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GOVERNMENT AND ECONOMIC LIFE
Development and Current Issues of
American Public Policy

**GOVERNMENT
AND
ECONOMIC LIFE**

**Development and Current Issues of
American Public Policy**

VOLUME II

**BY
LEVERETT S. LYON
AND
VICTOR ABRAMSON**

WITH THE COLLABORATION OF

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PREFATORY NOTE AND ACKNOWLEDGMENTS

The publication of the second volume of this study makes appropriate an acknowledgment of the aid of a number of collaborators, an indication of their responsibility, and the relation of their work to the study as a whole.

The nature of the material to be dealt with in this volume made it desirable to draw upon the expert knowledge of workers in a number of particular fields. Certain of them are, of course, regular members of the Institution's staff, and nearly all of the others were on the staff for various periods while the work was in progress. The study, however, should not be viewed as an edited collection of independent essays. In each instance the decision to invite the preparation of certain materials, and the general nature of treatment, were determined by the analysis which underlies the entire two-volume study. In every case there were necessary numerous suggestions to the collaborators regarding approach, content, plan, and emphasis—and many discussions concerning the relation of the individual chapters to the study as a whole. All the collaborators co-operated within the spirit of these suggestions, whatever might have been the treatment they would have accorded the material if writing in frames of reference of their own devising.

It was in these circumstances that Professor Frank A. Fetter prepared Chapter XX (Foreign Commerce), Professor Ben W. Lewis Chapter XXI (Public Utilities), Charles L. Dearing Chapter XXII (Transportation), and Edwin G. Nourse Chapter XXIII (Agriculture). Miss Eleanor Poland did all the research work for, and most of the writing of, Chapter XXIV (Bituminous Coal). Professor Paul T. Homan wrote a draft of Chapter XXIX (Government as a Producer of Final Goods and Services) which, after some redrafting, he put into final form. Professor Homan also prepared Chapter XXX (Public Relief). Except as indicated, these writers assume responsibility for their respective chapters. Professor Myron W. Watkins prepared a draft of a much longer chapter on the Petroleum and Natural Gas Industries which, with

extensive revision and supplementation by Aaron Director, formed the basis of Chapter XXV. Professor Watkins is not responsible, however, for the content or interpretation of the chapter in its present form.

Dr. Ewan Clague, then Director of the Bureau of Research and Statistics of the Social Security Board, gave valuable assistance and advice in the preparation of Chapter XXXI (Social Security). W. H. Bray acted as an assistant in the preparation of Chapter XXI, and Adah Lee in that of Chapter XXII. Marian Tolles acted as an assistant to Professor Homan in connection with part of his work. Miriam Camp assisted in the verification of references.

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We are responsible for the work as a whole, including its planning, its general organization and synthesis, and its relation to Volume I, and for all chapters for which authorship is not otherwise indicated.

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LEVERETT S. LYON
VICTOR ABRAMSON

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CHAPTER XIX

RELATIONSHIP OF VOLUME II TO VOLUME I

The two volumes of this study are conceptually a single unit. Since the plan of the work as a whole has been set out in Chapter III of the first volume, only a brief statement concerning the relationship of the second to the first is necessary here.

As was stated in Chapter III of Volume I, governments are utilized in economic life either to carry on directly the underlying processes of allocating resources, organizing conversion, and distributing income, or to sanction, construct, and aid private agencies to carry on these activities. As was there pointed out, governments in the United States perform both functions. They carry on direct production; and they promote, implement, and regulate private enterprise.

The first volume of this study dealt with governmental implementation and regulation of private enterprise as it has been applied *generally* to a wide range of industrial and commercial life, without important distinctions between one type of industry and another. This volume begins with a further analysis of governmental implementation and regulation of private enterprise, but of a type in striking contrast to that described in Volume I. The relationships here considered are those in which limited areas of economic life or limited time periods have been singled out for special governmental treatment. The objectives sought, the methods used, and the administrative and enforcement devices employed in the special treatment of private enterprise differ greatly from case to case, and from those which have been applied to industry and trade generally.

The nature of these objectives, methods, and administrative devices will appear as we proceed. It will be helpful, however, to restate at the beginning of this volume that the areas considered as "specially treated" by government are not so considered because they are "affected with a public interest," in the legal sense of the phrase, or because of the existence of more intensive governmental

action of the same sort that is applied to industry generally. The test is rather that of the more extensive restraints placed upon individual discretion and the greater degree of governmental authority exercised in determining the allocation and conversion of resources and the distribution of the product.

Special action by government is not always limited to *industrial areas*. There are *periods* as well, when the controls of government over individual discretion become so far-reaching as to call for special analysis. The two illustrations of such control considered are the period of the National Recovery Administration and the periods of war.

In the second part of this volume, having concluded the study of government in relation to private enterprise, we consider government as an actual producer of final goods and services (Chaps. XXIX to XXXI). As such a producer, our governments are in some cases involved directly in all phases of allocation, conversion, and distribution. In other instances they have undertaken only the distribution of privately produced commodities or have promoted and controlled private production through such devices as subsidies, tariffs, and loans. In some cases governmentally produced goods and services are sold at a price. In other instances they are widely provided without direct charge.

Direct production by government is a comparatively old phenomenon in our country, as is illustrated by the protective service of our army and navy, the postal service, and more recently by general education. During the past decade direct production by government has been greatly extended, particularly in connection with the granting of relief and the furnishing of insurance under the several aspects of the social security program. It has seemed sensible in discussing direct production by government to devote one chapter (Chap. XXIX) to an analytical consideration of the whole subject, dealing by way of illustration with those types of direct governmental production to which we have long been accustomed. On the other hand, the organization of large-scale relief activities and of a general insurance program are comparatively new; the issues involved are by no means thoroughly clear in the public mind; the administrative agencies concerned with this work are experi-

mental, and the principles which should underlie administration in each field by no means determined. Accordingly, a somewhat more extensive treatment (Chaps. XXX and XXXI, respectively) is given to each of these phases of direct governmental production.

We present first an analysis of the special treatment of private enterprise. This special treatment is discussed under two major headings: (1) the special treatment of a number of individual industries (foreign commerce, public utilities, transportation, agriculture, bituminous coal, petroleum and natural gas, and foods and drugs), and (2) the exercise of special controls on certain specific occasions (the N.R.A. and war). Part V A deals with the special treatment of individual industries, and Part V B with special occasions for temporary broad extensions of the range of governmental controls. In Part VI we discuss direct production by government.

PART V
GOVERNMENT AND SPECIAL TREATMENT OF
PRIVATE ENTERPRISE
A. INDUSTRIES

CHAPTER XX

FOREIGN COMMERCE

Restrictive regulation of the freedom of private citizens to carry on commerce between the territory which is now the United States and foreign countries has taken varied forms. The period preceding the adoption of the Constitution, lasting more than a hundred and fifty years, will be but briefly treated here, mainly to make clear the change of dominant public sentiment in respect to freedom of commerce that took place a generation or two after the beginning of national self-government.

I. COLONIAL AND EARLY AMERICAN ADHERENCE TO FREE TRADE

Contrasting economic conditions in England and the colonies. The greatest difference between economic conditions in the English colonies in North America and those in "the mother country" was in the abundance of certain natural resources in the new lands as contrasted with their growing scarcity in the British Isles.

In these conditions many of the English colonists, although they came here as skilled craftsmen and brought their tools with them, found it advantageous almost at once to turn to hunting, fishing, lumbering, and raising food, tobacco, and other crops, getting other products from Europe by exchange. Because, mainly, of the comparative bounty of natural resources, money wages of those in the colonies engaged in the extractive industries were from the first higher than wages in the same occupations in England.

No better illustration can be found of the practical working of the "economic principle of comparative advantage." So far as they were left free to do so the colonists chose to produce the things in which they were much more efficient than producers in England, rather than those things in which they had less advantage, or none. As Franklin told the House of Commons in 1766, the colonists could, if they wished, manufacture for themselves every "single article" that they were importing from England. But he added that, if left free, they preferred not to do so. The colonists preferred to export their own products to the best paying buyers, and in exchange to

import goods from places where they could be bought most cheaply. The economic and political conditions of the colonies were such therefore as to foster a strong sentiment in favor of freedom in foreign commerce.

On the eve of the American Revolution, the population of the English colonies on the American continent numbered about two million, and the commerce of England with these colonies was about one-seventh of England's total foreign commerce. Two-thirds of the total commerce of the continental colonies was with the mother country. New Englanders were the chief shipbuilders, merchants, and ocean carriers in this trade, and in inter-colonial trade as well.

The English colonial system. Upon this colonial trade and colonial industry there was imposed by English laws, between 1651 and 1770, a mass of regulations known as "the English colonial system." Every feature of this system was designed to benefit the mother country by enhancing the revenues and contributing to the public defense or by enriching certain British private interests at the expense of the colonists. It was in fullest measure an expression of the prevailing doctrine of mercantilism. To the thought of that day in the mother country, though not to the colonies, the justice of this view was self-evident. The regulations attempted were of three types: navigation laws, designed to give British sailors and shipping a monopoly; enumeration acts either forbidding or favoring commerce in specified articles, or with certain places; and production laws, intended to stimulate or to retard (even to prohibit) manufactures in the colonies. The lax enforcement of these laws and their extensive evasion, as well as certain incidental advantages to the colonies, kept resentment from growing greatly until shortly before the Revolution. Eventually, however, they were one of the most important causes of the American Revolution.¹

Beginning of American restriction on commerce. An unintended effect of the Revolutionary struggle from 1765 to the end of the war against England's colonial policy was an increasing interference

¹ It is true that the colonial policy of England toward the colonists of their own blood was moderate compared with the tyranny of other European nations toward native populations, but the verdict of Adam Smith still stands: "The best [policy] of them all, that of England, is only somewhat less illiberal and oppressive than that of any of the rest." Adam Smith, *Wealth of Nations*, Cannan ed. (1922), Vol. 2, p. 91.

with the foreign commerce of the colonies, at times amounting to an almost complete stoppage. The resentment against new and more severely enforced restrictions on commerce, and against the stamp taxes, during the late colonial period, took the tangible form of voluntary non-importation agreements entered into by merchants and supported by legislative resolutions and a strong public opinion. The first such voluntary agreement was in March 1765, and the second in 1769.

