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Broude: Steel Decisions and the National Economy

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influences of their profession, the importance of supplying this long-missing element is manifest. The law of the new United States derived from two sources — the more important being the principles developed in colonial practice, and the second being the English law. Men who found themselves faced with the responsibility for striking off in new and unknown courses in the process of state-making, would also be ready to advocate fresh turns of theory for the law.

One looks forward with anticipation to the second volume of this masterful study; and if the editor is to be pardoned, as well he might be, for grouping the most dramatic documentary material in the first publication, there is consolation in the fact that Professor Goebel is also to be the author of the first volume in the Supreme Court history earlier described. With as perceptive a study of nascent Federal law as he has provided here for New York law, the cause of legal history and the legal profession will have been admirably served.

As a postscript — the present volume is superlatively printed.

WILLIAM F. SWINDLER∗
Broude is worried about the problem of resolving gaps between "public" appraisal of requisite capacity in an industry and capacity forthcoming from private responses to market forces. While no general treatment of this subject is presented, the iron and steel industry is examined as a case study. The particular questions to which Broude addresses himself are:

1. Is the industry so strategically "placed" in the structure of the national economy that actions within it have pivotal significance to the well-being of the economy; and

2. What policies, if any, can and should be instituted to affect behavior and performance in the industry?

The approach taken in the examination of these issues is threefold: (1) a review of the historical association between steel output and gross national product (in Chapter II) and of the relationship of steel demand and capacity requirements (Chapter IV); (2) the formulation of a simplified model of the role of the industry in the course of economic change (Chapter III); and (3) interviews with and compilation of published statements of industry leaders to ascertain factors in entrepreneurial decisions (Chapter V). There then follows a concluding chapter which proposes national economic policies to obtain socially desired steel industry capacity.

Broude discovered that, in terms of turning points and secular trend, the relationship between steel production and GNP is almost fixed; from 1919 to 1950 constant dollar GNP grew at 3.2 percent per year while steel output rose at 3 percent per year. Furthermore (and not surprisingly), there was an even closer correspondence between steel output and investment activity in the economy. These trends (and deviations from trends) were examined in some detail, and it was concluded that, because of the high variability of the amplitude of the relationships and occasional lapses from consistent timing, steel output series are not useful indicators or forecasters of levels of business activity.3

Broude’s Chapter III is misplaced; it is discussed below. In Chapter III he examines several major previous attempts, particularly that of Dunn, to determine capacity requirements for the industry.4 Dunn made the valuable observation that, even in physical (in contrast to economic) terms, the concept of capacity is ambiguous. Capacity might be defined as: (1) the instantaneous maximum output attainable if all facilities were utilized to the fullest extent; (2) the output attainable under normal operating conditions with normal "down time" taken into account — called "rated capacity" (the concept employed in the industry’s trade association reports); or (3) the output attainable under high demand pressure with less than normal "down time" — “reliable capacity.” In terms of long-run capacity adequacy, the second concept

3. The timing is generally coincident. Broude, supra note 1, at 59-60.
appears to be valid; for investigating short-run bottleneck phenomena, the reliable capacity definition may be the most reasonable.  

While these concepts are expounded in depth, no use is made of them; the author merely continues on to report on other demand and production requirement studies. Finally, the static Leontief interindustry model (complemented by an output-capacity vector) is proposed for use in demand prediction, and summary results of the 1953 U.S. Office of Business Economics input-output steel requirements study are presented.

Surprisingly, "in order to allow evaluation of the relative 'realism' of the foregoing (interindustry) approach as applied to the steel industry," Broude next turns to "a consideration of some aspects of entrepreneurial behavior in the industry." He first briefly sketches the organizational history of U.S. Steel, Bethlehem, and Inland, and then passes to the decision-making framework.

