329

89th Congress } JOINT COMMITTEE PRINT
2d Session }

DISCRIMINATORY OCEAN FREIGHT RATES AND THE BALANCE OF PAYMENTS

A REPORT

OF THE

SUBCOMMITTEE ON FEDERAL PROCUREMENT AND REGULATION

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

AUGUST 1966

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

66-689 O WASHINGTON : 1966

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C., 20402 - Price 15 cents

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

WRIGHT PATMAN, Texas, *Chairman*
PAUL H. DOUGLAS, Illinois, *Vice Chairman*

HOUSE OF REPRESENTATIVES	SENATE
RICHARD BOLLING, Missouri	JOHN SPARKMAN, Alabama
HALE BOGGS, Louisiana	J. W. FULBRIGHT, Arkansas
HENRY S. REUSS, Wisconsin	WILLIAM PROXMIRE, Wisconsin
MARTHA W. GRIFFITHS, Michigan	HERMAN E. TALMADGE, Georgia
THOMAS B. CURTIS, Missouri	JACOB K. JAVITS, New York
WILLIAM B. WIDNALL, New Jersey	JACK MILLER, Iowa
ROBERT F. ELLSWORTH, Kansas	LEN B. JORDAN, Idaho

JAMES W. KNOWLES, *Executive Director*
JOHN R. STARK, *Deputy Director*
MARIAN T. TRACY, *Financial Clerk*
HAMILTON D. GEWEHR, *Administrative Clerk*

ECONOMISTS

WILLIAM H. MOORE
JOHN B. HENDERSON
NELSON D. MCCLUNG
GEORGE R. IDEN
DONALD A. WEBSTER (Minority)

SUBCOMMITTEE ON FEDERAL PROCUREMENT AND REGULATION

PAUL H. DOUGLAS, Illinois, *Chairman*

SENATE	HOUSE OF REPRESENTATIVES
JOHN SPARKMAN, Alabama	WRIGHT PATMAN, Texas
WILLIAM PROXMIRE, Wisconsin	MARTHA W. GRIFFITHS, Michigan
LEN B. JORDAN, Idaho	THOMAS B. CURTIS, Missouri
	WILLIAM B. WIDNALL, New Jersey

LETTERS OF TRANSMITTAL

AUGUST 3, 1966.

To the Members of the Joint Economic Committee:

Transmitted herewith, for your consideration and use and for the use of other Members of Congress and other interested parties, is a report entitled, "Discriminatory Ocean Freight Rates and the Balance of Payments" by the Subcommittee on Federal Procurement and Regulation.

Sincerely,

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

AUGUST 1, 1966.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. Congress, Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a report of the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee.

The report is an outgrowth of the hearings held in April, May, and June of 1965 and in May of 1966, and is based on the testimony of Government officials and experts, steamship operators, labor union officials, and other interested parties.

It reviews briefly the previous findings and recommendations of the subcommittee, examines the progress that has been made, and sets forth recommendations for the further improvements that are needed.

It should be noted that the subcommittee concentrated on assuring vigorous continuation of the Maritime Commission regulatory efforts to eliminate discriminatory ocean freight rates; on emphasizing the need for revising the Defense Department's procurement of ocean shipping to reflect a greater reliance on competitive bidding; and on stimulating the development by the Commerce Department of statistical analyses of the effects of discriminatory ocean freight rates on U.S. exports and the balance of payments. The ensuing report examines these developments in some detail and calls for continued efforts along these channels. It also calls for the development of a subsidy program that would separate operating subsidies from construction subsidies and extend coverage to some of the U.S.-flag operators that are now excluded from the benefits of the subsidy program.

PAUL H. DOUGLAS,
Chairman,
Subcommittee on Federal Procurement and Regulation.

CONTENTS

DISCRIMINATORY OCEAN FREIGHT RATES AND THE BALANCE OF PAYMENTS

Introduction

During 1965–66 the Subcommittee on Federal Procurement and Regulation continued its study of ocean freight rates and the balance of payments. This subject has been a concern of the Joint Economic Committee since May 1963—a concern that has had some salutary effects on certain phases of government administration in this field.

On January 6, 1965, the Joint Economic Committee issued an interim report dealing with discriminatory ocean freight rates and their effects on the balance of payments. In addition to setting forth preliminary findings and recommendations, the report directed the Subcommittee on Federal Procurement and Regulation to continue the committee's investigation.*

The original focus of the investigation was the impact of discriminatory freight rates on the balance of payments. The subcommittee's work has been concentrated on stimulating the Government departments responsible for procurement, regulations, and promotion of shipping further to study and reform their methods of administration along the lines proposed in the Joint Economic Committee's report cited above. The most interesting developments have been (1) a vigorous continuance of regulatory efforts by the Federal Maritime Commission; (2) a strong stimulus to the conversion of Defense Department liner service procurement from conference negotiation to competitive bidding; and (3) an approach by the Department of Commerce to statistical measurement of the adverse effects of discriminatory rates on the balance of payments.

The present report deals with all these developments in the analytical order of Senate Report No. 1. Public hearings were held in April, May, and June of 1965 and in May of 1966. The report is based on the testimony received from Government officials and experts, as well as that received from steamship operators, labor union officials, and other interested parties.

Chapter 1 sets forth, in summary form, the subcommittee's recommendations respecting future efforts of the Government departments concerned with ocean shipping. Chapters 2 and 3 review the status of the subcommittee's prior recommendations set forth in the interim report of January 1965 and reviews developments and progress to date. Chapter 4 deals with the related topic of Government cargoes.

In brief, the subcommittee believes that substantial progress has been made and will continue to be made to guarantee fair and adequate regulation of our foreign commerce transported by ocean carri-

*(See "Discriminatory Ocean Freight Rates and Balance of Payments," report of the Joint Economic Committee, S. Rept. No. 1, 89th Cong., 1st sess., hereinafter referred to as "Senate Report No. 1.")

ers. Moreover, the new procurement procedures of the Department of Defense should result in more efficient and economic ocean transportation service for the U.S. Government. While much remains to be done, satisfaction may be taken in the fact that a good deal has been accomplished. The subcommittee is firmly of the opinion that the executive branch should now propose a new merchant marine policy to keep pace with its new regulatory and procurement policies.

CHAPTER 1

RECOMMENDATIONS

1. The Federal Maritime Commission should continue its vigorous efforts to:

   (*a*) Equalize outbound and inbound ocean freight rates between the United States and Europe and between the United States and Japan.

   (*b*) Determine the degree of discrimination and economic injury resulting from higher ocean freight rates on shipments from the United States to foreign ports than on shipments from Europe and Japan to these same ports.

   (*c*) Bring to light the facts on how requests and complaints by shippers are treated by the conferences of carriers.

   (*d*) Determine the extent to which bloc voting against U.S. commercial interests is conducted by foreign-flag lines in the conferences.

   (*e*) Render rate filing and rate analysis more efficient through the use of computers.

2. The Department of Commerce should undertake to develop a new merchant marine policy which would include:

   (*a*) Establishment of one Government agency to administer the cargo preference laws for nondefense cargoes.

   (*b*) Development of a new subsidy program which would extend coverage to more U.S.-flag operators including nonliner operators and separate the operating subsidy program from the construction subsidy program.

   (*c*) Promulgation of rules to prevent subsidized lines from belonging to steamship conferences which establish rates detrimental to U.S. foreign commerce.

   (*d*) Elimination of the operating subsidy payments to U.S.-flag operators on that portion of their cargoes for which there is no foreign flag competition by reason of cargo preference laws.

3. The Department of Defense should implement as quickly as possible its new system of competitive procurement of transportation service. This should benefit both the Government and the American merchant marine.

4. The Department of State in conjunction with the Federal Maritime Commission and the Department of Commerce should develop plans for an international maritime convention through the United Nations. Such a convention could set up international rules to curtail unfair practices and eliminate unreasonable rates. It could also attempt to solve such problems as flag discrimination and state trading preferences. We recognize the difficulty of convening such a convention but believe that it would resolve many of the basic international maritime problems. In the meantime, however, the FMC and State Department must combine their efforts to protect American-flag ships.

