FEDERAL TRADE COMMISSION
Washington

FAIR TRADE IN OPERATION

ADDRESS BY
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BEFORE THE
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Adopting a literal definition of the subject assigned to me - Fair Trade in Operation - it would be responsive were I to discuss almost any phaso of the work of the Federal Trade Commission. However, from the titles of other speeches on the program, I gather that you use the expression "fair trade" as synonymous with "resale price maintenance". Therefore, I shall treat my subject as if it were "Resalo Price Maintenance in Operation".

In this connection, it has long been my feeling that someone could make a great contribution to popular understanding of current economic problems by working out an acceptable glossary of terms. I am never quite certain of the intended meaning of such labels as "fair competition", "fair trade", "stability" and the like, unless and until I know the context in which they are used. We all remember how some industries construed their N. R. A. codes of fair competition to restrain all price competition as "unfair".

I would like to preface my remarks by stating to you that the Federal Trade Commission, as an administrative body charged with the enforcement of policies declared by Congress, does not determine those policies, nor does it have authority to alter or amend them.

While the Commission in its annual reports has recommended to Congress the passage or amendment of legislation on subjects in its field, it does not participate in the enactment of any law nor can it encroach upon the functions of Congress and the Executive in that field.

While the Commission also, at the express request of the President, did submit to him a report commenting on the probable economic effects of the then pending Miller-Tydings bill, Congress subsequently having determined to enact it as an amendment to the anti-trust laws, it would be improper for me to argue its basic policy. For this reason, I hope that none of my remarks will be misconstrued as criticizing the basic policy of this law. My intention is rather to discuss certain difficulties, economic and legal, which necessarily arise from business policies under the modification of our previous legislative policy.

THE EXTENT OF RESALE PRICE CONTRACTS

From the speed with which state and national laws were passed to authorize resale price maintenance contracts in 42 states, one might have expected that, as soon as the legal obstacles were removed, there would be a deluge of such contracts. In fact, however, many manufacturers are apparently hesitating.

I know of no complete list of the contracts in effect. On November 15th in New York State, however, there were about 5,000 such contracts, according to an estimate by "Business Week". Of these, approximately half were in the cosmetic and drug fields, about 1,200 for books, about 360 for liquor, and only a little more than 400 for all other industries.

In appraising these figures, one must remember, too, that some contracts apply only to a single commodity and that consequently a single manufacturer who undertakes resale price maintenance may account for several contracts. Hence, it is probably fair to say that, except in the sale of cosmetics, drugs, books, and liquor, the use of resale price maintenance contracts is still sporadic.

The hesitancy of manufacturers is all the more conspicuous because distributors' trade associations have been widely interested in the new laws and have often sought vigorously to get contracts issued. It is anomalous that statutes whose legal theory is to protect the manufacturer's good-will should be more acceptable to distributors than to manufacturers.

COMPETITION OF PRIVATE BRANDS

Why have not manufacturers hastened to take advantage of the new laws? There appear to be several reasons. The most conspicuous is the fact that a manufacturer who fixes the retail price of his product makes it easy for the others to get the advantage of selling their products at lower prices. Distributors whose policy is to sell at low retail prices may concentrate their efforts on products whose retail list prices are not maintained. So long as only a few manufacturers engage in resale price maintenance, the tendency is to switch the bargain-hunting consumer to the brands of a rival manufacturer. When, as in the sale of cosmetics, resale price maintenance is widespread, the price-cutting distributor pushes low priced goods under his own private brand.

The most conspicuous illustrations of the threat of private brands are to be found in the policy of Macy's and of the large mail order houses. In full-page advertisements in the New York papers, Macy has called attention to the price increases it has had to make upon goods whose prices are maintained and has urged the public to buy other goods. On its counters, Macy's has placed side by side the price maintained brands and its private brands, with signs calling attention to the difference in price. Similarly Montgomery Ward has included in its catalogue an editorial entitled "You Don't Have To Pay For It", and has reinforced the editorial by the slogan "Save More. Buy a

Ward Product.". In its catalogue, Sears Roebuck has explained the prices of certain articles by the notation, "Price Fixed By State Law", and has announced that money can be saved by buying Sears brands, identified therein by a black-faced cross.