The "first complete piece of national commercial legislation" in this country was the resolution³ passed by the first Continental Congress October 20, 1774, creating what was called the "continental association."⁴ According to this resolution the importation of all goods from Great Britain or Ireland, of various products from the British West Indies, and of tea from East India, was to cease. A later resolution sought to stop all exportation to the places just named. These resolutions were adopted by nearly all the colonies and so vigorously enforced that both imports from and exports to British territory fell to the vanishing point.⁵

The ultimate purpose of these measures was not to limit and destroy foreign commerce, but to liberate it, at whatever temporary sacrifice, from the monopolistic control of European governments. This policy was based on the belief, partly true but greatly exaggerated,⁶ that the right to trade with the North American continent was of such great value to the European countries (and especially to the British) that they would make great political and economic concessions to avoid losing it. It was thus at the outset not a policy directed toward lasting self-sufficiency and commercial non-intercourse, but rather one of temporary retaliation, intended to force or induce others to follow the liberal commercial policy which was then the ideal and desire of the American colonies.⁶ With this purpose, however, there were intermingled, from the first, more immediate financial and military purposes, such as to induce the British to desist from war and to tempt the French to render military and financial

³ Vernon G. Setzer, *The Commercial Reciprocity Policy of the United States, 1774-1829* (1937), p. 6.

⁴ Ernest L. Bogart, *Economic History of the American People* (1931), p. 221.

⁵ The same.

⁶ See Setzer, *Commercial Reciprocity Policy*, p. 15, on the treaty plan of 1776.

⁷ The same, p. 3.

aid.⁷ The period of embargoes and non-intercourse between 1807 and 1812 was to see the repetition on a large scale of these largely erroneous beliefs and largely futile measures.

Domestic advocacy of restriction of commerce, after 1783. At the close of the Revolutionary War there arose a great confusion of policies and measures in respect to commerce both with foreign nations and among the states, which did not yet know exactly whether they were parts of one nation or "foreign" to each other. It is a familiar fact that this very confusion was important in bringing about the adoption of the Constitution as the only solution of the difficulties.

Peace in 1783 brought with it sudden and great economic changes. For a while, as always happens at such times, measures appropriate temporarily and in emergency became confused in popular thought with the policies fitting for more normal and lasting conditions. The first striking fact that revealed itself when foreign commerce was resumed was that there had developed in the larger northern centers, such as Boston, New York, and Philadelphia, and in many towns and villages, local manufactures to supply the kinds of goods formerly imported.⁸ There thus came into existence a new domestic-producer interest consisting of manufacturers (usually spoken of at that time as "merchants and tradesmen"), a group which from that day to this has been very vocal and politically influential in tariff discussion and action. The parties seeking restrictive tariffs in their own favor were henceforth to be not distant "foreigners" but fellow citizens of the buyers and consumers whose business interests were more or less closely bound up with those of the producers, especially in times of emergency distress.

The tidal wave of imports, 1782-85. The commercial events after the treaty of peace in 1783 should be clear to us now, but they caught the business men of that time unawares and threw them into

⁷ See the same, p. 23, as to various missions in 1776; and the Netherlands, 1782, the same, p. 32.

⁸ See, for example, Malcolm R. Eiselen, *The Rise of Pennsylvania Protectionism* (1932), especially pp. 12-14; William Hill, *The First Stages of the Tariff Policy of the United States*, American Economic Association Publications, Vol. 8 (1893), pp. 42-107, and contemporary materials in Appendix, pp. 133-62. The rapid development of manufactures and the very high prices after 1775 are described by Edward Channing, *A History of the United States*, Vol. 3 (1927), pp. 390-93.

a panic. The causes are now evident. The purchase of supplies in America by both the British and the French forces had put into circulation in America the largest amount of gold and silver money the community had ever had, while there was a corresponding scarcity in western Europe, which had been drained of its normal supply by the pressing needs of the war. As a result, while prices were abnormally high in America they were somewhat depressed in Europe. When free commerce was resumed with Europe the colonists, having a large stock of specie for the first time in their history, spent money lavishly for the long lacking luxuries of Europe. The newspapers of the day were filled with advertisements of jewelry, silks, millinery, broadcloths, wines, and liquors, and frequent moral admonitions began to be heard against these demoralizing foreign luxuries.⁹ Like water seeking its level, the excess coin quickly flowed out of America and back to Europe, and loud complaint of its growing scarcity soon began to be heard.¹⁰

Beginning of reciprocity in commercial treaties. In the half-century between 1778 and 1829 twenty treaties of commerce were concluded by the United States, while many articles in other treaties dealt with commercial affairs.¹¹ In these measures, as well as in much of the contemporary tariff legislation and regulation of shipping, the purpose was at first largely to secure freer conditions of commerce for this country by retaliating against those nations that would not trade freely with us, while at the same time offering more liberal conditions of trade to those countries that would reciprocate with the same (or equally valuable) concessions. Resentment was the chief motive in most of our early state tariffs. Other countries suffered as greatly as did we by our refusal to trade with them, but they, too, could be stubborn to their own hurt. Thus in large measure a policy whose ultimate aim was reciprocal advantage resulted rather in reciprocal injury.

Imperceptibly, in all these measures of restriction of commerce, there became intermingled other motives than those of attaining greater freedom of commerce, and restriction began to be looked upon in influential quarters as good in itself, and freedom of com-

⁹ Hill, *First Stages of the Tariff Policy*, pp. 65-68.

¹⁰ The same, p. 64.

¹¹ Setser, *Commercial Reciprocity Policy*, p. 1.

merce as an evil. It was, however, only restriction of imports that came to be favored, while freedom to export was still deemed highly desirable.

The treaty of "amity and commerce" concluded with France on February 6, 1778 was the first commercial treaty in our history. A treaty of "alliance" was concluded with France on the same date. The commercial treaty contained a most-favored-nation clause in conditional form, stipulating that if one of the contracting parties should grant a special commercial favor to a third nation the other party should enjoy the favor only on allowing some compensation equivalent to that paid by the third nation.¹² This form of the most-favored-nation clause continued, despite its troublesome results, to be observed by our government in most treaties of commerce entered into until 1922.

One other treaty of this nature, that with the Netherlands (October 8, 1782), was entered into before the end of the war. The chief motive of Congress in negotiating it was again not merely commercial, but was to obtain a loan from the Dutch. The most-favored-nation clause included was without condition, and (an important concession to us) was to apply to trade between the United States and the Dutch West Indies.

The Continental Congress, having exaggerated notions of the eagerness of European nations for American trade, continued active negotiations for commercial treaties in the next few years.¹³ With two exceptions, the effort was without success, because the United States was asking for "privileges such as no European nation had ever granted to another."¹⁴ Our demands ran counter to the whole current of mercantile prejudices and practices of that time. What we had to offer did not seem to the great colonial nations an equivalent for the right we were asking to become co-partners in their colonial monopolies. Sweden and Prussia, which had no colonies, concluded with us treaties of "amity and commerce," in 1783 and 1785, respectively. The insignificant treaties with Morocco, in 1786, conclude the list of commercial treaties until the Jay Treaty with

¹² The same, pp. 19-20.

¹³ The same, p. 55 ff.

¹⁴ The same, p. 74.

Great Britain in 1794, five years after the Constitution went into effect.

The growing movement for restrictive tariffs. The very real distress of the merchant and artisan classes increased during 1784 (the year of the greatest excess in the value of imports over exports) and reached its peak about the middle of 1785 after the balance of shipments already had begun to return toward equilibrium. Everywhere arose a clamor for restrictive duties. The beginnings of an organized movement were led by the merchants of Boston, who, in a circular letter to the merchants of other states, urged them to petition Congress to pass measures to regulate commerce.¹⁵ Philadelphia was equally a center of agitation for restrictive duties. With the appeal in favor of the distressed "tradesmen" there was skillfully mingled a moral argument for the benefits from sumptuary laws discouraging the use of luxuries and strong drink—if they were produced abroad.

The response of the more industrial states was immediate, and numerous tariff acts were passed, mostly in 1785 and 1786, imposing duties at the then unprecedented rates of 15 to 20 per cent. The diversity of these measures and the rivalry of interests that developed between neighboring states resulted in much bitterness and in retaliatory legislation and discriminatory rates that added to the general confusion. The tariff law enacted by Pennsylvania in 1785 later became the model for the first tariff act under the Constitution in 1789.¹⁶

Repeatedly between 1781 and 1785 the Continental Congress sought in vain to get the states to grant to it the right to regulate commerce between the states and to impose a moderate duty on imports purely for revenue purposes. The impotence both of the individual states and of the Continental Congress to deal with the regulation of commerce was among the strongest arguments for a

¹⁵ Hill, *First Stages of the Tariff Policy*, p. 96.

¹⁶ See, for example, John Fiske, *The Critical Period of American History* (1899), p. 142 ff.; Harold U. Faulkner, *American Economic History*, revised ed. (1931), p. 183; Isaac Lippincott, *Economic Development of the United States*, 1st ed. (1921), pp. 110-11. For a brief summary see Bogart, *Economic History of the American People*, p. 242; for further details see Hill, *First Stages of the Tariff Policy*, pp. 40-107; and for the important part played by Pennsylvania, see Eiselen, *Rise of Pennsylvania Protectionism*, pp. 9-19.

closer union under a new constitution, and the transfer of interstate trade from the field of "foreign" commerce to that of domestic commerce was among the most important consequences of the adoption of the new Constitution. It has made the United States the greatest free trade area in the world.

II. THE GROWTH OF RESTRICTIVE POLICY UNTIL 1832

The tariff act of 1789. When the members of the lower house of the first Congress took the oath of office, April 8, 1789, the need of revenue for the new government was pressing. James Madison urged the adoption of a simple measure levying a low flat rate on all imports. This met the strongest opposition from the members of the Pennsylvania delegation, who were bent upon getting a restrictive measure as nearly as possible like the Pennsylvania state tariff of 1785.¹⁷ After three months of debate, their demands were substantially met in the act signed July 4, 1789. The advocates of a restrictive policy won a lasting victory in the adoption of a preamble declaring "the encouragement and protection of manufactures" to be one of the purposes of the law co-ordinate with the raising of revenue and the payment of the public debt.¹⁸

This first and briefest of all the general tariff acts is complicated by the distinction between enumerated and unenumerated articles, by specific and ad valorem rates, by exceptions in a free list, and by rates varying according to the nationality of the vessels in which, and the countries from which, the imports came. The average rate has been estimated to be about 7½ per cent.