66-689 O—66——2

CHAPTER II

OCEAN FREIGHT RATE DISCRIMINATION AND THE BALANCE OF PAYMENTS

SECTION 1: OCEAN FREIGHT RATE DISCRIMINATION

The Joint Economic Committee made six recommendations to the Federal Maritime Commission in its interim report of January 6, 1965. These recommendations were based on findings developed from an investigation which began in 1963. The first two recommendations dealt with regulation needed to achieve fair and equitable rates. The other recommendations dealt with methods to improve the regulation of the conference system. The investigation of the committee and its subcommittee has been limited to rates and practices of liner-type steamship service.

The first interim recommendation was:

> "The Federal Maritime Commission should continue its investigations of ocean freight rate disparities. It should utilize its full statutory powers to remove discrimination against American exporters. To date the Commission's actions have been moderate. Although we recognize the traditional caution of the quasi-judicial process and the difficulties encountered by the Commission in its request for information and documents from foreign sources, we feel that the Commission should go further, faster. It should use the recently adopted amendment to the Shipping Act, section 18(b)(5), to order every conference whose outbound rates appear too high, or every conference whose inbound rates appear too low to justify those rates. If they fail to justify them, and if the rates are found to be detrimental to U.S. commerce, the Commission should disapprove the rates or issue an order under section 15 of the Shipping Act to show cause why the conferences themselves should not be disapproved. When an inbound rate is lower than an outbound rate on a comparable item, the justification by the conference should include a showing either that the inbound rate includes the full cost or that a higher rate would not be more profitable. Members of the Joint Economic Committee do not believe, at this time, that the Federal Maritime Commission should set ocean freight rates, but we do insist that all necessary steps be taken to eliminate discrimination against our foreign commerce." (Senate Report No. 1, p. 3.)

The earlier hearings of the joint committee revealed the existence of an ocean freight-rate structure broadly discriminating against American exports. Our present hearings have received overwhelming evidence, confirmed from many diverse sources by entirely independent techniques and investors, that the essential basis of the international freight tariffs profoundly disfavors exports in most of our major trades. Besides special economic studies described below, general studies and recommendations were submitted by leaders of American industry and labor.

The AFL–CIO Maritime Committee on Ocean Transportation Rates submitted a statement beginning on page 186 of the record. (Hearings, "Discriminatory Ocean Freight Rates and the Balance of Payments," pt. 1, April 7 and 8, 1965.) The statement indicated the grave concern of maritime labor regarding discriminatory ocean freight rates. It recommended immediate action by the Federal Maritime Commission. In addition, in a recent report introduced into the subcommittee record on May 6, 1966, the National Export Expansion Council stated that ocean freight rates should be adjusted to remove unjust discrimination against our exports. The council also pointed out that ocean rates are currently a substantial impediment to our export expansion efforts. The council numbers among its members some of our leading businessmen and steamship executives. (Hearings, "Discriminatory Ocean Freight Rates and the Balance of Payments," pt. 4, May 6 and 19, 1966, p. 510.)

The specific studies described below verify beyond doubt the existence of ocean rate discrimination.

A. In pursuance of suggestions emanating from the committee, and in preparation for the consultations with foreign countries that resulted from its own attack on the problem, the Federal Maritime Commission developed a standard analysis of the conference tariffs in the several trades under the guidance of its able chief economist, Dr. Dan Mater (the loan of whose services from time to time the committee desires also to acknowledge). Part 2 of the hearings on "Discriminatory Ocean Freight Rates and the Balance of Payments" contains the analysis of the important trade between ports of North Atlantic, United States, and United Kingdom (pp. 412–431). Among other valuable insights, this shows that only one-half of the 1,659 items in the outbound conference tariff bear rates below $48 per ton, while 85 percent of the 2,731 items in the tariff of the inbound conference fall below that level and the 50 percent mark inbound is actually reached below $30. The highest concentration of individual rates in the inbound tariff is in the range of $28, while that of the outbound is at $33 and $34. This pattern was closely verified by the manifests of random voyages. On the scale of ascending prices the curve of the outward rates is markedly to the right of the inward rates.

B. The special study prepared by the Department of Commerce at the committee's request indicated the effects of rate discrimination. This study, which is more fully reviewed in a later section, worked back from a sample of the export and import declarations to the tariffs, including for this purpose the dual rates of the conferences and, as well, the rates of the nonconference carriers where applicable. The sample covered 1,093 declarations of manufactured goods that moved on the principal trade routes from the Atlantic ports of the United States, including the United Kingdom, North Europe, Scandinavia, and Japan. In 65 percent of the cases representing 69 percent of the value of the shipments, the outbound rate exceeds its inbound counterpart, while in only 35 percent of the cases, representing 31 percent of the value, was the reverse true.

C. Following Admiral Harllee's accession as Chairman, the Federal Maritime Commission had served demands for financial reports on all common carriers in our foreign trade. As Senate Report No. 1 relates (p. 32), some foreign maritime powers interposed, forbidding lines under their flags to comply. Though no question exists of the right of the United States to condition participation in its commerce upon compliance with its laws, the Commission agreed to international negotiations. One product of the meetings that ensued was an agreement, known as the Agreed Minute, by 14 individual governments to gather certain operating figures from their respective flag lines for the year 1963, including gross revenue earned and revenue tons carried in total and for certain particular commodities. These data were aggregated by conference, each conference following its own method. Of course, it is practically certain that diverse methods were employed even if (as we may take for granted) the conferences consulted with one another. The results, shown in the following table, may be viewed as what lawyers call an admission against interest.

TABLE 1

[1963 figures]

Trade	Revenue-tons (thousands)	Gross revenues (millions)	Average revenue per revenue-ton	Percentage, out over in
US No Atl/Bel-Holl-Ger:				
Out	1,054	$28.2	$26.74	6.2
In	1,118	28.2	25.18	
US No Atl/UK Eire:				
Out	601	21.6	35.93	31.6
In	1,066	29.1	27.30	
US No Atl/Fr Atl:				
Out	374	11.6	31.00	20.9
In	308	7.9	25.65	
US No Atl/Swed:				
Out	266	6.4	24.05	9.8
In	326	7.2	21.90	
US No Atl/Italy:				
Out	245	8.6	34.91	------------
In	482	20.5	42.38	
US Atl and G/Japan:				
Out	838	35.4	42.25	53.6
In	2,038	56.0	27.49	
US Pac/Eur:				
Out	922	32.0	34.73	6.7
In	542	17.6	32.54	
Total out	4,300	143.8	33.44	18.1
Total in	5,880	166.5	28.31	

Thus the differential between export and import rates for these trades is $5.13 per revenue-ton or 18 percent against the former. When the important U.S. Pacific/Japan trade is added, which was not complete at the time of hearing, but can be readily adduced,[1] the differential widens. The outbound average becomes $32.96, and the inbound $26.90, and the difference $6.06 or 22½ percent. If the peculiar Italian trade is excluded (the Chairman of the Commission explained that the existence of far-reaching pooling agreements makes Italy a special case[2]), the outbound average for the remaining trades is $32.85 and the inbound $25.82, the differential of $7.03 constituting 25 percent excess charge for exports over imports. Of course, this average is far exceeded in some of the largest cases, being 32 percent in the United Kingdom trade, at least 40 percent in the West Coast/Japanese trade and 53 percent in the Atlantic Coast/Japanese trade. On our four largest trade routes, the outbound

[1] The inbound figures were 1,654,000 revenue-tons producing $36.1 million or $21.82 per revenue ton. Earlier testimony of the American lines showed an average outbound revenue in this trade exceeding inbound by $10 per ton, or 60 percent. Assuming only the 40 percent submitted by the American lines belonging to West Coast American-flag Berth Operators the outbound rate becomes $30.55 by 876,000 tons equals $26,761,800 gross revenue.

[2] The Mediterranean data reported by the all-flag commercial conferences are so different from those of the all-American conferences that a serious error must be suspected. The commercial conferences indicate an inbound average revenue 21% higher than outbound; the American military conference reports its outbound commercial average as 47% higher than inbound. The reporting lines should, of course, be asked to show their underlying data if some obvious typographical inversion has not occurred in the foreign conference figures.

revenue per ton exceeded the inbound by 33 percent. In short, outbound rates are one-third higher than inbound rates.

