of the various facets of the uniform f.o.b. system as he does of the basing-point system. He does not, for instance, consider the vexing problem of what to do about large buyers of an industry's product if the industry is compelled to adopt a uniform f.o.b. price system. Would buyers be prevented from exerting monopsonistic pressure in the form

³ Machlup explains why neither "freight absorption" nor "phantom freight" are unambiguous terms.

⁴ It is apparent that the ease with which monopoly is established, the kinds of monopoly, and the effects of monopoly would differ considerably under the basing-point and monopoly type f.o.b. systems.

⁵ Much different is the point of view of Professor John M. Clark, a leading scholar in the field of industrial price policy, who feels that any such sharp break with the basing-point system would probably bring destructive price wars, great dislocation of labor, and a radical readjustment of investment values. See, for example, his *Basing Point Method of Price Quoting*, 4 CAN. J. ECON. AND POL. SCI. 477 (1938). Professor Clark feels that the presence of large overhead costs and the economic strength of large buyers make a considerable measure of restriction inevitable in these industries.

of paying different delivered prices for their purchases of a product? What about the existence of monopolistic suppliers of raw materials and labor services who might hold the whip hand over a chastised, fractionalized, ex-basing-point industry?

A major issue Machlup mentions is the increase in government "interference" that a compulsory f.o.b. pricing system would entail.⁶ On this point is not FDR's dictum applicable, namely, that "the minimum regulation businessmen can expect is the preservation of competition?" Machlup, as an "old-fashioned liberal," is probably going to be increasingly unhappy as few forces emerge to block the movement toward Bigger Business, Bigger Labor, and Bigger Government.

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⁶ The author expresses his own credo (p. 50) as being ". . . old-fashioned liberalism: an unbounded respect for political and economic freedom, a belief that a truly competitive order is not only the best guarantee for the preservation of freedom but also the most efficient mechanism for the allocation of economic resources, a conviction that private property and free private enterprise are necessary for the working of a competitive order, a disrespect for vested interests . . . and a confidence that a free society can be established and maintained by a people who insist on a wide dispersion and decentralization of economic and political power."