Because the number of factors which might be evaluated in expansion planning is extensive, Broude limits himself to matters of timing, thereby neglecting the determinants of expenditures. He proposes to investigate whether decisions to expand steel capacity occur in the midst of or in anticipation of a change in the demand for steel. It is found (from company publications) that firms in the industry base estimates of more immediate demand on patterns of current and expected production of major steel consumers, but that questions of the longer-run future are examined before decisions to meet short-run expected rises in sales are made. As Broude observes, such forecasts must, of course, give weight to product mix and regional factors, and, in an individual firm, its own and its rivals' sales penetration strategy. The subsequent logical steps are to see whether facilities in existence and under construction will be adequate to meet anticipated demand, and to plan revisions in the capital budget consistent with the firm's objectives. However, practically no quantitative evidence on the timing of investment in relation to changes in demand is presented, and that which is, is not clear-cut.

5. Obviously, in an integrated production process, a bottleneck in any segment can seriously retard final output. Unless they are frequent, stochastic occurrences of this nature must be neglected in preparing capacity estimates; longer-run shortages automatically should alter these figures.

There is also a need to be aware of the effect on steel capacity of varying the quality of input raw materials. The difference in blast furnace capacity of using high instead of low grade iron ores can be as much as 20 percent.

6. There is also a long digression on the 1950 proposal to erect a steel works in the New England region.

7. U.S. DEPT COMMERCE, OFFICE OF BUSINESS ECONOMICS, INVESTMENT COST AND CAPACITY IN IRON AND STEEL: AN EXPLORATORY STUDY (Sept. 1953).


9. Some fragmentary Inland Steel data reveal an apparent one to two year lead of output to net additions to property.

Delivery time data published in Iron Age and Department of Commerce on new orders, unfilled orders, shipments, and inventory statistics could also have been utilized. Relating these data to investment appropriations (available from the National Industrial Conference Board) and outlays might have given Broude clues to the timing of investment relative to changes in demand.
Broude's next move is an investigation of managerial objectives and motivations for capacity additions. After first rejecting the influence of interest rates on investment and discarding profit maximization, the author looks at the decision-maker in the role of an "economic actor," pursuing perceived goals of security, continuity, growth, prestige, and power of the firm, identification with the firm, social approbation, and participation in an "absorbing game." In order to gain insights on behavior four open-ended interviews were conducted with chief executives or directors of steel corporations. The companies and dates of the interviews are, unfortunately, not given; the questions asked centered on predictions of future capacity expansion and industry output, future types of industry personnel, implications of future government interference, and industry structure vis-à-vis monopoly and competition. The answers revealed little of interest, except perhaps some concern about financing and the inadequacy of allowable tax depreciation charges.

Next a content analysis of 45 statements of steel executives between May 1931 and December 1952 is presented to ascertain whether a new capacity expansion attitude developed in the industry after 1950. Given the selection of the initial depression period and ending on peak Korean demand, and the structuring of the data, it would be startling if the industry's attitude were not more optimistic about expansion in the later years. Nothing much can be drawn from the content analysis as it was executed, or from the following discussion of expansion, new technology, and foreign competition (except that the U.S. has been lagging behind foreign producers), or from the mystical characterization of the "representative entrepreneur."

Returning now to the misplaced Chapter III and the role of the steel industry in the course of economic change, first, it can readily be shown, although Broude does so laboriously, that the rate of increase of steel demand depends on the aggregate marginal and average capital-output ratios in the economy (and the steel intensity of the capital stock) and will be less than the rate of increase of GNP if these parameters are constant. An acceleration or deceleration of GNP will normally have the opposite effect. Secondly, as to cyclical leverage phenomena, it is inconceivable (except through demonstration effects inducing parallel action in other sectors) that the industry acting independently could prevent a downturn of the economy at the upper turning point of a cycle by increasing its investment from normal levels. Broude uses an arbitrary multiplier-accelerator model to show this, but merely noting the industry's average share of total business investment (about 3-4 percent) would have been sufficient. This is aside from correct anticipation of the turning point with a sufficient lead time so that appropriate capital additions could be planned and the expenditures undertaken.

10. While these may be ultimate forces underlying executive behavior (just as the desire for satisfactions underlies personal consumption behavior), it seems quite dubious to this reviewer that such motives are the determinants of particular capacity expansion decisions. I, for one, am unwilling to abandon the explanation of economic phenomena to the psychoanalyst's couch.