D. A final source of comparison between outbound and inbound rates was the evidence originally submitted by the American conference lines in proceedings instituted by the Federal Maritime Commission to test the fairness of conference charges to the Department of Defense (docket 65–13). As part of a study of costs of carrying military cargo, the carriers distinguished commercial cargo, and separated outbound from inbound. A special feature of this study is that it is not based on the measurement of the cargo, as is usual in the tariffs, but purports to allow as well for broken stowage; thus it attempts to measure space occupied in the vessel by the cargo. A number of conceptual and methodological criticisms can be made (as will be explained below in the passage on military rates), but we may pass over these for the moment in order to examine the following table, which sets out commercial earnings for the total American-flag sailings terminating in the fourth quarter of 1964 in the several trades in which military cargo chiefly moves:

TABLE 2

[1964 figures]

Trade	Space occupied (million cubic feet)	Revenue (million)	Revenue (cents per cubic feet occupied)	Excess outbound over inbound (percentage)
Worldwide:				
Out	59.4	$33.4	56	30
In	67.4	29.1	43	
A&G/UK Cont:				
Out	24.8	11.6	47	15
In	27.3	11.3	41	
A&G/Med:				
Out	11.5	6.4	56	47
In	12.5	4.5	38	
A&G/FE:				
Out	10.9	7.7	70	27
In	9.2	5.1	55	
WC/FE:				
Out	12.1	7.7	64	42
In	18.4	8.2	45	

Several points should be borne in mind in weighing the differentials thus revealed: (1) The inbound figures are raised appreciably by inclusion of household goods and other cargo of the Department of Defense, and it is not known to what extent this distribution is offset by the countervailing error of including bulk cargo. Bulk cargo revenue, however, would reduce the average per cubic foot occupied by only 2 cents, and is therefore of minor consequence to liner operation, except in the Pacific westbound trade. (2) Space occupied inbound was admittedly understated for the purpose of the study; outbound stowage experience was projected to the inbound leg because, as space is not at a premium inbound, speed of loading is a more important consideration than space utilization, and accordingly the space actually occupied by inbound cargo was deemed unrealistically high. It was at any rate substantially greater than reported. Nevertheless, the total inbound space occupied is shown as more than 13 percent higher than outbound. (3) Space occupied being on the average much greater than dock measurement of cargo (except for bulk cargo, which is accepted as unitary), and the dock measurement of inbound cargo being generally larger than that of outbound, projection of the latter in lieu of the former further distorts the relation unfavorably to exports. All these considerations mean that the study overstated the inbound revenue by some substantial quantity.

There is, however, a similarity between tables 1 and 2, the worldwide discrepancy between outbound and inbound being shown as respectively 25 and 30 percent. Except for the Mediterranean,[3] the scale of discrepancy is roughly similar, and the differences may be accounted for by the fact that the American lines, having in general the best ships and an enormous backlog of highpaying military cargo, also receive the highest paying commercial cargo. At any rate, the average excess of total export rates over total import rates appears to be in the order of 25 to 30 percent, with peaks in the Japanese trades reaching up to 50 percent and beyond. Moreover, both tables indicate that more space is occupied inbound than outbound. According to traditional principles of steamship operation, this should call for a rate structure just the opposite of the existing one. Finally, the tables reflect very similar results even though the statistics are for 1963 in table 1 and for 1964 in table 2. This indicates that discrimination has and continues to plague our trade expansion efforts.

The testimony presented to the subcommittee by all government experts verified the original position of the Joint Economic Committee. Detailed and unbiased economic analyses have proved the existence of discrimination and indicated its adverse effects on our balance of trade. However, additional testimony has led members of the subcommittee to shift their emphasis from a commodity-by-commodity approach to discrimination to an overall tariff structure approach. Earlier recommendations of the committee were focused mainly on the higher rates on exports than apply to imports of comparable commodities. The emphasis has now shifted to the elimination of inequitable and uneconomic rate structures which place U.S. commerce at a competitive disadvantage. Specific commodities were symptoms of a much more serious structural imbalance. The present concern of the subcommittee is with entire ocean tariffs which in effect provide subsidies to our importers and penalties to our exporters. The present concern is identical to concern with governmental tariffs. The levels of export ocean freight rates are a trade barrier just as a quota, or tariff, of a foreign government. Adjustments must be made, particularly now, when our trade surplus is declining.

SECTION 2: EFFECTS ON THE BALANCE OF PAYMENTS

A freight-rate structure weighing disproportionately upon outbound cargo obviously causes exports to bear a part of the cost of carrying imports. This can be a vice or a necessity, depending on whether the imports can reasonably bear their allocable share of shipping costs. But there is a further effect that goes to the heart of the Nation's concern with the balance of payments. Higher prices will normally contract sales, other things being equal, and conversely, lower prices will stimulate them. One would therefore expect that to the extent

[3] See footnote 2.

excessive shipping costs are reflected in export prices, they tend to inhibit export sales.

We have been much interested in discovering whether this tendency can be measured. One of the most interesting and genuinely important contributions the committee has received from a Government department has been a methodological study along this line prepared by the then Assistant Secretary of Commerce for Economic Affairs, Dr. Andrew F. Brimmer, whom the President has since appointed a Governor of the Federal Reserve Board. Dr. Brimmer is careful to emphasize the preliminary nature of the study, whose chief purposes were to determine the availability of data and to act as a pilot guide to technique. The study was done in very conservative fashion and based on very moderate premises. (See hearings, pt. 3, especially p. 467, "Report on Pilot Study.")

The study is based on manufactured goods, including, among others, chemicals, machinery, and transport equipment, which by value represent about 65 percent of our exports and 45 percent of imports, about $14 billion and $7 billion, respectively. Nonmanufactured goods were excluded as less directly affected by the price machinery because of relative inelasticity of demand (shown even on the import side by the fact that there are no domestically produced substitutes for about two-thirds of our agricultural imports). The range was further reduced to trade between the United States and the industrialized nations, specifically those of North Europe and Japan, which by value account for about 30 percent of manufactured-goods exports (20 percent of all exports) and two-thirds of corresponding imports (25 percent of all imports), because it was deemed impracticable to ascertain third-country freight rates to the underdeveloped areas of Latin America, the Far East, and Africa.

The Bureau of the Census selected a sample of commodities amounting to about 6 percent of the total manufactured-goods groups, and from these, 1,093 trade declarations of shipments that had actually moved in the North Atlantic trades with North Europe and Japan. About 37 percent of the shipments were outbound and 63 percent inbound, roughly in proportion to actual conditions. Recognizing that some but not all of the conferences on these routes have, in fact, dual rate systems that charge a penalty rate to shippers not according them exclusive patronage, and recognizing further that on some of the routes there exists more or less vigorous and successful independent, nonconference competition, Dr. Brimmer next assigned to each declaration, freight rates that would be applicable under three possible tariffs: conference contract, conference noncontract, and nonconference. In addition, in order to examine the reciprocal relation of outbound and inbound, he followed the same plan employed earlier by Dr. Mater, and assigned the rates applicable not only for the direction in which the shipment actually moved but also in the reverse direction. This reflects the fact that the sample does not show to what extent commodities move in both directions, and makes visible for each commodity the nine rates that might apply to it (depending on whether the shipper patronized a conference carrier exclusively, partially, or not at all), if it did move in both directions. The difference between the outward and inward rate in seven of these nine possible combinations was then observed, and translated into a percentage of the total outward or inward rate and a percentage of the total c.i.f. landed value of the commodity. Since the actual proportions of cargo that moves under the various freight systems were not known, it was not possible to weigh all these figures; accordingly, the percentages of freight rates that the differentials represented were aggregated by simple average, and those of landed value by the median.

The differential between outbound and inbound rates applicable to the outbound cargo was found to equal 14 percent of the outbound freight and 0.7 percent of its landed price. The differential between the outbound and inbound rates applicable to inbound cargo was found to equal 56 percent of the inbound freight and 2.5 percent of its landed price.

The attempt was then made to determine the effect on the balance of payments. Two courses of analyses were considered: (*a*) increasing inbound freight rates by 56 percent to match their outbound counterparts, and (*b*) decreasing outbound rates 14 percent to match their inbound counterparts. This calculation turns on estimates of the relative elasticity of demand respectively of foreign consumers for our goods and of our domestic consumers for foreign goods. Another factor concerns current elasticity of supply which will determine to what extent (*a*) producers will absorb freight increases or pass them on in price increases, and (*b*) producers will experience cost increases from expanding production to meet demand generated by lower freight rates, thereby offsetting the latter through higher f.o.b. prices.

