

CHAPTER II

THREE REMEDIES OFFERED

In the attempt to solve this problem we are confronted with a perfect babel of confused counsels. Space does not permit a detailed analysis of the suggested remedies. In a general way they all fall under three classes; socialism, regulation and the abolition of privilege. Measures like bank supervision, the prevention of food adulteration, forestry laws, child labor laws, water ways, drainage of swamp lands and flood control, are not included in this analysis because they command universal approval.

Socialism

Much confusion exists in the discussion of these problems because of the failure to define accurately the terms used, and to adhere to that definition throughout the discussion.

It is necessary to define socialism. It is loosely used as a term of reproach by the reactionaries to discredit any proposition that involves any change of the existing conditions. We are all socialists in the sense that we believe in the public construction and maintenance of roads, the public operation of the post office department, public schools, fire and police departments and

other public services, and there probably is a preponderance of sentiment even among conservatives for the public ownership and operation of water supplies.

Socialism as presented to us by its advocates in this country, and as used in this discussion, goes much further than this. Socialists would have the government own everything, operate everything, produce everything, and employ everybody. The two principles which distinguish fundamental socialism are that competition is a wasteful process and should be abolished, and that the profit motive leads to greed and injustice and should be abolished in favor of the government distribution of the product of labor and capital as owned and operated by the government, upon the principle that each employee, irrespective of service rendered, should receive exactly the same wage or share of the general product.

Natural Monopolies Should Be Owned By the People

Government ownership and operation of utilities and transportation facilities and natural resources, as hereinafter set forth, can be justified on other than socialist grounds, viz: that the private ownership of such properties offer such tremendous profits that the beneficiaries are compelled to control the local, state and national governments by an alliance with politicians, in order to prevent or control regulation, and that this constitutes a corrupting force which in the end will destroy the Republic.

Bearing this distinction in mind, let us proceed to consider the fundamental principles of socialism.

Competition is not only not a wasteful process, but it is a natural law exactly like the law of gravitation, which can not be permanently suppressed. The profit motive is not in itself a promoter of injustice, but is on the contrary the only motive yet evolved among men by which a maximum of production can be secured from the workers.

Russia Disproves Socialist Theories

The idea of Marx, Lenin, Shaw and other socialists that everybody contributing to production shall share alike has already broken down in the Russian experiment. The practical difficulty in putting all workers upon the same scale of reward is that the temptation of some workers to shirk their share of labor is irresistible. All labor, physical or mental, is onerous and often extremely disagreeable. In practice the weakest and the most unprincipled of the workers commence to shirk, and when the more conscientious and altruistic workers find the shirkers sharing with them equally the rewards of their common toil, they gradually yield to the temptation to shirk also. This is a principle of human nature which is just as sure to operate as any physical law.

The attempt to concentrate the management of all industries and services under one head or department is bound to result in great waste and inefficiency, because the job is so vast that no official or bureau can co-ordinate it, or even keep track of it. The Russian experiment has already demonstrated this truth. Socialism therefore as herein defined is based upon false premises and can never succeed.

It is not suited to the genius of our people, and the attempt to graft it upon any existing political creed, or to educate our people to the support of the Socialist party, seems a hopeless proposition.

Regulation

Supervision of certain businesses to prevent adulteration of food products, or misuse of banking facilities fall perhaps under the head of regulation, but as the term is used here it is confined to government attempts to fix or limit prices or earnings of monopolies and privileged trusts.

Regulation of monopoly and of privilege has completely failed in this country, and there is no instance in history of the successful regulation by the government of any private monopoly or privilege. An elaborate trial of this policy has been made in this country, beginning with the Sherman Law in 1889. Much confusion has grown up by a false notion of the nature of the evil in our capitalistic system to be removed. It was John Sherman's idea that we were in danger of large units of production merging and by mere size and large aggregation of capital dominating a given trade. Experience has demonstrated that we are in no danger whatever from any combination between merchants or manufacturers, unless one of the parties to the merger is possessed of a privilege denied to competitors, such as a transportation privilege, a natural resource privilege, or a patent privilege. There is no instance in our marvelous development of industry in the last fifty years where any combination has ever been made between concerns possessing no

privilege which was able to materially raise prices. There therefore is no need of regulatory statutes designed to prevent such mergers or combinations.