The tendency to switch the customer to private brands is not confined to these large organizations. "Advertising and Selling" reported in June that large liquor retailers and chain drug stores were increasing their sales of private label goods. "Drug Trade News" for September 27th, announced that, although retail sales of private brands had been recently declining, manufacturers were disturbed by retailers' purchases of increased amounts of off-brand unadvertised merchandise designed to compete with nationally advertised brands.

A spokesman for one large manufacturer declared at the last convention of Federal Wholesale Druggists Association:

> "For years you have asked the manufacturer to give you stabilization. You said that if he would do this the retailer in turn would give the manufacturer cooperation. Buying increased quantities of off-brand merchandise to compete with nationally advertised products is not the kind of cooperation we looked for. What does this mean? What is going to happen to the big parade? If the manufacturer does not make money out of stabilization he will quit and we will be back where we started."

Spokesmen for other manufacturers expressed similar views.

Certain manufacturers have attributed their increased sales to the help of distributors pleased with their resale price contracts. However, the distributors' sales effort is now concentrated in support of only a few price-maintained products, and it probably could not maintain equal effectiveness if required to support larger numbers of such products. The effectiveness of private brand competition would be increased, moreover, if the number of price-free national brands should materially decline, and in the face of a threat of private brand competition, many producers of national brands appear reluctant to gamble with the consumer's good-will.

RETAIL MARGINS VERSUS MANUFACTURERS' PROFITS

A second reason for the manufacturer's slowness in espousing resale price contracts is the fact that many of them find it to their own interest to encourage competition among distributors who sell their products. Distributors' price competition tends toward lower retail prices by reducing the distributor's margin instead of the manufacturer's profit. If distributors' margins are guaranteed, the retail price is likely to be on a higher level, and unless the consumer cheerfully accepts that increased price, the manufacturer may face the unpleasant alternative of a decrease in sales volume or a reduction in his unit price to the retailer.

The arguments which were made on behalf of resale price maintenance laws during their legislative consideration, emphasized this possibility, and insisted that the consumer would be protected by the competition of manufacturers for volume sales. Manufacturers evidently fear that this argument may be in part true.

They realize, moreover, that once the retail price is fixed, and the manufacturer remains responsible for it, the size of the contractual margin becomes a matter for negotiation, in which there will be strong pressure from retailers for a liberal margin.

For example, one of the chief spokesmen for the retail druggists declared at the last conference of the national association that -

> "The manufacturer must be made to realize that he must compete not only for the consumer's patronage but also for the retailer's good-will. ... the retailer should scrutinize every manufacturer's contract for the specific purpose of determining first of all whether it is fair to him; ...".

Thus, the retailer's insistence upon a wide margin may be a threat both to the maintenance of a retail price low enough to move manufacturer's goods and to the maintenance of the manufacturer's customary wholesale price.

DIVERSITY OF DISTRIBUTOR'S INTERESTS

A third problem which may deter manufacturers from adopting resale price maintenance contracts is the inherent difficulty of finding a minimum price for which they are willing to invoke the sanctions of the law. Price making in distribution is no simple matter. Some goods are sold direct to retailers, some through wholesale channels, some through cooperative wholesaling organizations, and many products by the use of all these channels jointly. Issues have already developed between retailers and wholesalers as to the division of the distributor's margin.

Again the drug field affords an example. The secretary of the retail drug association has insisted that the wholesale contracts must not provide for the full customary wholesale margin until the retailer is given protection for his full conventional retail margin; and that, prior to that time, manufacturers must see that resale price contracts covering sales through wholesalers allow for the retailer's special 10% discount customarily received from the wholesale drug trade. Of course, any manufacturer, undertaking to draw his contracts in accord with this suggestion, would encounter opposition from wholesalers.