11. Both statements presuppose realistic values of the parameters.
Finally, although the objective of the book is to examine and prescribe policies to assure "adequate" steel capacity, only nine pages are devoted directly to the analysis of bottleneck phenomena. The fact that inadequacy of supply of a primary input such as steel can play a significant part in bringing on a downturn is obvious. Broude demonstrates that such is the case by a clever introduction of bottlenecks into Goodwin's diagrammatic accelerator model (driven by income and discrepancies between desired and actual capital stock). Investment responses to income are assumed, as are feedbacks on income as a result of new capital formation. The model clearly reveals that "a bottleneck condition could precipitate a downturn sooner than would have been expected, or conversely could shorten the period of expansion in that phase of the cycle." It might be added that the amplitude of cycles would be decreased while their frequency would rise.

Having shown that bottlenecks could cause recessions, Broude devotes the final chapter of his book to national economic policy for "ideal" functioning of the industry.

The psychological motivations and public forces on steel management are first re-examined and then several alternative "social control measures" are presented. These range from extreme moves to increase and enforce competition (e.g., by strong anti-trust policies or dissolution to form firms of a maximum size of one integrated works) to maximizing control over operations (e.g., by public utility regulation or government ownership). Other intermediate measures take the form of "carrot" incentives (e.g., accelerated amortization, tax credits, government loans) or indirect coercion (e.g., through the government's buying power, competition with the industry of the TVA variety, control by admonition). All of these have distinct disadvantages, to varying degrees, in terms of interference with the market mechanism, discrimination between and among existing firms and potential entrants, creation of inflationary pressures, and so forth.

Except to the extent of keeping entry conditions as open as possible and opposing mergers, Broude rejects the extreme measures, ex cathedra, as "neither economically, politically, nor administratively feasible or desirable." Taken together with loan and tax incentive measures, some features which normally would be a part of regulatory policy form the basis for Broude's recommendations. He proposes the establishment of a review body responsible to the Joint Economic Committee, which would work with the projections of GNP prepared by the Council of Economic Advisers and break them down to provide estimates of aggregate national capacity and product mix required of

12. As Duesenberry notes, it is, however, unlikely that such shortages can cause major depressions. DUESENBERRY, BUSINESS CYCLES AND ECONOMIC GROWTH 280-81 (1958).
13. Whether investment responses are brought about by subsidiary changes in output prices, profits, the cost of capital goods, or directly via income changes is irrelevant, if the former are related to the latter.
14. P. 89.
the industry. These forecasts would then be the subject of public hearings held in conjunction with those on the President's economic report and would be put into the Congressional Record as a set of targets against which the industry as well as the society might judge the industry's performance. In the suggested public review, the burden-of-proof is to be placed on the industry to show cause why it is unable, or unwilling, to meet the government's capacity targets. Small firms would be exempted from the procedure which would endeavor, after any revisions of desired capacity decided upon as a result of the hearings, to obtain compliance by admonition, preferential tax treatment and purchasing, and other rewards and penalties. The advantage of this type of social control (as claimed by the author) is that it replaces the present "erratic, capriciously applied, ad hoc" admonitions and procedures with a formal mechanism that establishes overt standards. Yet, the disadvantages (ignored by Broude) are numerous — a matter to which I shall return after presenting some reservations to the capacity adequacy analysis.

First, findings based on the relationship between steel production and GNP or investment imply little, of course, about the causal role played by the steel industry in influencing aggregate cyclical movements and growth. It would be a simple economic world, indeed, that depended solely on steel output to determine its expansion path. A complex of forces is involved, of which steel is only one factor, i.e., the availability of steel is a necessary but not a sufficient condition for growth and stability. Moreover, it may be inappropriate to draw inferences from long annual time series, since the short-run effects of normal peacetime shortages of steel might be felt only near particular peaks of certain cycles.

