Journal of Institutional and Theoretical Economics (JITE) 147 (1991), 94–98
Zeitschrift für die gesamte Staatswissenschaft

Resale Price Maintenance: What do Economists Know and When did They Know it?

Comment

by

ARNOLD PICOT

Professor BREIT'S [1991] paper is an insightful, thorough and also critical assessment of what the profession seems to know about resale price maintenance (RPM). Of course he develops a primarily American perspective. Using a lively style, he unfolds interesting aspects of the history of economic thought on RPM. Thus, a subject which seemed to many economists definitely dead and buried is revitalized.

I do agree with Professor Breit's closing words that – regarding RPM – " 'the end of history' has not yet arrived" and I may add: combining the American view of the history of RPM with the European one – or at least with the German development – means that some parts of Professor Breit's history have to be rewritten.

Let me start with Prof. Breit's initial proposition: "Alfred Marshall's Principles of Economics was the first commodity in the English-speaking world to be sold under a scheme of resale price maintenance." (p. 72) If this were true for the whole world, we could pour out some champagne and celebrate the centennial of that institutional innovation; or, if you have a different stance on this matter, we could be happy that this anti-competitive measure has been more or less removed at last after one hundred years. But RPM is much older than a hundred years and it is hardly possible to date its birth exactly. Burkhard Röper, one of the older, but still living German economists who have closely studied RPM over some years, remarks in a quite recent article (RÖPER [1981]) that PRM in the book trade is more than 200 years old. There is also evidence that RPM for branded industrial goods was introduced in Germany before 1877. So let us be careful with dating birthdays. Of course I would not see any advantage in the fact that presumably RPM was introduced in Germany prior to the US or UK. What I want to point out is that it is very difficult to date precisely the beginning of some trade institution.[1]

[1] Johann Wolfgang von Goethe, in his correspondence with his publisher Johann Friedrich Cotta, gives us knowledge that RPM was implemented already around the turn

Similar arguments can be advanced with respect to Prof. Breit's contention that "no published treatment of the subject is to be found in the economic literature prior to 1907," (p. 77) since I obtained one major publication on RPM that is prior to 1907. Published in 1895 by Ludwig POHLE [1895], it is a pretty long paper that offers a thorough account of the German cartel in the book trade; explores the factual development of RPM in book trade over the preceding hundred years; and describes the long-lasting fight of the book traders' association which eventually arrived at an overall agreement on RPM. Furthermore it also reflects many of the pros and cons that are discussed in Prof. Breit's paper, namely the service argument, hints to the free rider argument, possible additional sales through RPM, reduction of transaction costs through RPM (costs of search and comparison). Pohle also compares the situation in Germany to that in England and maintains that RPM, which, at that time, was an exclusively German institution, provided greater welfare to consumers and dealers. All in all, he is in favor of RPM, and he points out that it was the trade and not the publishers who fought for RPM.

Another early publication on RPM was written by E. ROSENBERG [1913]. He describes and discusses the development of vertical price restrictions in the pharmaceutical and in the cosmetic industry during the 19th century and shows under what conditions RPM agreements worked or broke up.

Again it seems very difficult to date "What do economists know and when did they know it?"

This is also true for the free rider argument. POHLE [1895] – in a rather weak way – has already used that argument in 1895. The English economist Basil Yamey, who published several pieces on RPM, described it already in 1954 in a very clear way, but without using the phrase "free riding":

> "A retailer may hesitate to spend much on the provision of a large stock, adequate outlay and expert sales staff unless there is reasonable expectation that the benefits of his investment will accrue to him and not to his competitors. It is always possible that some customers will take advantage of his facilities, decide to buy, but make their purchases elsewhere. It is reasonable to suppose that more customers will behave in this way if they can buy what they have selected cheaper from his competitors; and his competitors may be able to undersell him because they do not provide the costly services of which they nevertheless get the benefit. In this way retail price competition may tend to inhibit expenditure on the provision of certain retail services and this may reduce the sales of the products." (YAMEY [1954, 52f])

---

of the 18th to the 19th century. This can be indirectly concluded from many pieces of that correspondence. A conspicuous example is the discussion of a new edition of Goethe's complete works in 1826. Refering to dissatisfactions in the booktrade, Goethe demands a different price policy from Cotta. It is obvious that resale prices are fixed by the publisher. In his interesting answer to Goethe, Cotta adds complaints of several German booksellers who demand higher discount rates within Cotta's price regime. See KUHN [1979, 177–182] and [1983, 152–156]. I thank Erich Schanze who drew my attention to this correspondence.

This description was six years prior to TELSER's [1960] article, where Prof. Breit detected the free riding argument for the first time and where he sees the main source for rethinking the benefits of RPM.

Whithout describing the legal development in Germany in full detail[2], it might be noteworthy that in Germany the legal assessment of RPM took a different course compared to the US: it went from supporting RPM to its prohibition. At the beginning of the century, a break of RPM agreements was ruled to be incompatible with the German Unfair Trade Law. Later, RPM was allowed only under certain conditions (branded goods, books) by anti-trust law. Only in 1973 was RPM generally prohibited by anti-trust law with the exception of books and seed goods. There are also exceptions for pharmaceuticals and energy, which are laid down in different laws. It could be interesting to discuss why the legal treatment of RPM developed so differently in the two countries. And more attention should be paid to the explanation of the exceptions in new institutional economics terms. It also seems remarkable that in Germany it was very often the trade who demanded RPM, not so much the manufacturers. At least this is true for the book industry. As far as I understand it from Prof. Breit's paper, manufacturers in the USA took the initiative. This difference should be discussed and an attempt made to explain it. For Germany it seems to be true that retailers, distributors and the like used to play a more important role as constituency and as voting potential than manufacturers.

