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PROBABLE EFFECTS OF THE PROPOSED QUALITY STABILIZATION ACT ON PRICES, INCOMES, EMPLOYMENT, AND PRODUCTION

A SUMMARY ANALYSIS

PREPARED BY THE

COUNCIL OF ECONOMIC ADVISERS

AT THE REQUEST OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

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LETTER OF TRANSMITTAL

OCTOBER 29, 1963.

To Members of the Joint Economic Committee:

Transmitted herewith is a summary analysis prepared by the Council of Economic Advisers of the probable effects of the proposed Quality Stabilization Act (S. 774) on prices, incomes, employment, and production. The analysis was prepared by the Council at my request. A copy of my letter of August 29, 1963, to the Hon. Walter W. Heller, Chairman of the Council, and Dr. Heller's reply of October 18, 1963, are also transmitted. This material is being transmitted with the concurrence of the ranking minority member of the committee, Representative Thomas B. Curtis.

The proposed legislation would amend the Federal Trade Commission Act by permitting the owner of a brand, name, or trademark to revoke the right of any seller to use such brand if, in reselling, the distributor made misrepresentations about it or used it as "bait merchandise." A similar right to revocation would also apply if sales were made at other than the resale price fixed by the owner of the brand name or at other than a price within the currently established resale price range. Under the terms of the proposed bill, price competition at the retail level, based on local conditions, and on costs of management at the individual store, would be illegal for price-maintenance items of the same brand.

Faithfully,

PAUL H. DOUGLAS, *Chairman*.

RELATED CORRESPONDENCE

JOINT ECONOMIC COMMITTEE,
Washington, D.C., August 29, 1963.

Hon. WALTER W. HELLER,
Chairman, Council of Economic Advisers,
Executive Office Building, Washington 25, D.C.

DEAR WALTER: Our committee is interested in the possible economic effects of the proposed Quality Stabilization Act which is now before the Congress.

The committee's interest is not in the legislative and antitrust aspects which have been discussed, but rather what the effects of this legislation would be upon production, employment, prices, and incomes. This would be very valuable to our members as well as the other Members of Congress, and I hope you will be able to prepare such as economic analysis for the use of the committee.

Faithfully yours,

PAUL H. DOUGLAS, *Chairman.*

THE CHAIRMAN OF THE
COUNCIL OF ECONOMIC ADVISERS,
Washington, D.C., October 18, 1963.

Hon. PAUL H. DOUGLAS,
U.S. Senate, Washington, D.C.

DEAR SENATOR DOUGLAS: In response to the request in your letter of August 29, there is transmitted herewith a summary analysis of the probable effects of the proposed Quality Stabilization Act on prices, incomes, employment, and production. From it one can only conclude that not only the consumer, but the retailer himself, would be served poorly by the enactment of this legislation.

Sincerely,

WALTER W. HELLER.

SUMMARY ANALYSIS OF THE PROBABLE EFFECTS OF THE PROPOSED QUALITY STABILIZATION ACT ON PRICES, INCOMES, EMPLOYMENT, AND PRODUCTION

A. PRICES

The major economic effects of the Quality Stabilization Act would flow from its impact on the level and flexibility of prices. Resale price maintenance legislation of this type tends to increase prices in a number of ways.

1. The uniform resale prices that manufacturers would set for the products they select for price maintenance would almost surely be higher than the average of the nonuniform prices that now prevail for those products. Competition among retailers who are differently situated now produces a variety of prices for most branded products. With price competition eliminated, manufacturers would tend to set uniform prices at or near or in some cases even above the top of the present range. There are several reasons for this:

(*a*) For many types of goods, the total demand by consumers is sensitive to the number of retail outlets which handle them, and manufacturers therefore like to have as many outlets as possible. Thus they would tend to set prices (and gross margins) high enough to protect and encourage high-cost outlets which presently do not handle these items.

(*b*) Manufacturers want their retailers to be enthusiastic about pushing their products instead of other products. Thus they want their retail markups to be financially attractive to retailers.

(*c*) With price competition eliminated, retailers would be able to put pressure on manufacturers to provide wider gross margins. For many goods (e.g., drugs) consumer demand is not very responsive to the price charged so long as all retailers charge the same price. Thus manufacturers would lose very little by way of sales in giving in to the pressure of their retail outlets.

The present distribution of retail prices for many branded goods often finds a large number of retailers selling below the "standard" price, or the price "suggested" by the manufacturer. The stores that now sell for less usually provide fewer services or less elaborate facilities, or are located where they pay lower rent, or do less advertising, or accept lower markups to achieve greater volume, or for other reasons operate at lower costs. The uniform price that manufacturers would establish would tend to approximate the present "standard" or "suggested" price, and would be high enough to provide a suitable profit for the full-service, high-rent, average-volume retailers.