Why Regulation Cannot Succeed

There are several reasons why regulation necessarily must fail to the extent that it is designed to prevent the abuses of monopoly or privilege. As applied to the trusts which produce or handle goods, regulation would require such a supervision over such a vast amount of detail that it would be equivalent to the operation of the business itself. The government can not prevent the railroads from granting favors to trusts in the way of expedited transportation, excessive damages for delays, and juggled classification of rates, except by such an elaborate supervision as would be equivalent to the government ownership and operation of the transportation facilities.

The Failure of Utilities Regulation

In the domain of public utilities and rate making regulation has completely failed. This is due primarily to the fact that the profits of these monopolies are so enormous and are so illegal, that the beneficiaries are compelled to control the legislative, administrative and judicial machinery of the government charged with the task of regulation. They do this by alliance with the politicians who control the political machines throughout the country. These politicians in return for direct money payments, or for other opportunities for profit, see to it that men nominated for municipal, state and national positions, legislative,

executive or judicial, will take no action to lessen the excessive profits of these monopolies. The result has been in practically all the important states and in the nation, that the regulating laws have been delayed and filled with jokers, and the regulating machinery has fallen into the hands of administrators who are practically the representatives of the monopolies and trusts sought to be regulated. This has become notorious.

In addition the numerous law suits brought by or before regulatory commissions to reduce excessive charges for utility service have, with few exceptions, completely failed, after entailing enormous expense on both sides. Where commissions have temporarily broken away from the control of the utilities, the state and national courts have afforded the latter a final protection by the decisions which have been rendered. It is conceded that a utility should have only a fair return upon the fair value of its property, but the courts have laid down rules which are absolutely fatal to any attempt to cut the value of any utility below the amount represented by its excessive or watered capitalization. They have done this by rejecting the single yardstick of original cost or prudent investment, and substituting for this rule additional elements to be considered, such as going concern value, reproduction cost new less depreciation, capitalization, ability to earn, and other considerations which throw the whole subject into inextricable confusion.

Difficulties in Regulation

Governor Franklin D. Roosevelt and Governor Lehman of New York have declared for a law making prudent investment the yardstick to be used in fixing

a fair value of public utility property. This yardstick or its equivalent, original cost, is the only logical and reasonable method of ascertaining fair value, but State courts and the United States Supreme Court have declared that any valuation of existing utility property by any commission upon the basis of prudent investment or original cost is unconstitutional.

In the O'Fallon case a valuation was made by the Interstate Commerce Commission upon the basis of original cost with the deliberate purpose of getting a categorical ruling on this point from the Supreme Court, and the Court set aside the valuation on the ground that it had repeatedly decided that no single yardstick like original cost or prudent investment could be used to measure the value of a utility property.

Practically in every state in the union the attempt to lower rates by litigation based upon public utility laws has now been abandoned. Regulation, therefore, has been shown by experience to be a complete failure.

Fair Return Not Sufficient Incentive

If regulation of utility monopolies could be made successful a consequence would follow which has been completely lost sight of in the discussion. This is that all such regulated monopolies would be promptly turned over to the government. Consider for illustration the public utilities, the gas, electric light and power business.

Assuming that the courts could be induced to reverse their decisions, or that the constitution could be amended and prudent investment or original cost be applied to existing utilities, the result would be that

the rates would be so drastically reduced that the companies could pay only a nominal return upon their existing capitalization, a very large percentage of which represents no investment, but is merely what we call watered stock. The result would be not only to discredit the stock of utility companies in the market, but would render impossible stock manipulations, the watering of stock, the payment of huge salaries to officials, and the expenses for controlling politics.

Under these circumstances the financial institutions which back these corporations would lose interest in this business. They are not satisfied with getting 6 percent or 8 percent upon actual investment. Rake-offs, commissions, unconscionable salaries, flotation of stock issues, reorganization and merger profits are what keep them in the utility field, and in the financing and control of the railroads. Once they are reduced to the function of lending money with no reward but the current rate of interest, they would have no use for the business, and they would promptly turn it over to the government.

Government Ownership of Railroads Inevitable

Signs are not wanting that the ability of the bankers to milk the railroads is coming to an end by reason of their long mismanagement, and also because of the bus, truck, and airplane competition, and that they are getting ready to turn over these roads to the government. The extensive loans now being made by the government to save railroads from bankruptcy can never be repaid, because the competition with railroad service is bound to increase in the future and very rapidly. This is particularly true of the airplane.