The first tariff act and the three accompanying acts dealing with tonnage, collection of duties, and clearing of vessels, involved a number of inconsistencies, the result of political compromises. The fiscal purpose of revenue was partly sacrificed to the demand for restrictions favoring the manufacturing and commercial interests. The shipping interest, which naturally favored freedom of commerce, was seduced by discriminatory tonnage dues in its favor as against foreign vessels. However, with a view to avoiding entangling alliances, all foreign nations were given equality of treatment both as

¹⁷ Hill, *First Stages of the Tariff Policy*, pp. 110, 151.

¹⁸ Orrin L. Elliott, *The Tariff Controversy in the United States, 1789-1833* (1892), pp. 67-92; Hill, *First Stages of the Tariff Policy*, pp. 109-30; C. W. Harris, *The Sectional Struggle* (1902), pp. 34-55.

to tariff rates and as to tonnage dues. Nothing either specifically retaliatory or offering reciprocity was contained in the several acts of 1789. The new government retained complete independence of action in commercial matters. The policy as to tonnage rates was to be modified or replaced after 1815, and as to tariff rates still later, by various experiments in reciprocity.

Sectional and class rivalries in the first tariff act. Sectional rivalries were clearly marked in the tariff debate, and largely corresponding with these were the divisions between the three main classes of occupations—commerce mainly in New England, agriculture mainly in the South and West, and manufactures mainly in the middle states, where, however, there were also strong commercial interests. The debate on each item—setting the model for all later tariff debate—was a frank attempt by almost every congressman to secure high restrictive rates on the things his constituents produced and sold to domestic buyers, and to keep rates low on the things his constituents had to buy. Again and again it was complained that some restrictive rate which appeared laudable to one section “was opposed to the interests of other sections.” It was seen that to “protect” one domestic product by a tax on competing imports, thus raising its price, was to depress and injure other citizens, not merely the ultimate consumers but other manufacturers whose costs were thus raised. For example, to “protect” manufactures by taxing nails, anchors, cables, cordage, etc., was to burden shipbuilding, and in turn shipping, with higher costs—a stubborn truth that has had to be faced with every tariff revision. Repeatedly the advocates of more “protection” for manufactures declared that raw materials should never be taxed. However, few of the duties imposed on the import of agricultural products had any appreciable effect, because these products were regularly exported. From the first the tariff was essentially a bounty to manufactures. The advocates of higher rates to favor their own localities besought their opponents to “get rid of local considerations” for the general good.¹⁹ So the various rival interests bargained, and combined, and traded votes.²⁰

¹⁹ Harris, *Sectional Struggle*, p. 41.

²⁰ “Log rolling began with the beginning of the government.” Channing, *History of the United States*, Vol. 4 (1929), pp. 62-63; and Elliott, *The Tariff Controversy*, p. 83.

Because of the comparatively moderate schedule of rates, this first tariff act has often been spoken of as purely for revenue purposes. But in the scramble for favors the revenue purpose was at times lost sight of. Members of Congress repeatedly objected to proposed rates on the grounds that they were too high to produce the most revenue. More clearly than anyone else, James Madison saw how easily the revenue effects of a rate might be weakened by the so-called "protective" effects.

Hamilton's Report on Manufactures, and tariff policy. Alexander Hamilton's Report on Manufactures, which was presented to the House in December 1791, was the first systematic plea for an American tariff policy.²¹ It has served as an arsenal of arguments for the high tariff policy ever since, and hence deserves somewhat careful consideration, despite the fact that on careful analysis it is baldly inconsistent and self-contradictory. An understanding of Hamilton's purpose will aid in comprehending both the merits and the defects of the devious economic argument in this famous report. Hamilton was not a member of the Congress which passed the first tariff act, although he undoubtedly had an influence in its discussion and adoption. Hamilton's motives were political (though not in a personal or petty sense) rather than economic. He believed it to be urgently necessary to enlist in hearty support of the new government the commercial and financial interests in the states, the "big business" of that day. To put it bluntly, he planned to purchase the loyalty of the manufacturing class for a strong central government by granting favors to that class at the immediate expense of the other classes of the community. He did this in the sincere belief that in the end everybody, even those who paid the bill, would be the gainers from the resulting stable and orderly national government.

A feature rarely and inadequately recognized is that, early in his discussion, Hamilton concedes the superior economic advantages of "the system of perfect liberty to industry and commerce" if it "were the prevailing system of nations,"²² and he says more "in favor of leaving industry to its own direction." But, says he, the system of

²¹ Reprinted in Frank W. Taussig, *State Papers and Speeches on the Tariff* (1893), pp. 1-107, to which page references are here made.

²² The same, pp. 26, 27.

perfect liberty "is far from characterizing the general policy of nations." As things are, "the United States cannot exchange with Europe on equal terms." Thus, at the outset of his argument Hamilton expresses essential agreement with the other public leaders of his time, Madison, Franklin, and Jefferson, who looked upon any restriction of commerce as an unhappy temporary necessity for defense and retaliation against the illiberal policy of European nations. Logically, Hamilton would have been bound to go to the utmost limits of mutual reciprocity to which other nations could be induced to agree.

Here, however, Hamilton's self-contradictions begin. He suggests the idea that this "want of reciprocity" by European nations forces the American states "to confine their views to agriculture, and refrain from manufactures."²⁸ Yet on the next page he says more truly that "the measures which have embarrassed our trade have accelerated internal improvements" (clearly meaning the growth of domestic manufactures), and shortly declares that "the natural remedy" is for enterprise to shift from agriculture where prices and profits are relatively low, "because of the restriction of commerce, to manufactures." In this connection and elsewhere he shows that this remedy was already vigorously operating under the existing conditions. Nevertheless he continues to argue on the contrary assumption that this would be impossible unless we imposed higher duties on imports. It is evident that the refusal of foreign nations to buy our agricultural output must have operated to divert some of our enterprisers from the extractive industries to domestic manufactures and thus to accomplish the very diversification of occupations which Hamilton desired. If foreign nations had received our exports freely, it might have been necessary for us to impose restrictive duties to ensure a further growth of domestic manufactures (if that was our desire) but not under the conditions which he so deplored. The higher were the foreign tariffs, holding out American agricultural products, the less would have been the need for domestic tariffs to foster domestic manufactures.

In his zeal to show that manufactures can be developed further by tariff favors, Hamilton (in the most valuable portion of the

²⁸ The same, p. 27.

whole report) shows that they have already developed. He gives "the pleasing result of the investigation" he had caused to be made, which presents the "vast scene of household manufacturing" carried on "in many instances to an extent not only sufficient for the supply of the families in which they are made, but for sale, and even in some cases for exportation." Further, he lists 17 "most considerable" kinds of production which were "carried on as regular trades," that is, for sale and exchange. He describes how the states had already, in 1791, become busy hives of manufacturing industry "with a rapidity which surprises."

Yet this evidence does not deter Hamilton from developing his famous "infant industry" argument for the need of a policy of higher tariff rates. An essential feature of it is that higher tariff rates to start "infant" industries do not raise prices, at least not more than temporarily, but on the contrary "it is *universally* true that the contrary is the ultimate effect with *every* successful manufacture. When a domestic manufacture has attained to perfection . . . it *invariably* becomes cheaper."²⁴ Of course, much depends on the meaning of the phrase "attained to perfection," which may be a mere begging of the question; "perfection" is not attained until the products become "cheaper." But it is important to ask, cheaper than what? Cheaper than the price at the time the tariff was imposed, or cheaper than the foreign price at some later date? In the latter case the tariff would no longer be needed to foster or "protect"—that being the essential significance of the term "infant."

Whatever be the truth of that matter, Hamilton's argument to prove his claim that a higher tariff will eventually bring lower prices is palpably fallacious. It creeps by inches to an unwarranted conclusion. He first concedes that measures which restrict the free importation of foreign articles "have a *tendency* to occasion an enhancement of prices"—an obvious truth, for the increase of price is the measure of the "protection" to the domestic producer. He next merely denies that this is *always* true, "but the fact does not *uniformly* correspond with the theory." He then refers to *several* instances when a reduction of prices had immediately succeeded the establishment of a domestic manufacture, but gives only *one*

²⁴ The same, pp. 48-51. Our italics.

instance, that of "fabrics," and it is a matter of common knowledge that just at that time the new processes in the textile industries were everywhere reducing the price of these products. He thus credits to a higher tariff the reduction resulting from the establishment of domestic manufactures using the new machinery.

Again admitting that the first investors in a tariff-aided infant industry may for a time get a "monopoly" price, he declares that "internal competition" will in time reduce "the price of the article to the *minimum* of a reasonable profit on the capital employed." This evidently confuses the thought of a reduction of the early monopoly rate of profit with a reduction of price of the products below the former price. He concludes with the *non sequitur*: "A temporary enhancement of price must always be well compensated by a permanent reduction of it."²⁵ Thus whatever truth there may be in the claim that in some cases it may in the long run be good policy for the public to bear the initial cost of experimenting and establishing *some* new industries, certain it is that not a single link in Hamilton's chain of arguments supports his conclusion.

Assuming the need of higher duties to be proved, Hamilton declares "the present a critical moment" for entering "with zeal" upon the task of raising restrictive tariff rates and granting bounties, which he recognizes as being essentially the same in purpose and effect. Elsewhere in the report Hamilton had estimated that the current tariff rates together with other costs of importation already gave an advantage of 15 to 30 per cent to domestic over foreign producers of the same kinds of goods. He lists "the objects" which he thought merited encouragement and "the measures to adopt in respect to each." In brief, his formula was to increase considerably the tariff duties (or to grant bounties) on nearly all manufactures in the more industrialized localities while placing no duties on crude materials, the products of mining and agriculture.²⁶

Whatever were the logical defects of Hamilton's tariff argument, it had lasting political effects. It enlisted the support of manufacturers for any party that would continue and enlarge the policy

²⁵ The same, p. 51.

²⁶ The same, p. 62 ff.

of tariff favors.²⁷ This was not Hamilton's intention, to be sure, but it was an inevitable result. The infant industry argument was long the chief reliance of the restrictive policy in political discussion, and never has been completely abandoned. However, after forty years, most of the infants had not outgrown their swaddling clothes, and new reasons for high tariffs had to be found.