Second, there are several difficulties with the interindustry approach for demand forecasting.

a. The use of input-output coefficients only yields exact estimates of steel needs if the final demands on the major steel consuming industries (on both a direct and indirect basis) have been precisely specified. As the forecast period is lengthened, such detailed specifications become more and more uncertain, causing a corresponding variability in the accuracy of prediction of steel demands. Moreover, even in the short run, large predictive errors may be encountered because changes in inventory accumulation by steel consumers cannot readily be fully anticipated.

b. In the long run, input coefficients are not likely to remain constant, since they are altered by technological change, competitive market conditions, and relative price substitution effects. There is no presumption that the entire matrix of input coefficients will be so altered over time by technical progress and revised profit margins that steel requirements per dollar of final demand...

15. These are to be devised so as to "assure adequate capacity at all times" (emphasis added). Obviously, the price of such sufficiency is excess capacity, which Broude views not as a net social cost, but as standby capacity that yields a net positive social return. Pp. 305-07.

16. The matter of secular shortages in steel capacity will be treated subsequently.
will remain constant. Although substitution may never be complete, the long run elasticity to relative price shifts can be large, causing substantial displacement by one input for another. To cite one example, prestressed concrete has been widely substituted for steel in much building construction. In certain uses, over long periods of time, particular materials do frequently retain marked cost advantages, giving rise to so-called “thresholds of substitution.” Yet, if all uses and total production of an industry are considered, marginal substitution in many uses can sum to a substantial loss in volume.

c. The relevant capacity requirements coefficients must be of a marginal nature, stating the capacity increments needed to satisfy additional demand. Moreover, in order to avoid bottlenecks, they must be highly disaggregated to account for the specialized, as well as the interdependent, capacity needs of different product mixes. This represents a formidable problem, since a large number of mixes are bound to be encountered. For industry capacity requirements forecasts, variations in production methods between plants or firms manufacturing identical products may also be important; significant interfirm capital input coefficient differences, even where the production process basically is the same, have been observed. Additionally, the regional pattern in demand may markedly influence capacity adequacy — West Coast steel requirements cannot economically (due to transport costs) be satisfied by production in Pittsburgh.

d. For short-run purposes, use of the interindustry technique is bedeviled by the need to adjust for inventory stocks on hand and inventory responses and technical and human inertial lags to fluctuating demand and capacity pressures.

Nonetheless, all of these problems are not so severe as to invalidate the general approach. In fact, the interindustry methodology probably has more promise than other alternatives for preparing accurate forecasts. However, modifications of the input and capacity coefficients are definitely required for longer-run projections, and even in the short-run, cyclical adjustments might be needed. Therefore, analysis of time series aggregates might be viewed in a complementary rather than competitive role, being employed as a guide, with other evidence to potential shifts in input factors.\footnote{17. Broude wisely observes that the two methods could be employed in combination. P. 145 n.72.}

Third, the timing and amounts of investment outlays are inextricably interwoven and cannot be analyzed separately. It cannot be assumed that capacity which might be warranted by future demand can, willy-nilly, be stuffed into the present to meet current needs. The timing of capacity increments does affect and in turn is influenced by costs, the availability of funds, rates of return and pricing. These factors should not blissfully be set aside or swept under the twin rugs of ignorance or \textit{ceteris paribus}.

Fourth, while Broude’s elegant demonstration of the theoretical impact of bottlenecks is commendable, in the light of the policy formulation intent of
the author, it is far from adequate. The more important questions to be answered are:

1. Have peacetime steel bottlenecks in fact existed in the recent past;
2. If so, what was their nature, extent, and effect on the economy; and
3. Are they likely to recur and have serious deleterious consequences?

Only after a response has been offered to these queries can policy for government intervention validly be formulated.

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<tr>
<th>TABLE I</th>
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<tr>
<td><strong>Production and Capacity Utilization</strong></td>
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<td><strong>Iron and Steel Industry</strong></td>
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n.a. = not available.

†American Iron and Steel Institute, *Annual Statistical Report*, various years.