Similarly, the secretary of an association of cooperative drug wholesalers insists that manufacturers must not yield to the pressure of other drug wholesalers by writing resale price contracts which will interfere with payment of dividends to member customers on the basis of their patronage. In determining resale prices, the manufacturer necessarily takes responsibility for the relative operating margins of different types of distributors, and thus acts as the arbiter of competitive advantage or disadvantage to be accorded each separate method of distribution. It is not surprising that manufacturers who visualize this picture hesitate to undertake the task.

PROBLEMS OF ENFORCEMENT OF CONTRACTS

A fourth problem which the price maintaining manufacturer must face is the extent of the legal difficulties in which he may become involved by his resale price contracts. The most obvious of these difficulties, though not necessarily the greatest, is the fact that, if he does a national business, he must try to devise contracts which will satisfy the varying requirements of the laws of 42 states, while staying within the confines of the Miller-Tydings amendment to the federal antitrust laws. This formidable legal job is not finished when a form of contract is once devised. Thereafter, the manufacturer must keep track of judicial interpretations of all these laws.

A further difficulty is that, since most of the state laws make contracts binding not only upon signers but also upon competing distributors, the manufacturer incurs an obligation to enforce the contracts generally. At best, this must require considerable watchfulness and substantial legal expense. At worst, it may mean unexpected difficulties for the manufacturer himself.

R. H. Macy & Co. recently argued, in an injunction proceeding concerning its sale of Philco radios, that the Philco contract was invalid because of its wide and flagrant violation. Weissbard Bros., well-known as a cut-rate retail store in New Jersey, recently filed a counter-charge in a suit brought against them by McKesson-Robbins & Co., claiming that McKesson is not forcing other retailers to maintain prices on certain products for which price maintenance by Weissbard is being required.

If such contentions are upheld, the manufacturer may have to choose between an intensive policing of a far-flung system of retail prices and the invalidation of his contracts. Moreover, there will necessarily be extensive proceedings to determine in various states such questions as whether a particular state law permits the fixing of trade-in allowances, prevents the granting of premiums, applies to patronage dividends, and the like. It is not surprising that even manufacturers who would like to maintain prices by contract prefer to hesitate until others have explored the boundaries of these laws and the expensiveness of their enforcement.

EFFECT ON RETAIL PRICES

Since retail price maintenance contracts are relatively new, little can yet be said about their effect upon retail prices. Studies by Professor Grether, of the University of California, from experience with the drug and cosmetics industries under the California law, however, may afford some indication of what may be happening elsewhere.

In general, Professor Grether's conclusions, published in March, 1936, were that whereas dealers had demanded 33-1/3% gross margin, the arithmetic average of the contractual margins studied was about 31%, with wide variations on particular items. The introduction of these contracts had led to some lowering of price in independent small drug stores. It had allowed a very nice basis for net profit by the more efficient dealers and by the limited service dealers, provided they maintained their sales volume. It had led to a significant increase -- about 25% -- in the price of contract items advertised for sale by metropolitan price-cutting and chain outlets.

Professor Grether concluded;

> "Without doubt, those consumers who wish to buy standard drug products with a minimum of professional attention and merchandising services are harmed by resale price maintenance, except in so far as they are able to obtain an equivalent quality under private labels .... Conversely, it appears that the position of the consumers who are attached to the smaller, especially the neighborhood, stores is improved by resale price control because they will continue to purchase at prices no higher than previously, perhaps even lower as contractual prices become the going prices".

Such bits of information as have become available elsewhere are not sufficient to give a broad picture of the effects of resale price maintenance. That there have been conspicuous price increases on certain items in certain outlets is evident. R. H. Macy & Co. have reported from time to time the average increase required by resale price contracts over the prices formerly charged by their store. In July, this increase averaged 8½% for cosmetics, 17% for drugs, nearly 13% for liquors and nearly 33% for books, and Macy's corresponding profits were reported as more than 39% for cosmetics, 36% for drugs and liquors, and 41% for books. Presumably the term "profit" is to be taken as meaning the gross operating margin, not a net profit on sales.

In June, "Advertising and Selling" reported that liquor distributors were demanding 40% profit and that, under pressure, certain manufacturers had reissued their contracts with resale price increases of from 3% to 10%. Here, too, the term "profit" is ambiguous, but presumably it refers to operating margin. Drug journals, on the other hand, have asserted that prices are not higher than the levels formerly prevailing in independent drug stores.