More recent German research on RPM, namely the very thorough book of Herbert HAX [1961], discusses all the arguments that are presented in Prof. Breit's account. This research is more critical about the efficiency effects of RPM. Theoretical and empirical evidence show that (HAX [1961, 165]):

- RPM leads to higher trade discount rates.
- Dangers of damage to branded goods by loss leaders in the absence of RPM are exaggerated.
- Tendency towards open or de facto cartels of manufacturers and resalers is strengthened by RPM.
- Necessity for rationalization and selection of better sales and service structures, especially development of new forms of marketing channels and distribution systems, is hindered.
- No real advantages for the consumer could be detected in several empirical studies.

Thus, on balance, RPM seems to be merely an instrument for increasing market power without increasing efficiency or consumers' welfare.

[2] It is interesting to note that the German Reichsgericht ruled already in 1890 on RPM, i.e. simultaneous with the alleged start of this institution in the English-speaking world according to Prof. Breit. The court ruled that the organization of RPM in book-trade is allowed under certain conditions. See RGZ [1892, 238–251] and SCHRÖDER [1988, 11–15]. I thank Wernhard Möschel who drew my attention to this early ruling.

It seems too, to be nothing more than a remainder of old feudal trade habits from times when the entry of new forms of trade into the market was not welcome. Perhaps in the 19th century it was also an efficient means of providing certain services in the absence of alternative solutions. Today, however, there are many alternatives to ensure the alleged advantages of RPM without creating all the unfavorable side effects. To mention only a few alternatives:

- The manufacturer may deliver his goods to resalers only if the latter offers some minimum service.
- The manufacturer may offer the necessary service himself (presale services such as practical demonstration in decentralized showrooms of the manufacturer, advertising, handbooks, etc.).
- The manufacturer may integrate downstream (direct sales, direct marketing).
- The manufacturer can sell through agents who are not independent dealers.
- The additional service is provided as an extra product (consulting, training, special journals, teachware, etc.), or as a quasi-public good (consumer education and consumer information by mass media such as radio and TV).

We can clearly observe many of these institutional solutions today in various markets. Of course, all these and similar solutions must be evaluated in terms of transaction costs. The main point is that there exists a high potential for institutional alternatives to RPM. Abolishing RPM means introducing creativity for new forms of products, services or marketing channels in the area of the former RPM-products.

To put it differently: it is surprising that in the RPM discussion the free rider is rarely seen as a signal that points to chances of new services, products, institutional or organizational solutions. [3] RPM serves as a conservative device for good old trade structures. It is not an option that fosters efficiency or increases consumer benefits. I would not use the free rider proposition as an argument in favor of generally legalizing RPM (the easy way) but as one in favor of deregulation and allowing new institutions to develop. The argument "either RPM or lack of service for the consumer" seems much too simple and implies a static world. RPM was one result of a dynamic trade world 200 years ago. Today, it is too comfortable a solution and restricts institutional innovation. As there are now diverse other potential ways of providing consumer service, the conservation of RPM which tends to prevent price competition is not acceptable.

Of course, an overall evaluation of RPM is not the aspiration of Prof. Breit's paper; but the historical landmarks he reports stimulate the economic discussion on the subject. Arguments brought forward in favor of RPM even by some new institutional economists are not acceptable if the dynamics of markets and institutions are taken into account.

[3] FINK [1988] offers an inspiring interpretation of RPM on grounds of information and market process theory.

References

BREIT, W. [1991], "Resale Price Maintenance: What do Economists Know and When did They Know it?", *Journal of Institutional and Theoretical Economics*, 147, 72–90.

FINK, R. H. [1988], *Resale Price Maintenance: A Market Process Approach*, Dissertation, New York University.

HAX, H. [1961], *Vertikale Preisbindung in der Markenartikelindustrie*, Köln–Opladen.

KUHN, D. (ed.) [1979], *Goethe und Cotta, Briefwechsel 1797–1832*, Textkritische und kommentierte Ausgabe in drei Bänden, Vol. 2, Briefe 1816–1832, Stuttgart.

–– (ed.) [1983], *Goethe und Cotta, Briefwechsel 1797–1832*, Textkritische und kommentierte Ausgabe in drei Bänden, Vol. 3/2, Erläuterungen zu den Briefen 1816–1832, Stuttgart.

POHLE, L. [1895], "Das deutsche Buchhändlerkartell," pp. 459–532 in: *Schriften des Vereins für Socialpolitik*, Vol. 61, Verhandlungen von 1894, Leipzig.

RGZ [1892], *Entscheidungen des Reichsgerichts in Zivilsachen*, hrsg. v. den Mitgliedern des Gerichtshofes und der Rechtsanwaltschaft, Bd. 28, Leipzig.

RÖPER, B. [1981], "Preisbindung, vertikale und Preisempfehlung, vertikale," pp. 153–160 in: *Handwörterbuch der Wirtschaftswissenschaften*, Bd. 6, Stuttgart et. al.

ROSENBERG, E. [1913], *Der Vertrieb pharmazeutischer und kosmetischer Spezialitäten in Deutschland*, Berlin.

SCHRÖDER, R. [1988], *Die Entwicklung des Kartellrechts und des kollektiven Arbeitsrechts durch die Rechtssprechung des Reichsgerichts vor 1914*, Ibelsbach.

TELSER R. L. [1960], "Why Should Manufactures Want Fair Trade?," *Journal of Law & Economics*, 3, 86–105.

YAMEY, B. S. [1954], *The Economics of Resale Price Maintenance*, London.

Professor Dr. Arnold Picot
Institut für Organisation
Ludwig-Maximilians-Universität München
Ludwigstr. 28
W-8000 München 22
Germany