Consider short-run bottlenecks. If the demand for steel truly is price inelastic, then capacity utilization and production statistics should reveal bottlenecks at cyclical peaks. It can be seen in Table I that in the pre-recession peaks of 1948, 1953, 1957 and 1960, production and capacity utilization were somewhat greater than in the preceding years. Yet in each of these instances rated capacity utilization was less than 100 percent and reliable capacity utilization (the more relevant concept — cf. above) would have been even lower.18

18. There have been postwar monthly and quarterly periods when the utilization rate (not seasonally adjusted) approached or exceeded 100%. With the exception of 1948:4-1949:1 and the Korean years, these occurred in the quarters immediately preceding and following steel strikes. Also, when steel inventories are taken into account and production
The examination of the 1955 experience is also interesting. Capacity utilization was lower than during the Korean conflict, yet production reached its postwar peak in this year. It is dubious whether the 1955 automobile or the 1956 producer's durable equipment booms were restricted by a steel shortage.\textsuperscript{10} As to the postwar recessions themselves, Hickman's careful study revealed no indication that an unavailability of steel played any role in these downturns; the recessions were all ascribed to other sources.\textsuperscript{20}

Nevertheless, it might be proposed, due to price movements, that this is more apparent than real. If strong demand or cost-push pressures on steel caused sharp steel price rises, and these were then "passed on" to final consumers, aggregate demand (in real terms) might fall. While under the "pass on" assumption the relative percentage rise caused in other prices by steel price increases is significant, the absolute dollar magnitude of the rise would be small in the short run. For example, a substantial rise, say 10 percent, in the price of steel would (if just "passed on") cause a .7-2.3 percent increase in the price of motor vehicles; translated into absolute terms and 1964 prices, this would mean the average car would be approximately $15-$50 more expensive.\textsuperscript{21} From a cyclical standpoint it is dubious that this would have much direct short-run impact.\textsuperscript{22} Relaxation of the price elasticity assumption, i.e., marked substitutions of one type of expenditure for another, would tend to lessen any demand and output diminution as long as other sectors have adequate capacity to satisfy such shifts.

The same is true in the long run, but one cannot blithely assume as Broude does (p. 273 — however, he later contradicts himself on p. 306) that the specific is seasonally adjusted, any scarcity impact of brief high utilization is minimized. On the other hand, this might be offset to some extent by regional mismatching of capacity, inventories, and demand.

19. As emphasized earlier, this review of capacity utilization should be conducted by type of product (e.g., cold rolled sheet) and region of demand and production. (Shipment and capacity data available in Iron Age and from the American Iron and Steel Institute might be valuable in this regard.) However, trade reports at the time or T. A. Wilson's, "An Analysis of the Inflation in Machinery Prices," Study of Employment, Growth and Price Levels, U.S. Joint Economic Committee, November 1959, do not cite any steel shortages. Moreover, higher utilization rates generally result in greater profitability (cf. Ezekstein \& Fromm, "Steel and the Postwar Inflation," \textit{id. at 25-26}). In other words, steel producers are faced with incentives to increase and not lessen utilization.

Broude might counter with the argument that, by 1955, steel executives' "new attitudes" had assured sufficient capacity. If so, then there are unlikely to be any short-run bottlenecks in the immediate future.


21. These weights are taken from the 1947 Evans and Hoffenberg input-output table (\textit{Review of Economics and Statistics, May 1952}). The upper limit contains both direct and indirect effects of a steel price increase (including the cost of investment goods by the motor vehicle industry) and, therefore, should be regarded as the long-term limit of the price effect.

22. During an upswing in aggregate economic activity, there could be concern, of course, about the inflationary pressures generated by demonstration effects. These might in turn increase the savings rate to produce deflationary forces. Cf. Tyrni, "The Effect of Price Changes on Consumer Saving," \textit{Review of Economic Studies}, April 1964.
scarcity problem vanishes (in the long run) either through relief of the scarcity or through adjustment via substitution in the production process or the products demanded. Given the highly concentrated oligopoly structure of the industry (even without excessive profits), prices would tend to be higher and output lower than under more competitive conditions. If substitution is imperfect, then aggregate output will be retarded from otherwise attainable levels. Such gaps can be sizable and, if they persist over an extended period, entail a sizable diminution in potential welfare. Government intervention to secure adequate capacity might then be desirable.