Some manufacturers in the drug field have encouraged low prices during the controversy over the introduction of contracts by special offers of deals or combination sales. Thus, in September, a Dr. West's toothbrush and a 50¢ can of Calox were jointly offered by Weco Products Company and McKesson & Robbins at a combination price of 59¢, and 2 Tek toothbrushes were being offered for 51¢. Drug journals were suggesting that the combination deal, whose cost is borne by the manufacturer, might become a substitute for the loss leader, whose cost is borne by the distributor. The New York State Pharmaceutical Association, however, was contending that such combination deals violate the spirit of the laws and might lead to complete chaos.

The price policy underlying the distributors' approach to resale price contracts is much clearer than the present effect of the contracts themselves. For the drug trade, it was summarized in 1935, in an article in "Advertising and Selling" as follows:

> "The aim of the new laws was undoubtedly to have contract prices which include service charges and a reasonable profit for the independent dealer".

In discussing the adequacy of the operating margins provided by particular contracts, retail druggists have used average drug operating costs as their standard of measurement. The objective appears to be to protect the full operating costs of the averago retailer. Necessarily this must have the effect of guaranteeing a profit to all those whose costs are below the average.

Leaders among the retail druggists have issued warnings, however, against a too rapid rise in prices and have expressed willingness to cooperate with those manufacturers who hesitate to provide at a single jump what retailers regard as an adequate operating margin. Hence, there is some reason to believe that the present levels under resale price maintenance contracts are not as high as the proponents of the contracts hope eventually to make them.

PROTECTION OF CONSUMER INTEREST

Popular reaction to resale price maintenance as a system, no doubt, will depend in large measure upon the level of prices eventually established. From the consumer's stand point, the proof the resale price pudding will be in its eating, and any substantial general increase in prices will cause agitation for either governmental regulation of the contract prices or nullification of the enabling legislation. And nullification may take two forms -- either outright repeal of the resale price laws, or such consumer reaction as would make general observance of the contracts impossible.

A recent article in "Business Week" referred to the Miller-Tydings Act as "a measure which assures business a new era of freedom from government regulation . . "

Thoughtless or reckless jacking up and pegging of prices, however, would engender popular demand for intervention by the government to protect the consumer. And there is a wide difference in the type of government intervention sanctioned under the present antitrust laws and that which would be necessary should the government be required to regulate the reasonableness of resale contract prices. It is the difference between negative regulation and affirmative management -- between ordering a business man to cease and desist from some specific unlawful practice and supervising one of his managerial functions.

Apart from the possibility of direct efforts to elevate contract prices too high, there is in a system of resale price maintenance a danger that prices also may be raised through an increase in the costs of retail competition. In the absence of price considerations, retail dealers must emphasize other means of attracting business. If the emphasis is placed on such other factors as size of stock, service, location and facilities, it seems inescapable that the costs of such factors and consequently of distribution, will be increased.

If such a result occurs, it is hard to see that any great improvement will have been made in competitive relationships, and the public will have been saddled with the burden of wasteful and unnecessary increases in the costs of retail distribution.

LEGAL QUESTIONS TO BE CONSIDERED

Many questions of law remain likewise still to be considered. Since the Federal Trade Commission has the duty of proceeding against unfair methods of competition in the relation of manufacturers to distributors, except in so far as exemptions may have been provided by the Miller-Tydings rider, it would obviously be inappropriate for me to express any opinion concerning any question the Commission may have later pending before it for quasi-judicial determination.

CONCLUSION

In conclusion, let me remind you of two things: First, that the Miller-Tydings Act does not wholly repeal either the Sherman or Federal Trade Commission Acts, and that those who would use the provisions of the Miller-Tydings Act to accomplish monopolistic restraints of trade must still run the risk of anti-trust proceedings; and second, that, although the Miller-Tydings Act and the resale price legislation of most of the States represent an experiment based upon a partial reversal of our former law and public policy, their final test must be their practicality and the fairness of their economic results in actual operation, as determined in the court of public opinion.

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