Hamilton's Report seemed to have little influence at the time,²⁸ but within the next ten years his program had largely been realized through tariff increases ostensibly made to get more revenue.²⁹ By the end of 1807 some 14 tariff acts had been passed, most of them making comparatively minor increases. As the cumulative result of these several increases, the average rate on all dutiable articles rose from 7½ per cent under the first act to between 15 and 20 per cent.

Commercial and agricultural prosperity, 1789-1807. The unforeseen political events of the 18 years following the tariff act of 1789 were such as to set at naught the calculations of the early high tariff advocates. They had expected that the rates of the earlier acts would be high enough to turn enterprise largely from agriculture into manufacturing, and that the infant industries soon would be able to supply substantially all domestic needs for most manufactured articles at prices as low as duty-free foreign goods. Although,

²⁷ As one historian severely put it, Hamilton became "the organizer of exploitation, the originator of monopoly." Channing, *History of the United States*, Vol. 4, p. 66.

²⁸ Frank W. Taussig, *Tariff History of the United States*, 8th ed. (1931), p. 16.

²⁹ A year before Hamilton's Report and barely a year after the first act was passed, the latter was replaced (August 10, 1790) by a completely new schedule of rates (to go into effect December 1, 1790). Consistent with the primary purpose to get more revenue, the rates on some products not produced in this country—such as fine wines, teas, coffee, and sugar—were raised from 50 to 100 per cent. But under cover of the need for revenue a number of definitely restrictive duties (such as those on steel, cables, cordage, twine, salt, glass and stone ware, etc.) were increased by as much as a quarter to a half above the rates in the act of the preceding year. Again in 1792, in "an act for raising a farther sum of money for the protection of the frontiers," the specific rates on wines and spirits were raised, those on several manufactured articles such as nails, cables, cordage, were doubled, or more, and numerous ad valorem rates were increased from 12½ to 15 per cent. By the act of 1794 new specific rates were imposed on several articles, and 5 per cent ad valorem was added "over and above the duties" already payable by law on a considerable number of articles. That brought up to 20 per cent ad valorem the restrictive rates on a good many articles that had been started at 5 to 10 per cent only five years earlier, and doubled some specific rates.

as we have seen, rates were approximately doubled in that period, no such result followed. The growth of manufacturing did not keep pace, relatively, with that of either agriculture or foreign commerce.⁸⁰ What occurred was a striking exemplification of the principle of comparative advantage determining the choice of occupations in a country despite obstacles interposed by governmental policy.

From 1789 to 1807 European political conditions favored the growth of American commerce. The wars of the French Revolution, from 1793 on, gave to the Americans nearly all their own carrying trade and threw into their hands that of the larger part of Europe. The Jay Treaty with Great Britain in 1794 proved to be highly favorable to American commerce.⁸¹ "The carrying trade, in some years, exceeded in value the trade of the United States, in articles of domestic commerce."⁸² "The increase of American tonnage, during the period under review, has no parallel in the commercial annals of the world." "In proportion to our population we ranked as the most commercial nation; in point of value, our trade was only second to that of Great Britain." The profits of this commerce were, for that day, enormous and could be secured by men with little knowledge of usual commercial conditions. "The brilliant prospects held out by commerce, caused our citizens to neglect the mechanical and manufacturing branches of industry." "Many persons who had secured moderate capitals from mechanical pursuits soon became the most adventurous."⁸³

⁸⁰ Elliott, *The Tariff Controversy*, p. 130.

⁸¹ So named for John Jay, the Chief Justice, who negotiated the treaty. It cleared up many of the prickly differences between the two countries regarding navigation rights, in a spirit of reciprocity. Most notably, it embodied most-favored-nation treatment without a conditional clause. We gave up both the demand to share fully in the West Indian trade and the right to increase the discriminatory rates against British shipping, in return for a considerable easing of trade restrictions against us—a policy of reciprocity in shipping. However, the treaty did not in any way touch the subject of import duties.

⁸² The quotations are from contemporary opinions reprinted in Guy S. Callender, *Selections from the Economic History of the United States, 1765-1860* (1909). See pp. 239-51 on the period up to 1807. See John B. McMaster, *A History of the People of the United States from the Revolution to the Civil War*, Vol. 3 (1928), pp. 498-500. On Jay's treaty, see Channing, *History of the United States*, Vol. 4, pp. 136-38, 142-46.

⁸³ Seybert, *Statistical Annals* (1819), reprinted in Callender, *Selections from the Economic History of the U.S.*, p. 246.

The treaty of Amiens in March 1802 brought a brief period of peace to Europe, and American commerce decreased (both imports and exports) in the next two years to the proportions of a few years earlier. But in the next four years, following the resumption of war in Europe in 1803, commerce rose to record heights. The registered American tonnage employed both in foreign and in coastwise trade just about trebled between 1791 and 1807. The prices both of imported manufactures and of domestic articles of the same kinds were relatively high. The large increase in value of imports swelled the receipts from customs and to some extent practically converted the duties intended to exclude imports into duties for revenue.³⁴

Agricultural prosperity during this period was little less remarkable, and came largely from the same causes. American agricultural products were in great demand in all the warring countries of Europe. "The increased demand (in Europe) for the agricultural productions of this country . . . raised their price to a height before unknown."³⁵ The price of flour at Philadelphia between 1793 and 1807, excluding the two years of the Peace of Amiens, was nearly twice as high as before and after those dates, respectively.³⁶

Embargoes and war and their effects. Toward the end of 1807 the war in Europe reversed its effect in this scene of prosperity. Napoleon had issued his famous Berlin decree of November 21, 1806, declaring as lawful prize all merchandise coming from England or its colonies, even though belonging to neutrals. Britain countered a year later (November 11, 1807) with orders in council prohibiting all direct trade from America to any part of Europe at war with Great Britain. Napoleon answered with his Milan decree of December 17, 1807, practically outlawing American com-

³⁴ However, when allowance is made for re-exports and for higher prices, no flood of imports for domestic consumption is evident in the figures. See table in Taussig, *Tariff History*, p. 12, taken from the Treasury Reports. Per capita net imports in 1791-94 averaged \$7, and in the next 13 years ranged from \$7 up to \$13, averaging about \$10, during the period when the general price level was 50 per cent higher, indicating little if any increase in actual quantities.

³⁵ Pitkin, *A Statistical View of the Commerce of the United States of America* (1835) in Callender, *Selections from the Economic History of the U.S.*, p. 245.

³⁶ See table in American State Papers, *Finance*, Vol. 3, p. 538. The average was \$9.12 in the period under review as compared with \$5.41, according to Pitkin, quoted in Callender, *Selections from the Economic History of the U.S.*, p. 246.

merce with Europe. Under Jefferson's leadership the Congress at once retaliated by laying an embargo on all vessels in American ports. This would have completely paralyzed our foreign commerce if it had not been largely evaded.

As in every sudden blocking of the customary channels of commerce the embargo caused great distress, particularly among the commercial community.⁸⁷ The domestic prices of the usual articles of export "fell to half their wonted price, and even less," whereas the usual supply of imported merchandise "being cut off, its price rose proportionally high," which "operated as a bounty on manufactures . . . but this at first benefited but a small proportion of the community."⁸⁸

The Embargo Act was replaced March 1, 1809 by a less restrictive Nonintercourse Act which opened commerce to all nations except France and Great Britain, and, as a result, American commerce revived considerably in the fiscal years 1810 to 1812. Then the declaration of war against Great Britain (June 19, 1812) dealt our commerce an even severer blow. In the hope of increasing the public revenue a futile tariff act was passed (July 1) doubling all import duties and laying additional duties on all goods imported in foreign vessels. As a result of the naval war combined with these restrictions, foreign commerce was cut in half in 1813, and (a new embargo act having been passed in December 1813) it was almost wiped out early in 1814. The last embargo act was repealed in April 1814, after the temporary cessation of war in Europe had opened the ports of the Continent to our trade,⁸⁹ and by the middle of 1814 the worst was over. However, the violent forcing of American commerce out of its accustomed channels during the years 1808 to 1815 had lasting adverse effects, and "it was long after the peace [of 1815] before the West Indies furnished as extensive a market for American products as before the embargo."⁹⁰

Domestic manufactures were stimulated by the embargoes and the war. Before 1808 they had been expanding slowly, but from

⁸⁷ Faulkner, *American Economic History*, pp. 275-76.

⁸⁸ Williams, *Statesman's Manual I* in Callender, *Selections from the Economic History of the U.S.*, p. 256.

⁸⁹ Channing, *History of the U.S.*, Vol. 4, pp. 537-43.

⁹⁰ Williams, *Statesman's Manual I* in Callender, *Selections from the Economic History of the U.S.*, p. 256.

that time until 1815 they were greatly advantaged by the scarcity and high prices of imported manufactures. Immediately in 1808 the commercial interests of the New England and middle states began to turn to manufacturing, much of it of the sort requiring large investments in the new textile machinery. The temporary betterment of commerce in 1810 brought from manufacturers in various parts of the country petitions for higher tariff rates. They no longer pleaded for aid to a few infant industries, but they demanded that encouragement by higher duties be "made universal, and extended to every pursuit which is known in our country."⁴¹

Tariff views after the war and the act of 1816. By 1816 the economic after-effects of the war had begun to appear. Imports were increasing and the prices of manufactures were falling. Even before the war ended, manufacturing interests began to petition for new and higher duties. The spirit of the times was to meet these demands—extreme as they seemed—at least half way. The party in power, which drew its strength largely from the agricultural South and West, had been responsible for the War of 1812, whereas New England commercial interests had, to the verge of disloyalty, opposed its prosecution. Young leaders from the South such as Calhoun, Crawford, Cheves, and Lowndes, for a brief time strongly supported a new nationalism and the union. Especially strong in the dominant political circles was the wish, as the result of war-time experience, that the country should be made independent of Europe in respect to munitions and other military supplies (somewhat like the policy of autarchy and economic nationalism which in many countries followed the World War). Again, as in the period from 1783 to 1800, these military motives were mingled with resentment against England. The impulse to retaliate against her restrictive measures, rather than consideration of mere economic benefits, dominated the thought of the leaders. For nearly a decade it continued to be the fashion for public men from the South and West with these motives to avow support of a high tariff policy, although feelings were later to undergo a marked change. As late