As to the latter consideration, the elasticity of supply of the European and Japanese economies is low, since they are operating at capacity and are unable to meet foreseeable demand. This means that the whole assumed increase of 56 percent in inbound freights, amounting to 2.5 percent of landed value would be passed along as an increase in price of imports. Viewing the problem on the export side, a reduction in freight rates will not cause an increase in marginal production costs because of our unused productive capacity and because the proportion of production exported is so small. Because of these factors, Dr. Brimmer assumed American export supply elasticity to be infinite. Consequently, a reduction of 14 percent in outbound freight rates, amounting to 0.7 percent of landed value, will cause a full reduction of 0.7 percent in landed price of exports.

Thus, import value and volume would be expected to decline by 2.5 percent times the elasticity of demand for foreign manufactures, and export value and volume would be expected to increase by 0.7 percent times the elasticity of demand for our exports of such goods.

The method by which these elasticity factors are elicited is extremely interesting, but too technical to describe for present purposes. The record should be consulted for the underlying papers, with references to the literature. For manufactured imports, Dr. Brimmer concludes that each 1 percent increase in price will result in a minimum decrease in volume of 3.17 percent, and also in value because FOB prices would remain constant. Each 1 percent decrease in the price of manufactured exports will cause a minimum expansion of 2 percent in their volume and value. The difference in elasticity between our exports and imports is thought to stem from the high interchangeability between imports and domestic manufacturers: a rise in the price of imports causes a sharper tendency to divert to alternate domestic production than operates with respect to our exports which are much more nearly unique in their foreign markets.

Dr. Brimmer suggests that this apparent greater impact of price changes in imports (far greater than the relative elasticity factors suggest) may flow from the unrepresentative nature of the sample. This seems probable, because inspection of his table of rate differentials reveals that for exports in the European trades, the corresponding inbound conference rates are listed as higher than the outbound. The effect is, indeed, to overweigh this extremely important category of conference rates to all areas in the sample, and markedly to drag down the averages. This seems entirely contrary to the conference reports furnished to the Federal Maritime Commission as summarized in table 1, as well as to Dr. Mater's complete study of these trades on the same plan laid down by Dr. Brimmer. Even in the continental trade with the Low Countries and Germany, in which the total dollar differential is reported as so narrow that it would be statistically insignificant (the consequence of substantial nonconference competition), the Mater traffic study showed that 60 percent of the outbound rates exceeded the corresponding inbound.

Without venturing to tamper with the sample, notwithstanding its doubtful cross-section validity, we may find worth noticing the consequence of substituting the figures reported by the commercial and military conferences, which also exclude bulk and separate military cargoes. The weighted average of all the commercial outbound rates in the Atlantic trades with North Europe and Japan (plus the Pacific-Japan trade covered by the value figures) is 28 percent greater than the total inbound rates, and the differential between the two ($7.13 per revenue-ton) is 22 percent of the outbound average itself, to follow Dr. Brimmer's pattern. If in his example a 14-percent decrease in freight entailed a reduction of 0.7 percent in price and an equivalent decrease in value of exports, then a 22 percent decrease will produce an increase 57 percent greater, or $94 million. Substitution of the worldwide differential of 30 percent (equals 23 percent of export rates) from the American-flag commercial data summarized in table 2 yields roughly comparable results, 64 percent greater than the sample, or about $99 million in increased exports of manufactured goods.

The potential expansion is probably larger than indicated by the elasticity factor, which assumes that there will be no decrease in price except in the freight rate constituent of cost. In time of surplus productive capacity, such as has characterized our economy for much of the recent past, increased demand can be supplied at no increase in production costs and possibly decreased cost.

The major point in this instructive study by the Department of Commerce is that, contrary to the argument advanced by shipping interests (and too readily accepted in some quarters of the Government), a difference in freight rates representing only a percentage point or less of the value of our exports can make a difference of millions of dollars both in the earnings of U.S. producers and in the Nation's balance of payments. The elementary economic relation between price and volume is demonstrated to apply to ocean shipping. The belief that the level of rates does not affect volume or profits, that demand for shipping is entirely inelastic, seems to be a general delusion of conference participants. What is being lost is an opportunity to expand exports appreciably at a time when we are suffering from a negative balance of payments and a declining trade surplus. These differential rate structures are not only inequitable and unfair to our exporters, but are causing serious detriment to our foreign commerce.

The Federal Maritime Commission is attempting to make a judicial determination under the Shipping Act of 1916, as amended, concerning steps to eliminate disparate rate structures detrimental to our foreign commerce. The Commission Chairman, Adm. John Harllee, has reported that on many of our major trade routes the outbound rate structure is higher than the inbound structure. However, before the Commission can exercise its powers to equalize these rates, it must demonstrate the degree of discrimination and detriment on specific trade routes.

After taking preliminary steps to obtain information, to establish the burden of proof, and to clarify the powers of the Commission, it is now in a position to proceed to formal hearings on the question of a disparate rate structure. The preliminary steps are outlined in Chairman Harllee's testimony before the subcommittee on pages 352 to 441 of the hearing record (pt. 2) and again in his testimony on May 6, 1966. (Hearings, pt. 4.)

The major effort on the Federal Maritime Commission is just beginning. Its first rate structure case will involve the trade route between the east coast of the United States and Great Britain. A case involving the United States-Japan trade area is expected to follow the British case.

In the British-United States trade area, the information revealed that (1) carriers were receiving $35.93 per revenue ton of U.S. exports carried but only $27.30 per revenue ton for imports; (2) this disparity was even greater on the major moving commodities in the trade; (3) the volume of imports exceeded the volume of exports; (4) the value and content of the cargoes were very similar in both directions; (5) virtually all the trade was controlled by conference members and there was less than 10-percent outside competition from other independent liner operators or irregular transportation operators. Finally, in this trade area, Admiral Harllee estimates that if adjustments were made and the rates equalized, our exporters would save $2.5 million, and the carriers involved would increase their profits by $1.6 million. (See hearings, pt. 2, p. 408.) Of course, the price of imports would increase so that these commodities would be assessed their fair share of the voyage cost.

As a result of this information, the Commission, together with the studies outlined above, has undertaken a formal proceeding to remedy this disparate rate structure.

Although it has taken almost 3 years for the Federal Maritime Commission to undertake a formal case involving an entire rate structure, it is the belief of the members of this subcommittee that the Commission's approach under existing law has been appropriate and a speedy remedy is now possible.

SECTION 3. THIRD COUNTRY DISCRIMINATION

The second recommendation in the interim report was:

> "The Federal Maritime Commission should continue to investigate third-market discriminations. It should be vigilant and obtain information concerning rates from European and Japanese ports to third-market countries, and it should constantly compare

these rates to those on U.S. exports to these same areas. The Commission has remarked on the difficulties of obtaining foreign rate information, observing moreover that its accuracy is diluted by widespread rebating practices generally acknowledged to exist in foreign-to-foreign trades. Conferences and carriers in U.S. foreign commerce disclaim knowledge or control of rate setting in foreign-to-foreign trades despite the fact that many carriers service both trades. Under the Shipping Act, if the same carrier is not involved in the fixing of competitive rates from different sources of supply, the Commission's jurisdiction is restricted to determining whether the outbound rate from the United States is so unreasonably high as to be detrimental to our commerce, a matter influenced by comparisons with third-country rates. But if the carrier or conference does serve both trades, section 17 of the Shipping Act empowers the Commission to alter the rates to the extent necessary to correct such prejudice. Members of the Joint Economic Committee recommend continued efforts in this field despite the difficulties to which the Commission alludes." (Senate Report No, 1, p.4)

This recommendation was based on testimony from Government witnesses that indicated it cost considerably more to ship U.S. exports to the emerging markets of South America, Africa, and India than to ship comparable products to these markets from our leading competitors in Europe and Japan. For example, an American paid $39 per measurement-ton to ship an automobile to Rio de Janiero, Brazil, where an English exporter paid but $15 per measurement-ton to ship an English car from Liverpool.

The Federal Maritime Commission, in conjunction with the Departments of Commerce, State, and Agriculture, is attempting to carry out this interim recommendation. The Commission has compiled an index of almost 300 carriers operating in at least 20 foreign-to-foreign trades. In addition, the Commission has compiled a list which indicates the extent to which certain carriers offer service, to the same countries of destination from both U.S. and foreign ports. It has finally identified some carriers belonging to conferences which establish rates for both U.S. foreign trade and foreign-to-foreign trades. As a result of this work, if it discovers a carrier discriminating against U.S. commerce it can invoke section 17 of the Shipping Act. The Commission is now attempting to discover the level of foreign-to-foreign rates charged by these carriers.