If undertaken for this reason or in response to cyclical bottleneck problems, it is still questionable, however, whether interference with the market mechanism should take the form advocated by Broude. The consequences of government dictation of capacity changes may involve not only the loss of psychological freedom of managers to determine their firms' actions (which may be relatively unimportant), but might also give rise to substantial waste and inefficiency. Enforced capacity standards (if they are not to induce expansion by high cost producers or in areas where demand already is being satisfied) cannot be set forth in a general sense; they must be for specific kinds of capacity, in specific regions, to supply specific types of steel for specific classes of users. Aside from accurately predicting demand, a myriad of dynamic factors must be taken into account in these specifications—evolving technology; changing sources, qualities, and costs of raw materials; shifting relative prices of competitive substitutes for steel; and so forth. Furthermore, the decision to satisfy demand (at given prices) entails knowledge that steel production and transportation costs are sufficiently low (in the absence of explicit or implicit subsidies) for reasonable after-tax profits to be earned on investment. Almost inevitably, as has been demonstrated in other regulated industries (especially transportation), the control of capacity leads to the imposition of constraints on pricing.

Moreover, in the case of steel, this is a virtual certainty. Given the substantial long-run direct and short-run demonstration impact of steel prices on other prices in the economy and the present-day concern about inflation, the industry's prices would soon be regulated after capacity reviews had been instituted. In theory, pricing control may not be harmful; in practice, it is sure to lead to distortions of prices from the real costs of resources.

23. Economies of scale are not required for this conclusion. Furthermore, it is valid for both static and dynamic cases. Incidentally, for the shift in demand-constant returns to scale case, Broude rediscovers that a monopoly or oligopoly firm will attempt to maximize output at the pre-existing price if it had been at a profit maximizing equilibrium prior to the change.

24. This assumes that imports of steel or production of steel by firms not in the industry (e.g., automobile manufacturers) also are inadequate to eliminate any long-run scarcity. Obviously, transport or production cost or some other type of barrier is required for this to be true.

25. In many respects, Broude's proposal is similar to the techniques employed in France, where capacity and price regulation are not uncommonly tied to one another. unpublished Ph.D. thesis, Harvard University, to be submitted in late 1964.
The establishment of capacity standards might also lead to misallocation of resources. The nature of the review procedure suggested by Broude leaves ample room for the exertion of effective political pressures by congressmen seeking to have production facilities or contracts awarded to firms in their districts. Surely, the long history of the undesirable effects of the "pork barrel" is a cause for concern in giving Congress the power to geographically distribute employment in the industry. Even if the process could be insulated from political forces, there still is no guarantee that government experts on the review board would choose economically ideal locations for new capacity. Certainly the government's selection of Fontana, California (60 miles inland), and Dangerfield, Texas, as steel production centers in the early 1940's (even taking account of the military situation at the time) is not reassuring in that regard.26

Other difficulties with regulation (including retarding effects on technological progress) might also be cited. Taking all these disadvantages into account, there is sufficient room for skepticism about the efficacy of utilizing a capacity review board to achieve socially desired behavior of the industry to urge that other alternatives be considered and carefully investigated. Efforts to obtain a less concentrated industry structure and more competitive market actions under the Sherman and Clayton Acts should not lightly be dismissed in favor of far more easily implemented, but potentially more harmful, regulation, whatever its form. This is all the more true because Broude has not demonstrated that the steel industry has or will retard the economy; in this light, his recommendations for control must at the least be regarded as unfortunate, if not capricious and irresponsible.

GARY FROMM†


The Jahrbuch has a distinguished tradition. Founded in 1906 as a forum for description and analysis of public law problems from the comparative view, the annual has provided a useful and reliable measurement of the evolution of constitutional and administrative law in many countries. Publication of the Jahrbuch was discontinued in 1939, but since 1951, with the appearance of