⁴¹ Petition from Lexington, Ky., in 11 Cong. 3 sess., *Annals of the Congress of the United States*, Vol. 22, p. 1275. See Elliott, *The Tariff Controversy*, pp. 146-59 for a brief outline of Gallatin's report of 1810 and of the debates in Congress.

as 1824, such southern leaders as Calhoun, Crawford, and Jackson "were declared advocates of protection."⁴²

Likewise of some weight was the "vested rights" argument, strongly urged by those who had gone into manufacturing during the period of embargoes and war, under what they chose to consider an implied pledge of the government to safeguard their investments. To this it was truly replied that other interests also suffered by the war, and that such a policy of indemnification would give rise to "an infinite order of pledges."⁴³

In this atmosphere of public opinion the tariff act of April 27, 1816 was passed to replace the emergency war tariff of 1812 which was to terminate automatically a year after the conclusion of a treaty of peace. Uppermost was the purpose of giving some vested-right "protection" to the industries called into being by the high prices of the war. Confusedly intermingled were other motives and purposes. The infant industry argument still played a part, and in the debate Henry Clay restated the thesis that the object of the tariff was to produce articles of necessity as cheaply here as abroad. The discussions showed "no very clear idea that protection would sometime be withdrawn because the need of it was outgrown."⁴⁴

The rates in the act were lower than those in the emergency war act, but both specific and ad valorem rates were much higher than the prewar rates. They averaged 35 per cent actually collected on all imports.⁴⁵ Among those seeking tariff favors the textile manufactures came off best.⁴⁶

⁴² Taussig, *Tariff History*, p. 74. On the sentiment of various public men in favor of fostering industries supplying means of defense, see Elliott, *The Tariff Controversy*, pp. 164, 165, 170, 179-80, 190, 193, 215.

⁴³ Representative Telfair of Georgia, 14 Cong. 1 sess., *Annals of Congress*, p. 1317.

⁴⁴ Elliott, *The Tariff Controversy*, pp. 184, 200.

⁴⁵ Estimate for the year 1821, when, in the main, the rates of this act were in force. (*Statistical Abstract*, 1910, p. 679.) Taussig gives the average rate as 20 per cent (*Tariff History*, p. 19).

⁴⁶ The rate on cotton textiles, which had been only 7½ per cent in the earlier acts, was raised to 25 per cent ad valorem, with a minimum valuation in the case of cottons of 25 cents a yard, which after a time, as the price of muslin fell, made the rate prohibitive. An argument for this exceptional encouragement to cotton manufacturing, in conflict with present social ideals, was that it would give factory work to women and children. George B. Mangold, *The Labor Argument in the American Protective Tariff Discussion*, pp. 21-25, in University of Wisconsin Economics and Political Science Series, Vol. 5, No. 2 (1908).

Liberalizing the navigation laws. The close of the War of 1812 was marked by a change in the direction of a more liberal shipping policy which within the next fifteen years did away with the discriminatory treatment of foreign vessels in foreign trade (not in the coasting trade). The lower cost of building wooden ships in America and the remarkable success of our sailors in the preceding years gave confidence that they could hold their own in competition with the world if allowed to trade in foreign ports. News of the treaty of Ghent, concluding the War of 1812, had barely arrived when the brief but notable act of March 3, 1815 was approved, repealing (on condition of reciprocity) every discriminating duty of tonnage and tariff duty on goods that was based on the nationality of vessels. But it is to be noted that this applied only "so far as the same respects the produce or manufacture of the nation to which such foreign ships or vessels may belong," not including goods transshipped from interior countries or from colonies; and also, that the repeal was to take effect only in favor of any foreign nation which abolished duties discriminating to the disadvantage of the United States.⁴⁷ The benefits of this Reciprocity Act were extended by presidential proclamation to many countries qualifying.⁴⁸ The first country to accept the offer of the United States was Great Britain, which did so in the treaty of commerce concluded July 3, 1815 regulating direct trade between the two countries.⁴⁹

In the next few years the principal European governments relaxed or abandoned many of the regulations of the old colonial system.⁵⁰ Except for our retaliatory navigation laws of 1817 and 1818⁵¹ provoked by British restrictions against our vessels in the West Indian carrying trade, our navigation laws and treaties underwent successive liberalization for the next fifteen years. The

⁴⁷ *Tariff Acts Passed by the Congress of the United States from 1789 to 1895*, compiled by William H. Michael and Pitman Pulsifer (1896), p. 47.

⁴⁸ See list in Hunter Miller, ed., *Treaties and Other International Acts of the United States of America*, Vol. 1 (1931), pp. 169-71.

⁴⁹ 3 Stat. L. 224 (1815); Revised Statutes, sec. 4228; U. S. Code, Title 46, sec. 141. This act, though specifically supplemented in later legislation, appears never to have been expressly repealed, but rather repeatedly reaffirmed in principle. Discrimination by foreign nations and measures of retaliation were more extensively dealt with in the Act of June 17, 1930; see U. S. Code, Title 19, secs. 128-31.

⁵⁰ Setser, *Commercial Reciprocity Policy*, p. 241.

⁵¹ For details see the same, pp. 227-38.

benefits were extended by treaty and by proclamation to numerous countries in Europe and in Central and South America.⁵²

General view of tariff history, 1816-33. In the years from 1816 to 1842, our tariff policy moved in a cycle. The trend was toward higher rates for a dozen years, to a level in 1828-32 not to be attained again for another half-century; then there began with the acts of 1832 and 1833 a gradual return to a level of rates in 1842 about the same as that of the act of 1816. The 18 years from 1816 to 1833 was the most intense period of tariff discussion in our history. Tariff policy came more strongly than before to determine political and sectional divisions, and was the plaything of politics and presidential ambitions. Rapid economic changes occasioned remarkable reversals of positions and of arguments on tariff policy by political leaders, and by the states they represented, notably by Calhoun from the South, by Webster in Massachusetts, and by Henry Clay speaking for the new western agricultural states. Every argument presented from 1789 to 1812 was more sharply defined, and new arguments and interests took form. The most potent factor at once evident in this post-war situation was the increased strength and influence of the industrial concerns called into existence in such large numbers by the interruption of foreign commerce from 1808 to 1815 and by the resulting high prices and profits of manufactures.

The philosophy of "protection" began to undergo a change. Some of the new investors of the 1812-15 war period were of the artisan type, working in small shops as in 1784-85, but others, especially those in the cotton and woolen textile, iron, and other industries, had installed new specialized machinery and could not as easily shift, without loss, to other occupations. Hastily built under new conditions, and by men with little knowledge and experience, many of these new factories, though costly, were inefficient and could (as Daniel Webster declared) be replaced by better plants for a fraction of their original cost. In any rational view of the matter, these sub-marginal speculative investments, made to reap high profits in war times, had to be liquidated before business could again be in a sound condition—unless, indeed, the public was

⁵² See list of treaties in Miller, *U. S. Treaties*, Vol. 1, pp. 57-58.

to assume the responsibility of guaranteeing perpetual profits on all private investments made at such times. That, substantially, was the claim of the manufacturing interests. They pleaded the public benefits they had rendered by starting manufactures during the war, and the "vested interest" they had because of what they declared was an implied obligation to continue giving them tariff "protection" after the war equal to that given by the blockades and embargoes which had nearly destroyed commerce.

Tariff discussion, 1820-24. The business crisis of 1819 accentuated the difficulties of many of the new manufactures. Petitions by the hundred, asking for higher tariff rates, poured in upon Congress from individuals, committees, and societies of manufacturers, and were met by opposing protests from agricultural societies and other sources. The movement for a higher tariff primarily for restriction (with incidental revenue tucked in the rumble seat) took form in the bill of 1820. The discussion took a remarkably wide range, including about every argument on either side that has been heard since—with the exception of the "pauper labor" argument that high wages are the *result* of high tariffs, which was not to appear until a few years later. The depression added to the popular appeal of the advantages to come from higher tariffs. But the advancing demands of the manufacturers aroused a growing opposition, not only in the agricultural South but in New England where the interests of commerce still were stronger than those of manufacturing, though the balance was beginning to shift.⁵³ After much discussion in Congress and outside, the bill failed of final passage by a single vote in the Senate.

In the high tariff argument at that time, the pleas for the restriction of commerce as a temporary policy of retaliation continued, as in 1789, to be mingled inconsistently with professions of belief in the desirability of free trade as a general principle. Free trade would, it was still said even by the advocates of high restrictive tariffs, be the best of policies if only the selfishness of other nations did not put up barriers against it.⁵⁴ Even Henry Clay declared: "I am, too, a friend of free trade, but it must be free trade of per-

⁵³ Elliott, *The Tariff Controversy*, pp. 216-20.

⁵⁴ See, for example, discussion of a Pennsylvania representative, 16 Cong. 1 sess., *Annals of Congress*, p. 1926.

fect reciprocity."⁵⁵ However, most of his accompanying argument would logically lead to the conclusion that the need of a high tariff would be much greater if all other nations practiced complete commercial freedom; for, evidently, the fewer the obstacles that were put in the way of the sale of our exports, the more profitable would have been agriculture, as an exporting industry, in comparison with manufactures, and the slower would have been the growth of domestic manufactures and of the home market.⁵⁶

The recovery of business conditions, very noticeable by 1822, considerably weakened the arguments for higher duties. The editor of *Niles' Weekly Register*, an ardent restrictionist, noted with satisfaction the prosperity of the manufacturing industry in Philadelphia and the large sales of domestic goods.⁵⁷ But the demand for higher rates continued until they were embodied in the tariff act of 1824.⁵⁸

The tobacco and cotton states, and the navigation and fishing states, were all but unanimously against the bill. The representatives of the southern states were bitter in their denunciations. This "was the most significant and ominous feature of the debate."⁵⁹ For the first time a tariff for the purpose of restricting and prohibiting imports, rather than for the public revenue, was denounced as unconstitutional, forecasting the nullification movement of a few years later. The majority for the bill in the House was only five votes and in the Senate four.⁶⁰

⁵⁵ The same, p. 2036.

⁵⁶ For a similar argument, see the analysis of Hamilton's Report, above, p. 537.

⁵⁷ *Niles' Weekly Register*, Vol. 23, pp. 1, 17, September 1822. For other evidences of prosperity, see Elliott, *The Tariff Controversy*, pp. 228-30.