Members of this subcommittee recognize the obstacles which must be overcome to obtain foreign-to-foreign rates and to establish U.S. jurisdiction when discrimination appears to exist. However, we believe progress has been made and we encourage the Commission in conjunction with other Federal agencies to continue in these efforts.

As a result of this committee's interest in this area, specific complaints have been received by the Commission from U.S. shippers and steamship lines. Complaints involving rates on beef, high pressure boilers, fertilizers, and involving discriminatory surcharges have been examined by the Commission. Shippers were granted relief in both the Philippines and Pakistan surcharge cases, as well as in the informal beef rate investigation. In the latter case, U.S.-flag lines cooperated with the Commission.

These two recommendations were put forth to guarantee fair and equitable rates to American exporters. Although the rate structures have remained unchanged, the Federal Maritime Commission is now in a position to assert its powers and jurisdiction to disapprove the agreements between carriers which are the cause of this discrimination. Members of the subcommittee want to congratulate the members of the Commission for their progress and encourage them to take the necessary steps to achieve equitable and reasonable rates for steamship service. While we recognize that rate regulation is not within the jurisdiction of the Commission, we believe that it must use the powers granted by Congress to guarantee that steamship rates reflect the cost of transportation service. Our foreign allies must assume their fair share of shipping cost. Rates should reflect the cost of service and not in fact be trade barriers. The Chairman of the Commission has assured this subcommittee that these revisions can be brought about without the enactment of additional legislation by Congress.

Chapter III

Regulation of Steamship Conferences and Practices

In Senate Report No. 1, members of the committee indicated dissatisfaction with maritime regulatory policies of the Government. The Shipping Act, passed in 1916, and strengthened in 1961, had never been implemented by maritime regulatory authorities. The purpose of the act was to protect American exporters and importers, as well as steamship operators, from the monopolistic practices engaged in by many steamship operators. The Congress allowed some monopolistic practices to continue, but only when supervised by a nonpartial governmental regulatory authority. But, as documented in Senate Report No. 1, lack of adequate regulation has made it possible for monopolistic practices to continue and the public has not been protected by effective regulation. Discriminatory rates, while perhaps the most serious in consequence, were but one of many unjust consequences resulting from the lack of adequate regulation.

The international freight conferences exercise great power and operate as monopolies.

Elsewhere in the world, these conferences can even control entry of competitors into service merely by refusing admission into their membership, so powerfully do they dominate shippers with deferred-rebate systems of exclusive patronage. In the American trades they can delay the entry of new carriers, and more than one new operator has been forced to litigate its long-settled legal right to membership. In all trades, the independent line that does not seek to join them meets the attack of their massed force. Their economic objective is to keep supply below the level that marginal costs would justify in free competition (using the term strictly). This shows itself in an illuminating way in the American subsidized fleet, whose spokesmen have for many years argued before Congress and before a succession of executive branch bodies that it is adequate to all national needs and should be held steady in size, subject only to the replacement for obsolescence. New applicants for subsidy are resisted through lengthy litigation. There is a vast holding operation going on to protect the vested interest in the national bounty. The result is a merchant fleet demonstrably too small for the purposes it is intended to serve. These very natural implications of monopoly power have their equally natural consequences in the pricing structure. Supply is kept below the level of marginal costs in order to keep prices above them.

The Deputy Under Secretary of Commerce for Transportation, Lowell K. Bridwell, testified that in a series of interviews conducted for him in 1964 by Prof. William Greiner, of the University of Washington, the conferences articulated their policy as in effect demand pricing; they attempt to measure demand for their services and to price accordingly. Theoretically, this should respond to the pressure of alternatives open to the shipper, including competition. But competition among ocean carriers is sporadic, owing to the conference system, and major independent lines tend in the long run to reach a state of equilibrium or even to join with the conferences; moreover, large shippers may require the services of more than one line and may, therefore, have no alternative, if the conference is empowered to exact exclusive patronage, short of entering the shipping business themselves. Thus, the chief meaning of demand pricing in this context is the simplest version of what the traffic will bear, responding not to competition among carriers for the business of shippers, not even to competition among the shippers themselves for their markets, but only to whether the rate structure is so high as to price shippers out of their market altogether.

Accordingly, the conference test for granting a decrease in rates is whether the total shipping volume will thereby increase by more than the additional cost of carrying it. That the individual shipper's business may expand at the expense of his competitors is not considered reason for a reduction (as it would if the carriers were competing among themselves for his patronage), since the competitors already employ the conference lines and a mere shift from one shipper to another does not increase total conference volume; that even total volume will actually increase (because foreign markets will absorb more at lower prices) is not considered reason for a reduction unless total conference revenue will increase by more than the additional cost, since there is no use carrying more cargo for the same net revenue.

Another barrier to reduction described by Mr. Bridwell is the policy of maintaining the rate as high as possible, because if it is too high the shippers will persist in their complaint, while if it is too low (from the carriers' point of view) they may not realize it.

We may discern here the classical monopolistic pricing policy based on a crude, pragmatic measurement of demand elasticity. Cost of service as a measure of the lowest price that could be accorded does not enter the case at all; value of service as a measure of the highest price that can be exacted is the sole relevant criterion. And even this standard may be exceeded. Large shippers or associations, as Mr. Bridwell indicated, may exercise pressure. Small shippers, or those far from the seaboard, are not encouraged to aggregate their strength through freight forwarders, and get little consideration. Conference ratemaking may be an art and not a science, as their representatives announced to Professor Greiner, but its objects are not obscure.

Now it is broadly agreed that, entirely apart from deliberate abuses of an antisocial character (which are, however, themselves inherent in this kind of economic structure), monopoly pricing and supply (the former being higher and the latter lower than indicated by marginal cost) do not achieve optimal production and distribution of resources. There are in theory two methods of overcoming the disadvantages of monopoly: competition and public regulation. In this Nation economic theory and legislative policy have long coincided. Our laws forbid monopolies and in those special cases, like utilities, where elements of monopoly are unavoidable they provide for public regulation. As was said in Senate Report No. 1, the American economy has flourished beyond historical comparison through adherence to this policy, which, by promoting the best interrelation of prices and costs, has stimulated technological and managerial innovation and afforded the highest standard of living in the world. It is the exceptions to the policy of open competition that engage our attention. The case nearest in point is the public utility, of which transportation is a principal example. The monopoly in the utilities, including the railroads, was in a sense natural because of their great relative size, a condition not clearly present in ocean shipping. But the abuses to which their economic power gave rise early occasioned Government intervention, including control by permanent regulatory bodies over the right of newcomers to enter the field, a control that could on no account be left in the hands of a private monopoly. In this way it was sought to preserve to the public the conditions that would have flowed from competition: reasonable prices and freedom from discrimination.

Although effective regulation did begin after Adm. John Harllee became Chairman of the reshaped Commission, members of the committee set forth specific guidelines in Senate Report No. 1, concerning more adequate regulation of the conference system.

Besides encouraging the Commission to continue its recently inaugurated regulatory practices, the committee made three recommendations. Admiral Harllee, in his testimony before the subcommittee on May 6, 1966, outlined the responses by the Commission as of that date. The third, fourth, and sixth recommendations of Senate Report No. 1, together with a summary of the Commission's actions, are repeated below because of the significance of this vigorous regulation.

The committee recommended that the Federal Maritime Commission should not approve an anticompetitive agreement, conference, or pool, without determining the voting procedures and the extent of bloc voting by members of such agreements.

Admiral Harllee pointed out that proper conference minutes were being requested so that the voting procedures could be determined. On January 29, 1966, 1 year after the committee's recommendation, the Commission issued General Order 18. This order requires all conferences and ratemaking groups to file detailed minutes of all meetings, formal and informal, and of all votes with the Federal Maritime Commission. This order will soon be effective. The Commission will soon have knowledge of the voting procedures and actual votes of all conference practices.

The committee also recommended that the Federal Maritime Commission should maintain strict surveillance over the conference system in order to protect American consumers from discrimination. If the conference system cannot stand public scrutiny, it is not entitled to antitrust immunity and should be discontinued.

Admiral Harllee outlined the Commission's program in response to this recommendation on May 27, 1965. (Hearings, pt. 2, p. 378 et seq.) Among other things, he stated:

"The Commission is in full accord with the proposition that the antitrust immunity granted under section 15 of the act cannot be continued unless the conferences are subjected to the most searching scrutiny. The Commission's program for maintaining effective surveillance over conferences is conditioned upon the ability of the Commission to get information about conference practices. Outlined below are the measures employed by the Commission for this purpose.