This position was definitely stated in an interview some years ago with President Rea of the Pennsylvania Railroad. He said that in the long run financial men would not continue to put up capital in a great business like the railroad business, when other people who risked nothing were to determine the amount of money that should be earned by the business, and the conditions under which it should be operated. This is a sound position. Mr. Rea's opinion was that as applied to the railroads, the people would eventually have to choose between government ownership and private control free from governmental regulation. It was Mr. Rea's opinion that the public would give up regulation and allow the railroads to be run substantially as private business is run. It must, however, be clear to all people familiar with politics, that the public will never give up the attempt to limit the earnings and control the capitalization and other essential conditions of the railroad business. Therefore the only other alternative, according to the logic of Mr. Rea's position, is government ownership and operation of these roads.

Railroad Regulation Fatal to Private Ownership

Another argument against regulation as applied to railroads seems to have been overlooked. It is true that regulation in the sense of fixing rates, while theoretically it can be applied to a local utility like a gas, electric light or power company in a city, can never be applied to a railroad. The theory of price fixing regulation is that of a regulated monopoly. The railroad is only a partial monopoly. Between Philadelphia and Harrisburg the Pennsylvania Railroad may be said to have a monopoly, but on through traffic from New

York to Chicago, and on traffic from Philadelphia to Ohio and Indiana and other western points, it is in competition with other railroads. More than twenty years ago Senator LaFollette undertook to have the railroads valued as a basis for fixing rates. Some twenty million dollars was originally appropriated, which has probably been very largely exceeded, and the work is still going on.

If any attempt as a result of this valuation should ever be made to fix freight or passenger rates as between the Pennsylvania Railroad and the New York Central Railroad, it is obvious that the valuation of the properties of the different railroads between New York and Chicago would substantially differ, no matter what yardstick was used. If the road with the lowest valuation thus found is limited to a fair return, and rates fixed upon that basis, although the Commission might allow the other road with a larger valuation to charge higher rates, these rates could not in fact be charged because the business would all go to the road having the lesser valuation. While this consideration does not apply to a local public utility, it is fatal to the theory of regulation as applied to railroads.

“Prudent Investment” Yardstick Futile

Two suggestions are now made by those who still believe in regulation.

Franklin D. Roosevelt, while Governor, said in one of his speeches that he favored the passage of a law making prudent investment the basis of computing the fair value of public utility property. Prudent in-

vestment means in effect original cost, which is obviously the only proper yardstick by which to measure the value of a public utility. It is conceded that any new utility which now is brought into being under the control of a State Commission can only set up the claim of a fair return upon a valuation ascertained by the yardstick of actual cost. This rule is also applied to extensions made to any public utility plant after a valuation of the existing plant has been once fixed. The only justification for any other yardstick is the desire to obtain a rate far in excess of the rate which would result by the application of the original cost yardstick. To sustain this claim it is necessary to say in effect that because the public did not assert its rights to limit rates when the utility franchises were first granted, the public lost the right to enforce this yardstick. This is contrary to the accepted rule that time does not run against the public.

The fatal objection to an attempt to apply this yardstick now is in the decisions of our State and United States Courts. In the face of these decisions, it seems plain that any law, state or national, making original cost or prudent investment the sole yardstick would be promptly set aside by the State and National Courts. There is therefore no hope in attempting to revive and enforce this original cost yardstick, and if it could be carried out it would result in municipal ownership of every plant to which it was applied.

Holding Companies

Hope is held out of more effective results of regulation by bringing holding companies within the con-

trol of regulating commissions. In face of the decisions of the courts, no hope of reducing rates can possibly result from an investigation of holding companies, or from placing these companies under the jurisdiction of State Commissions or of a special National Commission to be established by Congress. All that an investigation or control of holding companies could do would be to give us some idea of what becomes of the money earned by these companies which is not devoted to the payment of dividends; but after such information is obtained the fact still remains that under the court decisions there is no way to apply to a valuation any yardstick which will protect the public from excessive rates upon a capitalization largely fictitious.

No holding company can get possession of any money other than by the sale of its securities, except the earnings of the subsidiary operating companies, the stock of which is owned by the holding company, and all information in reference to these earnings is now accessible to every State Commission.

The extension of regulation to holding companies is urged on the ground that it will prevent the sale to the public of unsound securities, and prevent any future pyramiding of such companies. There is some force in this suggestion, but the Insull disclosures seem to indicate that these concerns have already anticipated the future possibilities in this direction for many years to come. Insull by pyramiding holding companies sold to the public over six hundred millions of securities, which were secured by assets at present values of only thirty-five millions.

An investigation of holding companies would have

the advantage of proving that there exists a power trust, and that enormous sums are annually expended in propaganda to offset public ownership projects, and in direct or indirect payments to political leaders to influence legislative action. Such an investigation is now being made by the Federal Trade Commission by order of Congress.