⁵⁸ This act expanded the list of tariff-favored agricultural and mineral products to include wool, hemp, iron, and lead, in order to bring to the support of higher duties on manufactures (mainly benefiting eastern and middle sections) the votes of the regions then called "grain-growing" in Vermont, New York, New Jersey, Pennsylvania, Delaware, Kentucky, Ohio, Indiana, Illinois, and Missouri. Rhode Island and Connecticut, in which manufactures had greatly increased, deserted the ranks of the commercial states.

⁵⁹ Elliott, *The Tariff Controversy*, p. 234.

⁶⁰ Carl Schurz gives an account of the debate on this bill in *Henry Clay*, American Statesmen series, Vol. 1 (1887), pp. 212-21. Because of the many changes in classification and description, and from specific to ad valorem rates (and vice versa), no very exact estimate of the average increase of rates in this act is possible. That it was very substantial is unquestioned. Cotton textiles were favored by raising minimum valuations some 20 per cent. In a number of cases where comparison is

Restriction of imports as "the American System." The result was a personal triumph for Henry Clay. He had taken the lead in the debate, and had christened the policy of restriction "the American System." He had eloquently championed it against what he denounced as "the foreign policy" of free commerce. Clay's catch term proved to be an effective and lasting popular slogan for the cause of high tariffs, more effective as a vote-getter than any more rational defense of the restrictive policy. This was so, despite the fact that the phrase "the American System" misrepresented the real situation, as critics saw at that time. Webster said incisively in the debate that Clay should have used the terms American policy and foreign policy "in a manner precisely the reverse of that in which he has in fact used them." "Names should in some measure be descriptive of the things to which they are given."⁶¹ For years one of the stock arguments for restriction had been to show that the most prosperous European countries, notably Adam Smith's own country, Great Britain, maintained high restrictive duties. This idea had been expressed in 1819 in a series of thirteen essays on "National Interests" issued by the Philadelphia "Society for the Promotion of Domestic Industry," known to be written by Matthew Carey.⁶² He bestowed unequalled plaudits on the English Parliament, "for the admirable and incomparable system it has devised."⁶³ "For the protection of her domestic industry [Great Britain] interposes the powerful shield of prohibition and enormous duties."⁶⁴ Even Russia was held up as a shining example because "she prohibits, under penalty of confiscation, nearly all the articles with which her own subjects can supply her."⁶⁵ The "paternal and fostering care bestowed on" manufacturers "by the Emperor of Russia" must, it was said, arouse the envy of "the same class" of our citizens. "The contrast is immense, striking and decisive,"⁶⁶

possible, the rates were about one-fourth higher than those of 1816 (in a few cases, three to five times those before 1812).

⁶¹ McMaster, *History of the People of the U.S.*, Vol. 5 (1927), p. 237.

⁶² Published in *Niles' Weekly Register*, Vol. 16 (1819), from which quotations are here taken.

⁶³ The same, p. 171.

⁶⁴ The same, p. 172.

⁶⁵ The same, p. 181.

⁶⁶ The same, p. 183.

that is to say, to the discredit of this country in comparison with Russia. Likewise the policy of Prussia under Frederick II in fostering and favoring manufactures was held up for admiration and emulation by our people, as "grand, liberal, and magnanimous."⁸⁷

The home-market argument. The new home-market argument, also skillfully voiced by Clay, was particularly appealing at that time and for years later to the interior agricultural regions—western Pennsylvania and the states of Ohio, Indiana, Illinois, Kentucky, and Missouri. Those regions (where Henry Clay's prestige was greatest) felt strongly their disadvantage in having to ship their products across the mountains for export or for sale in the more densely populated states. This situation had been little relieved as yet by either canals or railroads; and the western states had exaggerated hopes that a higher tariff would rapidly develop manufactures within their borders, providing them with "home markets." This belief accounts for the political and economic paradox that these great agricultural regions, rapidly increasing in population, upon which would fall a large part of the burden of higher prices for manufactures, eagerly supported a policy whose chief benefit would inure for generations to the middle and New England states. Clay's home-market argument served to detach the northern agricultural states from the support of the southern, and the tariff soon became so entangled with the slavery issue and the preservation of the Union that this sectional alignment lasted until long after the Civil War, and still, after more than a century, is an appreciable influence in national politics.

The "tariff of abominations," 1828. For a short time after the act of 1824 went into effect (June 30) the interests favored by the tariff seemed satisfied; business at home and abroad was on the upswing, and there was a lull in tariff discussion. Because of the duty on wool, starting at 20 per cent and rising to 30 per cent in two years, wool-growers prospered, for domestic wool was insufficient for domestic need, and this was one agricultural rate that, exceptionally, was effective. But because the tariff on wool increased the cost of the woolen manufacturers' chief raw material they had not received great (net) assistance. Nevertheless, for a year or more

⁸⁷ The same, p. 184.

they made good profits and unwisely over-extended their operations. "By their own confession" they "had expected too much from the tariff, and capital had been over-venturesome,"⁶⁸ so that domestic competition lowered prices. Added to this, business began to be depressed in 1825 both in England and America, and as usual the victims of their own over-investment rushed to the government asking that it come to their rescue with higher tariffs. The agitation and political jockeying which ensued was a disgraceful preliminary to the presidential race of that year, and terminated in the tariff act of 1828, dubbed by its opponents the "tariff of abominations."

This remarkable chapter in the history of our tariff legislation belongs more to politics than to economics, and has been frequently related.⁶⁹ It may here be observed merely that the political scheme was to unite in support of Andrew Jackson's candidacy the high-tariff middle states and the agricultural West with the anti-tariff Democrats of the South. To do so, the tariff bill was craftily loaded with extreme provisions intended to be so distasteful to various eastern interests, especially those of New England, that they would vote against the bill. Many of the staunchest supporters of high tariffs denounced it, but, to the dismay of its authors, it finally passed, thoroughly approved by no one, and went into effect September 1 of that election year. New England sentiment had been veering more toward the policy of encouraging manufactures, and even Daniel Webster, against all his previous utterances, voted for the bill apologetically, to please his constituents, as he said, saving his pride as well as he could by refusing still to approve the restrictive policy on general principles. The average level of duties in this act was 49 per cent ad valorem, higher than ever before or after until the close of the Civil War nearly forty years later. The woolen rates were especially extreme.

The opposition to protection aroused. The ultra-restrictionists complained that some of the rates in the act of 1828 were still too low, while with some justification disclaiming responsibility for the

⁶⁸ Elliott, *The Tariff Controversy*, p. 238.

⁶⁹ For further accounts of this incident see Taussig, *Tariff History*, pp. 78-103; Elliott, *The Tariff Controversy*, pp. 236-49; Channing, *History of the U.S.*, Vol. 5 (1930), p. 371; McMaster, *A History of the People of the U.S.*, Vol. 5, pp. 247-55.

worst "abominations" of the act. The South flamed with nullification sentiment, and after Jackson's inauguration in 1829, the necessity of some moderating changes was recognized by the leaders in Congress. A great free-trade convention, made up largely of southern delegates, met at Philadelphia in October 1831. A committee headed by Albert Gallatin issued the notable Free Trade Memorial,⁷⁰ which avoided the issue of constitutionality and presented a temperate defense of freedom of commerce. This memorial did not champion the idea of a completely agricultural state, the figment against which Hamilton's Report had argued. It did not deny that restrictive tariff rates have "a tendency to accelerate the establishment of manufactures" of some kinds "a few years earlier" than otherwise; but it showed by the aid of statistics that under the more moderate tariffs before 1824 domestic manufactures continued to increase faster than did either imports or population. It maintained that "no special protection beyond the ordinary revenue duties has been, or is, necessary for the introduction of the manufactures required by the wants of the country."⁷¹ Gallatin's good-tempered and well-reasoned memorial exercised a powerful influence on public opinion in the contemporary tariff controversy.

The pauper-labor argument. Alarmed at the rising tide of protest, the defenders of the recent tariff legislation assembled in convention the same month (October 1831) in New York with few western and southern delegates present, and issued a vigorous counter-address proclaiming the national benefits of high tariff duties. Here, along with the other more familiar arguments, was advanced for the first time the pauper-labor argument. The higher wages in America, as compared with Europe, it was claimed, were not pre-existent to the tariff, but were the result of the "protective tariff." This contradicted the main assumption of the infant-industry argument, that high wages made manufacturing impossible without restrictive duties. Now that a high restrictive tariff (act of 1828) was in existence, and the manufacturers were defending it against the imminent danger of its reduction, they declared: "Its highest recommendation is found in its beneficial action upon the many—

⁷⁰ Reprinted in Taussig, *State Papers*, pp. 108-213.

⁷¹ Taussig, *State Papers*, pp. 210, 208.

the laboring classes, the working men. . . . We consider it the most important and valuable feature in our system, that it tends directly to increase the . . . remuneration of labor."⁷³ To the system of high restrictive duties is attributed something of a divine character: "It is, as it were, the Providence of our political being. . . . Without that Providence not a laborer, not an artizan, whatever his calling, but would be straitened and brought to ruin."⁷⁴ In final appeal to those who considered themselves to be the victims of this system, the memorialists asked: "Is there an American who would raise his ruthless hand against the system which prevents such a calamity?"⁷⁵ The theory of international wage levels was stated very simply: "An unrestricted intercourse between two nations reduces the labor of one to the same scale of compensation with the labor of the other, and such a consequence is certainly to be deprecated by that nation whose labor stood highest in the scale."⁷⁶ This was badly out of accord with colonial experience and conclusions; moreover, it was a radical change from the plea for restriction in the first half-century after the Revolution when existing high wages, due not to tariffs but to the rich opportunities of this continent, were given as the chief reason why this country would remain exclusively agricultural unless higher tariffs were imposed.

The policy of prohibitive rates without revenue. In view of the near extinction of the public debt at that time there was good reason for the industries favored by high duties to fear that the reduced need of revenue, quite apart from other causes, might lead to an early reduction of tariff rates. This led the advocates of restriction to change the emphasis from a tariff for revenue with "incidental protection" to a tariff designed primarily and permanently to restrict imports without regard to revenue. In principle this was an abandonment also of the infant-industry argument. The New York address urged that the reduction of tariff rates (a reduction conceded to be inevitable) be applied only "to such commodities as are incapable of being brought within the scope of the protective system;

⁷³ The resolutions adopted by the Convention are printed in full in *Niles' Weekly Register*, Vol. 41 (1831), pp. 204-16. See p. 210 for quotation in text.