"1. *Automatic data processing.*—The Commission has recognized that it must be in a position to retrieve rate data with dispatch if it is to undertake timely studies, analyses, and rate comparisons. To achieve this goal the Commission's Foreign Tariff Circular No. 1 provides for the coding of commodities published in tariffs. The codifying of tariffs, assuming the requisite budget increases, will permit the Commission to institute a system of automatic data processing of freight rates.

"2. *Shippers' requests and complaints.*—Rules are about to be published to govern conference procedures for handling shippers' requests and complaints. Section 15 of the Shipping Act specifically requires that the Commission disapprove an agreement if it finds that the parties failed or refused to adopt and maintain reasonable procedures for promptly and fairly hearing and considering shippers' requests and complaints. The rules are geared to implement this congressional requirement.

"In this connection, this committee should be aware that information provided by the conferences to the Commission (both voluntarily and as a result of sec. 21 orders), indicates that conferences, on the whole, have a good record for handling shippers' complaints and requests. It is the Commission's responsibility to insure that that record is maintained for each and every conference and, wherever possible, improved.

"I would like to emphasize there, Mr. Chairman—and I think this is important—although we are in many formal proceedings, although we are trying to exercise authorities that haven't been exercised before, although we are trying to set precedent law, and exercise that authority, at the same time I think that where we can, with informal—official but informal—contacts with the conferences and the carriers, help out the shippers. We think this is a big service, and we think the conferences and the carriers on the whole have been pretty good about this.

"3. *Self-policing reports.*—Conferences file, pursuant to our General Order No. 7, reports of all actions taken with respect to members found to be in violation of the conference agreement by rebating or other malpractices.

"4. *Minutes review.*—As you know, the Commission requires the conferences to submit minutes of their meetings. As previously detailed, the Commission has under consideration a proposed rule which would greatly increase the effectiveness of this most important regulatory tool.

"5. *Pooling reports.*—Semiannual reports on the results of pooling operations must now be submitted to the Commission as a condition of approval.

"6. *Section 21 orders.*—If used sparingly, and in the right situations, this can be a most effective means of securing information.

"7. *Subpenas.*—This power is restricted to use in connection with formal proceedings, but used there has proved to be a most useful method of obtaining information.

"These are the tools and powers the Commission must use in its efforts to obtain the needed information about conference activity and practice contemplated by the Shipping Act, 1916. It is our view that this collection of information-gathering devices can provide the Commission with adequate knowledge of conference operations and practices, while at the same time keeping to a minimum the burden that such reporting requirements impose upon carriers and conferences. Naturally, there is a lot more one could know and one would like to know about how the conferences operate; but, seen in perspective, it must be acknowledged that the information we are able to obtain is much fuller and more complete than that obtained by any other government or any other group of shippers anywhere else in the world. As I have suggested before, we think that it would be in the conferences' own interest for them voluntarily to make fuller disclosure to the public and to the Government about their practices and operations."

On May 6, 1966, Admiral Harllee pointed out that all of these steps have been carried out. He also introduced into the hearing record a new publication, entitled "Ocean Freight Rate Guidelines for Shippers," (hearings, pt. 4, p. 532). This publication represents an additional number of steps to inform the public of methods of conference operation.

In Senate Report No. 1, the committee also recommended that more adequate information should be developed regarding pools and other anticompetitive agreements, the cost and profitability of shipping companies, and the principles the steamship companies have used in setting freight rates. Consideration should be given to an international conference to explore methods of developing such basic information.

Admiral Harllee responded to this on May 27, 1965, and again on May 6, 1966. On the latter date, he stated:

"We do not believe that any steps should be taken at this time looking toward an international conference to explore methods of developing basic information concerning the fixing of rates in international trade. At the end of the executive session held Thursday, May 27, 1965, by the Subcommittee on Federal Procurement and Regulation of the Joint Economic Committee, the chairman of this committee indicated that he was in favor of delaying any efforts to establish an international conference, since, as he expressed it, 'once in cartels, it is hard to get out.' We agree with that view." (Hearings, pt. 4, exhibit C, p. 597.)

Negotiations between the Federal Maritime Commission and the State Department, on behalf of the United States and 14 foreign governments, have provided the Commission information not heretofore obtainable. It is hoped that as discussions with the various foreign governments progress, arrangements can be established for a continuing exchange of the information needed to evaluate the freight rate structures in the various foreign trades. Additionally, we are hopeful that the final report in Fact Finding Investigation No. 6 will produce much additional information with respect to the functions of conferences and other anticompetitive agreements affecting our foreign commerce. The status of that investigation is as follows:

This proceeding was instituted by Commission order of October 22, 1963, as a nonadjudicatory factfinding investigation, a comprehensive factual study for the Commission's guidance in establishing basic policies, including legislative recommendations.

The Celler committee report, House Report No. 1419, 87th Congress, 2d session, recommended such an investigation as did Secretary of Commerce Hodges, as reported to the Joint Economic Committee, in his letter dated July 12, 1963. It is the first comprehensive study of the conference system and its effect on U.S. commerce by the Commission or its predecessor agencies. It embraces numerous questions raised before the Joint Economic Committee, the Celler committee, and the Bonner committee.

The staff in charge of the investigation, using as a basis various questions raised in testimony before the Joint Economic Committee, the Celler committee, and the Bonner committee, has prepared a comprehensive outline of the subsidiary areas of the investigation. Shortly after the institution of the investigation, the Commission staff began to screen and assemble material on these various questions. In addition, lists of several hundred shippers were obtained from the Department of Commerce and those shippers who expressed an interest on the basis of correspondence were interviewed for the purpose of developing a slate of witnesses. Basic aspects of all conferences will be studied and, in addition, a selected cross section of conferences will be studied "in depth."

Even though the Federal Maritime Commission has begun to regulate our oceanbound foreign commerce, and even though we are convinced that the Commission will continue and obtain results, we are not certain that it is wise to continue to grant antitrust immunity to steamship operators. Although regulation can effectively control monopolistic abuses, we are not convinced that it can be effective in controlling abuses by shipping conferences. Moreover, we are not convinced that American shippers and steamship operators are receiving more benefits under the current system than they would under a system of free competition.

Unlike all other present exemptions from the antitrust laws, the Shipping Act does not confer upon the Federal Maritime Commission power to fix reasonable rates in foreign trade. It may under section 17 correct unjust discriminations of a limited character, and under section 18 it may disapprove a rate that is so high or so low as to constitute a detriment to commerce, but these are narrower, and as yet unexercised powers. We would not be understood as implying that they do not reach the problem of the unbalanced rate structure at present prejudicing our exports. The fact remains that they fall markedly short of true ratemaking in domestic transportation.

The reason for this deficiency is, of course, the diffidence with which Congress has approached control of foreign trade. The right to regulate foreign carriers has really never been the issue; the persuasive argument has been that its exercise would be offensive to other nations, which might in retaliation do the same, with confusing results inimical to commerce. A recent example might be found in the direct orders several governments issued to their flag carriers not to comply with orders of the Federal Maritime Commission to submit certain financial data. Though contrary experience might be cited in other interntional fields, and though it might be thought possible to show the maritime powers their community of interest with us in sensible regulation of abuses (an effort we understand the Commission is pursuing at present), it is the case that national regulatory policy stops short at the water's edge.

In consequence, the shipping public has been deprived of the instruments that maintain other industries in optimal social balance. There is neither free and open competition nor is there public regulation to fashion the price and supply processes into a facsimile of such competition. The results are what we see: the shipping industry cartelized on an international scale, and prices heavily weighted against out export commerce.

The expedients that naturally suggest themselves at once are (1) to repeal section 15 of the Shipping Act or (2) to confer full ratemaking jurisdiction on the Federal Maritime Commission. Thus we should restore competition outright or invoke our conventional system for procuring its economic equivalent.

The first course has its obvious attractions. The world tramping industry has always operated without conferences and is not eligible for exemption from the antitrust laws under section 15; yet it is the fastest growing sector of shipping in our foreign trade. But Congress considered the question 5 years ago, and its conclusion that the conference system was still necessary should not be overturned without careful study of current liner economics. Such study may be particularly timely in the light of our recommendations. It should, of course, proceed (like the Celler and Bonner investigations) on a sophisticated level above the special pleading of conference chairmen. The Commission might also very usefully explore the matter.