Naturally, retailers who provide maximum services, have the best locations, and cater primarily to higher income groups prefer not to have their competitors who are in different situations sell for less. But to force all of their competitors to sell for the same price as they do is in fact to raise the average level of prices to consumers.

2. Temporary "sales" to move excessive inventories, reduced prices for seasonal demand, reduced prices for volume purchase, or advertised specials for individual products or groups of products at the initiative of the retailers would be eliminated. (Special sales should not be confused with illegal "bait merchandising," which has been outlawed by the FTC. Unlike the illegal "bait" practices, special sales are designed to increase the sales volume of the advertised goods, to move inventories, or to take advantage of the lower costs of volume merchandising.)

3. Once uniform resale prices were set, pressures would inevitably develop, over a period of time, to raise them. For several reasons, retailers operating under maintained resale prices would encounter, over time, rising costs, which would generate pressures for further increase of prices.

(*a*) With price competition at retail for these goods eliminated, other forms of retail competition would be intensified. Accelerated advertising expenses, fancier store decorations, additional services, and other forms of nonprice competition would be used to compete for sales. This would force up the costs of retailing, and retailers would not in the end have been protected from competitive pressures. This competition would eventually reduce the average retailer's net profit margin back to its pre-price-maintenance level. But prices to consumers would not be lowered.

(*b*) There also would be a tendency for the protected high markups to attract new dealers. This might temporarily accomplish the manufacturers' objective of expanding the number of outlets; but retail profits would be squeezed by the new entrants. The market shares of existing stores would fall until the higher costs of operating at low volume might in the end force weaker stores out of business.

(*c*) For price-maintained goods, retailers would not be able to use lower prices to take advantage of volume economies, sales to move excessive inventories, reduced prices for seasonal demand, or advertised specials for individual products or groups of products. When retailers are unable to adjust prices to the demand for, and their costs of handling, individual items, the inevitable result is inefficiency and higher costs.

For all these reasons the acceleration of nonprice competition, the entry of new dealers, and the loss of merchandising flexibility the costs of retailing would tend to rise, and manufacturers would be led to revise their resale prices upward. The gains in retail profits which many retailers foresee from "quality stabilization" would in fact prove to be only temporary. Manufacturers would therefore be under pressure to provide relief for their dealers through higher prices But the inevitable result of higher prices would only be a further acceleration of nonprice competition, further upward movement of retail costs, and continuing pressures to raise resale prices. Although a small number of individual retailers might be better off, for retailers as a whole, the "protection" afforded by price maintenance would be illusory. Retailers would not gain; but their customers would lose

In summary as to price effects:

1. Uniform resale prices would tend initially to be set higher than the present average of prices charged.

2. Temporary reductions in prices by retailers would be eliminated

3. Rising costs and reduced efficiency in retailing would put pressure on manufacturers to raise their resale prices further.

The main limitation on the extent of these upward price movements would arise from an accelerated development of private brands, sold under the labels of large department and chain stores and mail-order houses. Rising prices for the price-maintained items would surely encourage the use of private brands. Needless to say, this development would not be to the benefit of either the retailers or the manufacturers of the price-maintained items (except to the extent that the same manufacturers also produce the private brands).

B. INCOMES

Since aggressive competitors would use nonprice competition to improve their market positions, most small retailers would not in the end be better off under the Quality Stabilization Act, and their incomes would be increased only temporarily. It is not clear that the incomes of retailers as a group would be permanently increased. New entrants and increased merchandising expenditures would force profits (but not prices) back down to competitive levels. As a group, small retailers might, in fact, be disadvantaged in the end, because maintained resale prices would enable careful shoppers to make more obvious comparisons with private brands or other non-fair-traded items handled by big stores, mail-order houses, and chains. The price advantages of the cheaper products would become clearer, and their share of the market would rise.

More significantly, the higher prices caused by resale price maintenance would reduce the real incomes of consumers and erode the value of their savings. Low-income shoppers would be hardest hit. Retired persons and other low-income shoppers who are able to devote the necessary time to search for "specials" are now able to maintain a higher standard of living by such shopping. The Quality Stabilization Act would reduce the number of such opportunities.

C. EMPLOYMENT

Through its impact on prices, the Quality Stabilization Act could also affect total employment. A higher level of total market demand in money terms would be required to maintain full employment at the higher price levels associated with retail price maintenance, and this level would not automatically be forthcoming. To be sure, the expanded nonprice competition in retailing might tend to increase employment in advertising and in demand-creating services relative to employment in other industries. But employment in the production of price-maintained goods would tend to decline relative to employment in price-free sectors of the economy. To the extent that there would be an expansion of private brands, employment in smaller retail establishments would be reduced.

In some fields the production and employment of large manufacturing concerns might tend to increase at the expense of their smaller competitors. Retailers would have strong incentives to handle the merchandise of large firms that combine high markups with heavy manufacturers' advertising expenditures. With high markups protected against price competition, merchants would tend to feature