⁷⁴ The same, pp. 215-16.

⁷⁵ The same, p. 216.

⁷⁶ The same, p. 211.

holding it, as we do, to be indispensable . . . that that system . . . be sustained and preserved, without diminution in its application to every branch of domestic industry that may be benefited by its influence."⁷⁶ This plan had actually been followed in a small way in 1830 when duties were reduced on tea, coffee, cocoa, molasses, and salt, almost wholly revenue items, leaving all the intentionally restrictive duties undiminished. The only suggested basis for selecting industries suitable for protection was that the particular "branch of industry may be benefited," those engaged in each industry presumably being the judge of the benefit. No test of "benefit" is implied other than ability to make profits when tariff rates raise prices high enough to shut out competing foreign goods. Applied generally, such a policy means absolute prohibition of all imports excepting those impossible of production here because of unfavorable climatic conditions or complete lack of essential materials.

III. MODERATION OF RESTRICTIVE POLICY, 1833-61

High tariffs in retreat, 1832-33. The champions of "the American System" were thoroughly alarmed when a hostile bill was introduced in the House February 8, 1832 by the Chairman of the Ways and Means Committee, to reduce duties to the level of 12½ per cent. They had thought the battle won once for all, but they found it had "to be fought over again."⁷⁷ Henry Clay vainly attempted to effect a compromise. Ex-president John Quincy Adams, then a representative generally esteemed for fairness, was with difficulty persuaded by the alarmed tariff interests to act as umpire. He presented a somewhat conciliatory report, the proposals in which, though they did not please either extreme,⁷⁸ became law July 14, 1832, restoring the rates approximately to the level of the act of 1824.

The South was still far from satisfied, and "nullification"⁷⁹ flamed forth in South Carolina, followed promptly by President Jackson's anti-nullification proclamation on December 10.⁸⁰ Henry Clay, who

⁷⁶ The same, p. 216.

⁷⁷ *Niles' Weekly Register*, Vol. 42 (1832), p. 20.

⁷⁸ The same, pp. 231-34, 244-57.

⁷⁹ An attempt to establish the right of a state to disregard an act of Congress, without establishing its unconstitutionality in the federal courts.

⁸⁰ For an account of the Compromise of 1833, especially Clay's part in it, see Schurz, *Henry Clay*, Vol. 2, pp. 1-22.

had just been overwhelmingly defeated by Andrew Jackson in the presidential campaign of that year, again essayed the role of compromiser, this time successfully. To the dismay of the stalwart restrictionists, their champion, Clay, in secret agreement with Calhoun, introduced a compromise bill, and without the support of most of his own party and mainly by the aid of Southern votes, quickly secured the enactment of the rather bungling Compromise Tariff Act of March 2, 1833. All rates in excess of 20 per cent were to be gradually reduced to that rate by June 30, 1842. Clay argued, as always ingeniously, that this was still a "protection" measure, although it went far beyond the reduction proposed by Clay's old friend Gallatin only a year before, which Clay had insultingly condemned.⁸¹

Compromise, crisis, and the tariff of 1842. Because of the intense feelings that had been aroused by the "tariff of abominations" and of the grave political threat in the nullification movement, the Compromise Act was accepted with relief on all sides. It did not silence all discussion of the tariff issue, but it was regarded as an almost sacrosanct political truce on the tariff issue to be faithfully observed, and it continued in operation for the full stipulated period (with only minor amendments not violating the main terms of the act) and until replaced by the higher tariff act of August 30, 1842. The plan of rate reductions was crudely devised, providing for very gradual biennial reductions for the first eight years and a half (amounting to a total of four-tenths of the excess above 20 per cent ad valorem) and the abrupt removal of the remaining six-tenths of the excess in the last six months of the period.

Judgment of the economic effects of the Compromise Act has been mostly of a very partisan nature. It has been much confused with other issues of Jackson's administration, particularly his hostility to the Second Bank of the United States, whose charter was not renewed in 1836. Views on both the bank and the tariff issues were confused, too, by the severe financial crisis of 1837. When the Compromise Act was passed in March 1833, business in this country as well as in Europe was already well started on the up-wave of a business boom of large proportions. The four years until near the

⁸¹ The same, Vol. 1, pp. 362-66.

end of 1836 were marked by reckless speculative public and private financing, in large part with funds borrowed in Europe. These foreign loans stimulated imports into this country. The excess of imports into the United States for domestic consumption over the exports of domestic products in the seven years 1832-38 amounted to 167 million dollars, roughly approximating the amount of the foreign loans. Customs receipts were beyond the needs for revenue. The national debt was extinguished, and many millions of "surplus" were distributed to the states in 1836. The financial panic which broke in full force in 1837 was severe and prolonged, marked by the widespread failure of state banks and of private business enterprises, and by an amount of unemployment in the larger cities that was without precedent. The reduction of tariff rates that had become effective by that time (one-fifth of the excess above 20 per cent) was barely 3 or 4 per cent ad valorem even for the higher rates, and only the most extreme champions of high restriction suggested that this could have had any appreciable effect in causing a panic which began in England and which was rooted in speculative financial excesses both foreign and domestic.

After a temporary revival in 1838, the depression recurred, and business conditions continued bad in 1841 and early 1842. By 1840 the Treasury was incurring a deficit which became worse in the next two years. The usual confusion of thought between revenue tariffs and restrictive tariffs aided the manufacturers in their efforts to increase tariff rates. The result was the Tariff Act of August 30, 1842. There was, however, little popular or political enthusiasm for this measure, and it passed both houses of Congress by the scantiest possible majorities.²²

This act of 1842 was the longest and most detailed that had been passed up to that time. Its net result was to restore average rates to about the high level of the act of 1832, thus nullifying the reduction effected by the Compromise Act of 1833. During the four years of operation of this tariff act, business conditions got better, but whether this was due to the magical power of a high tariff to cure business depressions,²³ or whether business was at the point in the

²² See Edward Stanwood, *American Tariff Controversies in the Nineteenth Century*, Vol. 2 (1903), pp. 26-30.

²³ As maintained by Stanwood, pp. 30-37.

cycle where it was ready for an upturn,⁸⁴ may still be the subject of argument.

Increased emphasis on the high-wage argument. It has already been pointed out (see page 553) that the theory that a high restrictive tariff was the cause of high wages and that without it American wages would inevitably fall to the level of the so-called "pauper" wages of Europe and Asia, seems not to have been even hinted in tariff discussions until about 1831. From 1840 until the present time, however, the "pauper-labor" argument has held an important place,⁸⁵ and has largely replaced the plea for high tariffs to increase prices and profits. This shift of emphasis occurred as the trade union movement was beginning in the larger cities around 1833,⁸⁶ while at the same time Jacksonian democracy was widening the voting franchise, and socialistic experiments under the influence of the Owenite and other philosophies were multiplying.

Moreover, by 1840, a half-century of intentionally restrictive taxation of some kinds of imports, together with a substantial amount of incidental restriction afforded by the more moderate revenue rates, had helped to bring into existence a goodly number of manufacturing enterprises in the larger eastern cities which could not continue to pay the general level of wages being paid in other industries without a tariff to keep up their prices. The unemployment and temporary loss to specialized workers in subsidized industries caused by the sudden removal or reduction of tariff duties was also easily mistaken for proof that the tariff was the cause of the higher general wage level. These various factors brought about a situation in which the employers might still do the lobbying, but the appeal for votes was made to the workers and the humanitarian voters.

When certain restrictive tariff rates are first imposed, some limited classes of workers benefit as prices rise and employers compete for their services, and pass the added costs on to the consumers. It is certain, but less often recognized, that consumers of the products benefit when tariffs are removed and prices are lowered.

The fact, or historical accident, that the chief advocates of greater

⁸⁴ As seen by Taussig, *Tariff History*, pp. 116-21.

⁸⁵ Mangold, *Labor Argument in American Protective Tariff Discussion*, pp. 89-94.

⁸⁶ The same, p. 75.

freedom of commerce were representatives from the southern slaveholding states, served to connect freedom of trade with slavery, in the minds of many people of the North, and to foster the belief that high tariffs were especially designed to benefit free laborers. The very word "protection" suggested this thought.

The tariff act of 1846. Hardly had the act of 1842, passed by the Whigs, got to working when the Democrats replaced it, in 1846, by an act greatly moderating the rates. The tariff issue had been little discussed during the campaign of 1844. Both the politicians and the people were interested more in other issues. The Democratic candidate, Polk, avoided committing himself on it, and both Whigs and Democrats claimed to be the champions of the tariff in the high-tariff state of Pennsylvania,⁸⁷ which Polk carried against Henry Clay, the staunch champion of "home markets." The South, however, safely counted upon Polk to repeal the high tariff, and the appointment of Robert J. Walker, a former senator from Mississippi, as Secretary of the Treasury, fulfilled their hopes. His celebrated report of December 3, 1845⁸⁸ set forth his views, outlining with great clearness the principles followed with moderation in the tariff act of 1846, which became law July 30.

Whatever may be thought of the policy of tariff for revenue only, the Walker report must rank as the most thorough and consistent presentation of revenue tariff principles that had ever been given in any public document in this country. Its author recognized that there is for each kind of imported article a rate which will yield the maximum public revenue, more than either a lower or a higher rate. He clearly perceived the workings of what is now called the principle of elasticity of demand. He declared that "at least two-thirds of the taxes imposed by the present tariff (Act of 1846) are paid not into the Treasury, but to the protected classes." He favored a strictly revenue policy on constitutional as well as economic grounds.⁸⁹

⁸⁷ Stanwood, *American Tariff Controversies*, Vol. 2, pp. 39 ff.

⁸⁸ Printed with extensive tables in 29 Cong. 1 sess., *Report from the Secretary of the Treasury*, H. doc. 6 (1845-46). Reprinted in Taussig, *State Papers*, pp. 214-51.

⁸⁹ In the tariff act of 1846 articles were arranged in nine schedules: Schedule A, containing only a few costly liquors, carrying a rate of 100 per cent; Schedule B, containing mostly liquors and tropical luxuries, taxed at 40 per cent; Schedule C to H taxed at rates ranging from 30 per cent down to 5 per cent; and Schedule I, containing a few articles duty free.