As for conferring rate powers on the Commission, the practical arguments against it are probably still insuperable. Even apart from the expected resistance of the maritime powers, the technical problems are complex, and the proceedings would certainly consume such immoderate amounts of time as would limit their utility, at least at the outset.

A third expedient, less drastic than repealing section 15 or extending regulation, strongly appeals to us.

It is simply to make our subsidized fleet more competitive by directing their owners to withdraw from the conferences. This course requires no legislation, only an administrative order by the Secretary of Commerce under existing contracts. Without abolishing the conferences or otherwise disturbing current law affecting their operation, and without elaborate legal ritual, such a step instantly would procure some (perhaps most) of the benefits of free competition.

The immediate object of the Merchant Marine Act, 1936, is to enable American carriers to compete in foreign commerce by equalizing their capital and operating costs with those of their foreign competitors. The Department of Commerce annually disburses more than $300 million in direct subsidies for construction and operation. Although in our opinion seriously undertonnaged, the American liner fleet has capacity for about a quarter of our liner exports (including Government and Government-sponsored cargo for which it enjoys a flag preference). In practice, at least half this capacity is preempted by preference cargo, with a consequent sharp reduction of space available for commercial cargo. This means that foreign lines are carrying 85 percent of our commercial exports. Even so, sustained as it is by subsidies and cargo preferences, the American fleet could greatly influence rates (as it probably does to some extent by its mere existence). Equipped already with most of the largest and fastest tonnage in the world, and destined, it is hoped, to receive shortly a fresh stream of novel types with hitherto unexampled cargo fertility, this instrument of national policy could do much, judiciously employed, to alleviate our shipping problems.

In fact, everything has been done to attenuate and diminish its influence on world rates. Senate Report No. 1 related how the committee found, at the commencement of its inquiry, a formal ruling of the Maritime Administration that all holders of subsidy contracts must belong to the conferences controlling its routes. This simply meant that the whole power of the merchant marine to affect the rate structure was whittled down to (normally) a single vote in a cartel dominated by foreign lines, and without the smallest incentive to press for lower rates under current conditions of high demand.

The obvious contradiction between paying lines a subsidy to compete and then forbidding them to do so, has amounted to an actual subversion of congressional policy. The committee's direct approach to then Secretary Hodges procured prompt repeal of this order.

But the committee's report raised the fundamental question as to whether subsidized lines should not be forbidden altogether to belong to conferences. The difference between compelling and permitting them to belong is largely verbal; removal of the mandate has by no means stimulated wholesale withdrawals. The truth evidently is that the impulsion to membership did not originate with the Government but with the lines themselves, which over the years accomplished a work of indoctrination on the succession of shipping agencies described in Senate Report No. 1.

For the economic incentives motivating the American companies appear to take exactly the same direction as their foreign counterparts: they are moved toward cartelization in all its degrees, toward minimization of supply under their own control, and above all toward high rates. Their prolonged resistance to new subsidy applicants and their warfare against the "outsiders" have been related.

In conclusion, we believe that the FMC should continue its current efforts to effectively carry out the mandates of the Shipping Act. We further believe that our subsidized lines should not be allowed to participate in international shipping conferences. Regulation and competition should guarantee fair and reasonable rates and should stimulate the American merchant marine. If additional costs accrue to the Government, in the short run, more money should be spent on supporting our merchant fleet. In the long run, we would develop an effective, competitive fleet providing low rates and efficient service. Other American industries have overcome the obstacles facing the shipping industry. Effective Government policy and support combined with a competitive merchant marine are needed to complement the new regulatory policies of the Federal Maritime Commission.

CHAPTER IV

EFFECTS OF GOVERNMENT POLICY ON FREIGHT RATES

Senate Report No. 1 reviewed the pricing policies of several Government agencies in procuring shipping service. We observed that by law American lines enjoy preference for Government cargo ranging up to 100 percent in the case of the Department of Defense; and that "Cargo preferences naturally tend to increase freight rates because they reduce the eligible supply of ship space to the size of the American fleet, which is far below the size of the world fleet. In fact, the combination of heavy shipments restricted to a small body of the highest cost tonnage in the world, already fully utilized, is almost irresistibly inflationary" (p. 7). We found in effect that most of the departments had abdicated the function of testing the reasonableness of liner rates, and were simply paying the conference tariffs on the assumption that these bore the imprimatur of the Federal Maritime Commission. The Defense Department operated on a different principle of negotiating for its immense shipments blanket rates that became binding on the lines by force of a group of "all-American" conference agreements encompassing all U.S. carriers.

Cargo preference laws are more important to the American merchant marine than the Merchant Marine Act itself, which provides more than $300 million a year of direct subsidies to steamship lines and shipyards.

Virtually the entire revenue of the American tramp fleet is derived from the carriage of Government-sponsored cargo. More than 50 percent of the revenues of our U.S.-subsidized liner fleet are derived from Government cargoes and subsidy. The U.S. Government spends approximately $1 billion a year for the procurement of ocean transportation on U.S.-flag ships and for subsidies to sustain our merchant marine and shipyards.

In Senate Report No. 1, we recommended that "executive and congressional investigations are needed to determine whether or not cargo preference laws should be amended or changed and to determine whether or not Government agencies responsible for the movement of Government-generated cargo are applying the statutory requirements as to the reasonableness of freight rates." (P. 7.)

We can report that such investigations are taking place and, in one instance, have led to a complete change in Government procurement of transportation service. The Agency for International Development, the Departments of Agriculture and Commerce, and the Federal Maritime Commission are currently investigating the level of rates charged for shipments of Government cargoes and the administrative procedures guiding price and procurement. The Department of Defense, which spends approximately $500 million per year on ocean transportation and stevedoring, has completed its investigation.

On May 6, 1966, Hon. Robert Moot, Deputy Assistant Secretary of Defense for Logistics, reported to the subcommittee and stated:

> "Mr. Chairman, this opportunity to report on the Department's plans to improve its practice in the procurement of ocean

freight services is appreciated. While our letter to you, Mr. Chairman, dated April 2 of this year, did advise the subcommittee of our decision to make a significant change in procurement practice, that letter was remiss in one important respect. It did not say—as it should have—that the comprehensive hearings on ocean freight rates held by the subcommittee every year since 1963 were of the greatest help to the Department in its evaluation of this subject. Earlier this year, Secretary McNamara, in testifying before this committee stated that the Department's improved management program owes much of its inspiration to work of the Joint Economic Committee and its individual members. This revision in ocean freight service procurement is one more example of such constructure assistance.

* * * * * * *

"The Department of Defense through its operating agency, the Military Sea Transportation Service, is procuring commercial ocean freight services at an annual rate of more than $400 million in shipping costs.

"Approximately 50 percent of these ocean freight shipments move in berth or liner service. Rates applicable to these shipments for the most part are *negotiated between MSTS and carrier organizations* which have been granted antitrust immunity by the Federal Maritime Commission pursuant to section 15 of the Shipping Act of 1916. [Italics added.]

"Procurement of ocean transportation service to move the above mentioned volume of cargo has been for all practical purposes *on a sole source basis*. No price competition is involved. After the initial MSTS cost negotiation, adjustments in rates have considered only increases in specific items of operators cost. There has been no review of the total operating costs. Rates have been negotiated with the intend of excluding costs such as *brokerage fees and cargo handling expense* which are not applicable to the movement of military cargo to the same extent as such expense is involved in the movement of cargo for commercial shippers. [Italics added.]

"A revision in procurement practice has now been announced under which the Department intends *to actively seek price competition* to the maximum extent practicable and, in the absence of such price competition, to negotiate on the basis of total applicable costs rather than differential costs. In following this new policy, the DOD will be dealing only with individual shipping operators, and not with ratemaking groups or associations." [Italics added.] (Hearings, pt. 4, pp. 604–605.)

On May 19, 1966, Hon. Robert Baldwin, Under Secretary of the Navy, and Adm. Glynn Donaho, Commander, Military Sea Transportation Service, testified before the subcommittee and explained the methods of implementation of the new competitive policy. Since their testimony, a new procurement system has been established and competitive proposals are being sought. The Department of Defense, and, in particular, the individuals who testified before the subcommittee, are to be congratulated for this new policy. Last year, when competition was injected on one trade route, the Department of Defense saved more than $1 million per month. Widespread competition should guarantee savings of more than $25 million per year to the Department.

Besides substantial savings to the Government, competitive bidding should also benefit our shippers. The American fleet for the first time is being forced to experiment with price competition. It is our expectation that its success in this area will result in universal application.

The subcommittee also received testimony concerning the consolidation of all cargo preference responsibilities with the exception of defense cargoes. It is our belief that this ought to be done. The congressional mandates that at least 50 percent of Government-generated cargoes be shipped on U.S.-flag vessels at fair and reasonable rates could be much more effectively accomplished if one Department procured all the transportation services required.

Under current procedures, the Department of Agriculture, the Government Services Administration, the Department of Commerce, and the Agency for International Development can effectively carry out only part of the congressional mandate; namely, the 50-percent requirement. Government regulations specify that at least 50 percent of Government-generated cargoes go on U.S.-flag ships. However, they do not have a uniform method, and in some cases no method at all, to guarantee that the rates are fair and reasonable.

We believe that one department of Government ought to be given the procurement responsibilities of all Government-generated cargoes. We believe this can be done, as the Maritime Administrator testified, by Executive order. We believe that this agency could guarantee fair and reasonable rates, as well as sufficient allocation to U.S.-flag carriers. Finally, we would recommend that more than 50 percent of Government-sponsored cargoes be allocated U.S.-flag ships, provided such an agency is established.

The reason for the subcommittee investigation of rates charged on Government cargoes was the relationship of these rates to the general commercial rate structure—the high level of Government rates has encouraged many of our U.S.-flag steamship operators to abandon inbound cargoes to the United States in order to return from an overseas voyage as quickly as possible to once again load with high paying Government cargoes. Once these rates are adjusted to fair and reasonable levels, Government cargoes will become less attractive and more and more of our steamship operators will begin building inbound services and shifting some of the cost of operations for the full voyage to the importers.

The final recommendation of Senate Report No. 1 dealt with our U.S. promotional policies for the merchant marine. We stated:

> " * * * the Department of Commerce and the Maritime Administration should evaluate current subsidy and shipbuilding programs. Preliminary evidence indicates subsidized operators are in many cases tied to inflexible policies by current subsidy practices and *cannot maximize* profits or fully use ship space. It also reveals that more *ships are* needed. We further believe an evaluation of the current policy limiting construction and operating subsidies to liner-type vessels should be made. Finally, we recommend that the Maritime Administration should consider discontinuing subsidy payments to American operators belonging

to conferences that refuse to cooperate with the regulatory policies of this country." (Pp. 7–8.)

Hon. Alan S. Boyd, the Under Secretary of Commerce for transportation, testified before the subcommittee on May 19, 1966, concerning this recommendation. He pointed out that an interagency task force had recently reported that numerous changes needed to be made in our subsidy programs. One such change ought to be made immediately as a result of our new procurement policies for defense cargoes.

The Department of Defense has stated it will procure ocean service from the line offering the lowest price. But, for example, if Line A, which is not subsidized, offers a rate of 58 cents per cubic foot for vehicles shipped from New York to Hamburg, whereas Line B, which is subsidized, offers 54 cents, the Department of Defense will accept the subsidized line rate; however, at least a quarter of the cost of the subsidized operator is paid by the Treasury in subsidy. In this example, the lowest rate appears to be the subsidized carrier, but, in fact, it represents the higher of the two in total cost to the U.S. Government.

The Department of Commerce recognizes this competitive advantage in our domestic trades. For example, when a U.S.-flag ship sails from the Pacific coast to Hawaii, it receives no subsidy from the Department of Commerce. This is true whether the ship is subsidized or unsubsidized on its other voyages. Subsidized carriers are required to reduce their subsidies by the percentage of domestic cargoes carried. A similar policy appears needed for Defense cargoes as a result of the new procurement policy. Not only would this eliminate the unfair advantage these lines will have over their unsubsidized competitors if no action is taken, but it would appear sound because, as in the domestic trades, there is no foreign-flag competition for Defense Department cargoes.

While this subcommittee has not been concerned with the actual subsidy program, we do believe that most of the recommendations of the interagency task force report should be implemented. Specifically, we agree that the operating subsidy should be restricted to "allow greater freedom of operation, more encouragement toward productive, profitable operations, and less detailed Government interference. We also recommend that once our regulatory policies are effective, the merchant fleet should be increased and subsidies should be provided bulk carriers."

Finally, we concur in Senator Douglas' statement in his opening remarks at the May 6 hearing: "Significant steps have been taken in the past 2 years which should eventually guarantee fair and reasonable rates to American exporters, both private and public. Appropriate charges must also be made in our promotional subsidy policies to keep in step with our new regulatory and procurement policies." (Hearings, pt. 4, p. 524.)

O

249

88th Congress }
1st Session }

JOINT COMMITTEE PRINT

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

Printed for the use of the Joint Economic Committee

U.S. GOVERNMENT PRINTING OFFICE

24-902 WASHINGTON : 1963

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington D.C. 20402 Price .05 cents

PHC

JOINT ECONOMIC COMMITTEE

(Created pursuant to sec. 5(a) of Public Law 304, 79th Cong.)

PAUL H. DOUGLAS, Illinois, *Chairman*
RICHARD BOLLING, Missouri, *Vice Chairman*

SENATE	HOUSE OF REPRESENTATIVES
JOHN SPARKMAN, Alabama	WRIGHT PATMAN, Texas
J. W. FULBRIGHT, Arkansas	HALE BOGGS, Louisiana
WILLIAM PROXMIRE, Wisconsin	HENRY S. REUSS, Wisconsin
CLAIBORNE PELL, Rhode Island	MARTHA W. GRIFFITHS, Michigan
JACOB K. JAVITS, New York	THOMAS B. CURTIS, Missouri
JACK R. MILLER, Iowa	CLARENCE E. KILBURN, New York
LEN B. JORDAN, Idaho	WILLIAM B. WIDNALL, New Jersey

JAMES W. KNOWLES, *Executive Director*
MARIAN T. TRACY, *Financial Clerk*
HAMILTON D. GEWEHR, *Administrative Clerk*

ECONOMISTS

WILLIAM H. MOORE — THOMAS H. BOGGS, Jr.
GERALD A. POLLACK — ALAN P. MURRAY
DONALD A. WEBSTER (*minority*)

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 the well-advertised products of the larger companies. In addition large manufacturers are often better able to produce and market private brands through other outlets.

D. PRODUCTION AND GENERAL ECONOMIC VITALITY

In addition to the eroding effects of price rigidity on productive efficiency and the shifts in production implied by the employment effects described above, the Quality Stabilization Act could be expected to retard and distort the economy's response to changes in consumer demand for retailing services, and to potential innovations in marketing techniques.

In general, our market system uses the pressures of price competition to weed out the inefficient and to select the goods and services (including retailing services) that best satisfy consumer demand. In retailing, as in other sectors of the economy, this flexible competition has produced for the American consumer a great variety of goods and services and marketing techniques. Some experiments in retailing have failed because consumers were unwilling to pay their costs. But many marketing innovations have been accepted by consumers and are now important elements in our distribution system. This selection process is essential to our free market economy. By comparison, European markets, where resale price maintenance is more generally found, have not generated the variety of innovative distribution practices that we enjoy.

Consumers can now choose to patronize relatively high-priced shops that provide substantial services with their goods, or they may choose stores that sell at lower prices but without the auxiliary services. It is commonplace to find branded products such as cigarettes, gasoline, and packaged food sold at different prices through different outlets. Consumers do not think less of a brand because they pay a lower price at a self-service market than at a local store providing delivery, credit, and a helpful clerk. Through their purchases American consumers have expressed their preferences for a variety of combinations of price and service, price and location, price and credit, price and quantity, and so on. The Quality Stabilization Act would severely limit their alternatives for many products.

New developments in marketing are frequently introduced through lower prices. In the absence of price flexibility the market is slower and less effective in selecting and rewarding the successful innovator. Without the price mechanism to place ideas before the public as quickly as possible, consumers would be slower to learn of new merchandising techniques; therefore innovation would be riskier, and new marketing ideas would be less likely to develop. Reduction of costs by aggressive merchants would not benefit the consumer through lower prices; at best he might receive added services. The cost-cutting innovators would not attract the larger volume of sales that would reward their innovation and speed its adoption.

Under the Quality Stabilization Act, therefore, the distribution process would be less responsive to consumer demand, a major stimulus to marketing efficiency would be lost, and consumers would not benefit through lower prices when cost-reducing improvements are made.

O