The most conflicting opinions have been expressed regarding the success of the tariff act of 1846. It was denounced from the first by extreme restrictionists as a free trade measure,⁹⁰ which it was not, for the great bulk of its rates were between 20 and 30 per cent. The free list was small, and the average rate of duties collected proved to be between 20 and 25 per cent. Certainly it gave a large measure of "incidental" protection. It violated the revenue principle by admitting tea and coffee free, the two most perfect subjects for revenue taxation; but customs receipts were ample to yield a surplus above federal expenditures during the entire period of the act.

The evil results predicted by opponents did not appear. The period from 1846 to 1857 was one of remarkable general prosperity and growth for the whole country, owing to a combination of favorable conditions. The act of 1846 was destined, therefore, to remain in force unchanged for eleven years with as happy a record as any tariff act in our history. When a change was made in 1857 it was to lower, not to raise, the rates. Even in the administration of Taylor and Fillmore (1849-53) the Whigs, despite their strong bias for high restrictive tariffs, made no serious efforts to revise rates upward. It is the only notable instance in our history in which such a change of the parties did not bring a reversal of tariff policy in some degree.

Reciprocity with Canada, 1855-66. A fruit of the liberal tariff sentiment of this period was the conclusion in 1854 of a reciprocity treaty with Canada, marked by unique features. It effected a reduction of tariff duties by additions to the free list, not merely by liberalizing commercial regulations. The reciprocal concessions consisted of an identical list of items in which there was to be free trade, rather than a balanced list of equivalent concessions. Further, the treaty settled some long-standing subjects of controversy by giving reciprocal rights in the fisheries north of the 36th parallel, and to the use of certain canals, the St. Lawrence River, and Lake Michigan.

Canada sought such a treaty immediately after the repeal of the

⁹⁰ See Henry C. Carey's argument, reprinted in Ernest L. Bogart and Charles M. Thompson, *Readings in the Economic History of the United States* (1916), pp. 333-37.

British Corn Laws in 1846, at which time certain British preferences to Canadian commerce had been withdrawn.⁹¹ The proposals of Canada were met in a friendly spirit by the administration at Washington, although it is said that general opinion in the United States "saw very little advantage to itself in such an arrangement" and "it is not probable that the question of reciprocal trade would have received much consideration had not the fishery question been forced to an issue."⁹² In 1847, to pave the way for reciprocity, Canada, which already had a very low tariff, reduced its duties on American manufactures from 12½ to 7½ per cent, and raised the duties on British manufactures to the same figure.⁹³

In 1849 the total value of the commerce between Canada and the States was \$6,000,000. Two events in 1849, the opening of the Canadian canals and the adoption of the bonding system in the United States⁹⁴ (by which Canada could export and import through the United States in bond), were followed by an increase of this commerce to \$24,000,000 a year. After the Reciprocity Treaty of 1854 commerce rose to \$33,000,000 a year.⁹⁵

Abandonment of reciprocity with Canada. The treaty with Canada was to remain in force for ten years from March 16, 1855 (the date of the President's proclamation) and further for twelve months after abrogated by either party. Meantime, in 1858, the fiscal needs of Canada led to a very substantial increase of the Canadian tariff rates, mainly on revenue items (such as tea and coffee), and the opportunity was used by special interests in Canada to increase the duties restricting some imports of American manufactures.⁹⁶ Discontent with this change was felt in the States, although the Canadi-

⁹¹ On "the consternation" caused by "the news of the repeal of the Corn Laws," see E. B. Biggar, *Reciprocity* (1911), p. 7; and the severe depression in Canada that followed, p. 8.

⁹² Chalfant Robinson, *Two Reciprocity Treaties* (1904), pp. 31-33.

⁹³ United States Tariff Commission, *Reciprocity and Commercial Treaties* (1919), pp. 66-67.

⁹⁴ *Report of the Select Committee of the Chamber of Commerce of the State of New York on the Reciprocity Treaty* (1865), p. 23.

⁹⁵ The same, pp. 25-26. The Tariff Commission estimates that "the aggregate trade between the two countries increased approximately three fold" during the years of reciprocity, and the commerce of the United States with Canada became second in importance only to that with Great Britain. *Reciprocity and Commercial Treaties*, p. 87.

⁹⁶ Biggar, *Reciprocity*, p. 19.

an rates still were lower than ours, but action to abrogate the treaty was delayed until after the close of the Civil War. Then it was terminated by the United States as of date of March 17, 1866, after it had been in force eleven years.

The chief ostensible reason for this action was that the treaty "hampered the raising of revenue" then alleged to be needed by the government.⁹⁷ There was a real or pretended need to levy excise duties on goods imported free from Canada, a right which Canada eagerly offered to concede. There was the motive of resentment in the North because of British sympathy for the cause of secession. But there are good grounds for believing that the real reason was the re-growth of the restrictive tariff policy during the Civil War. As has been said:⁹⁸ "The fundamental reason for the rejection of reciprocity by the United States was the belief that it would be a blow to the policy of protection." In the discussions over the continuance or abrogation of the treaty the interests of the consumers were, as usual, "not at all considered" although "the main benefit had come to the consumer, being transferred to him by a competitive process."⁹⁹ Only the conflicting interests of the producers, organized and vocal, entered into the political decision.

A considerable opinion in the States, especially in the East, was favorable to the continuance of the treaty.¹⁰⁰ Sentiment in Canada in favor of continuing the treaty was nearly unanimous,¹⁰¹ but all efforts of Canada to revive the treaty proved unavailing.¹⁰² Thus ended until 1936 all special reciprocity agreements with Canada.

The abrogation of the treaty is said to have influenced powerfully the formation of the Confederation of the British North American Provinces in 1867 and the construction of an intercolonial railroad which in considerable degree took the place of transportation through the United States.¹⁰³

⁹⁷ Robinson, *Two Reciprocity Treaties*, p. 67. On the large increase of custom receipts in 1866, see below, p. 566.

⁹⁸ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, p. 91.

⁹⁹ J. Laurence Laughlin and H. Parker Willis, *Reciprocity* (1903), p. 110.

¹⁰⁰ See the *Report of the Select Committee of the Chamber of Commerce of the State of New York*, strongly favoring reciprocity.

¹⁰¹ Biggar, *Reciprocity*, pp. 23, 25.

¹⁰² On the many futile efforts to restore reciprocity between 1866 and 1911, see U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 92-100.

¹⁰³ Robinson, *Two Reciprocity Treaties*, pp. 73-74.

The tariff reduction of 1857. After 1850, the general price level was rising both here and in Europe with the large new supplies of gold from California and Australia. However, between 1853 and 1857 appeared signs of dangerous over-speculation in this country, the number of banks and the issues of bank notes more than doubling, and prices of railroads, land, and new business enterprises increasing far faster than their earning power. In 1857 came the collapse of this speculative boom. The receipts from customs had for years been in excess of the needs of revenue and, with some thought of relieving the dangerous financial strain on business, the tariff act of March 3, 1857 was passed.¹⁰⁴ It is clear that this was just the wrong time for a reduction of rates for revenue purposes, for receipts from custom duties decreased during the depression, causing Treasury deficits between 1858 and 1861. High tariff orators in the next half-century declared that "free trade" had left the nation bankrupt at the outbreak of the Civil War.

Mail subsidies before the Civil War. In 1840, Samuel Cunard established a regular passenger service to this country with the aid of a mail subsidy from the British government.¹⁰⁵ Thus began the modern era of postal subventions and shipping subsidies with its problems of pressure groups and political favoritism to private enterprise in foreign shipping. Our government was spurred to rivalry, and, in the act of March 3, 1845 to provide for the transportation of mail between the United States and foreign countries, the Postmaster General was required to give preference, in the awarding of mail contracts, to carriage in steamships which might on demand be converted into vessels of war.

Accordingly we embarked upon an ill-fated experiment, continuing until the Civil War, to develop a subsidized merchant marine of steam passenger vessels, uneconomical for freight service. Between 1850 and 1858 subsidies were paid to various companies

¹⁰⁴ This reduced to 30 per cent the rates of the upper schedules, A and B (bearing rates of 100 and 40 per cent respectively but applying to few articles), and cut the rates of each of the other schedules by about one-fifth, leaving the highest 24 per cent and the lowest 4 per cent. The actual average ad valorem rate of duties collected (on dutiable goods) in the next four years (1858-61 inclusive) fell about 3 per cent, to 19 per cent, the lowest point for fifty years.

¹⁰⁵ Royal Meeker, *History of Shipping Subsidies*, Publications of the American Economic Association, 3rd series, Vol. 6 (1905), p. 5.

for carrying the mails to Liverpool, to certain ports on the continent of Europe, to Cuba, and to Panama. Altogether \$14,500,000 was expended in this way with no lasting results. In 1858 subsidies ceased until after 1865.¹⁰⁶

IV. ANOTHER HALF-CENTURY OF HIGH TARIFFS, 1861-1913

The Morrill Act of 1861. As we have seen, the period of 29 years from 1832 to 1861 was, with one intermission in 1842-46, marked by tariff rate reduction and continued moderation of the restrictive policy. The period of 52 years from 1861 to 1913 was to be almost the reverse in respect to tariff policy, marked first by a rapid increase and then by the prolonged maintenance of intentionally restrictive rates, with one brief interval of somewhat lower (but still fairly high) rates in the years 1894-97.

The causes of the reversal of policy and public opinion in 1861 are fairly plain, and are a good illustration of the way in which political accident rather than economic reasoning have determined our tariff policy. The causes are linked directly with the secession of the southern states and the withdrawal from Congress of the southern members, always more favorable to revenue than to restrictive tariffs. The continuance of extremely high rates for nearly two generations after the war is mainly to be explained by the political feelings and attachment to the party in power, engendered in the northern and western states by the Civil War, and by the decreased influence of the southern states in the national councils.

The immediate motive for the attempt to increase tariff rates when Congress met in December 1859 was the need of increased revenue because of the falling off of receipts from customs in the depression years beginning in 1858. The need could have been met by restoring the rates of the act of 1846, as many advocated. But the high tariff group, centering around Pennsylvania, sought to bring about a general revision which in effect would increase restrictive favors rather than public revenue. In December 1860 the absence of twelve senators and of other members of Congress from the seceding states made easy the passage of the Morrill Act, March 2, 1861, two days before Lincoln's inauguration.

¹⁰⁶ For details, see the same, pp. 150-57.

The chief motive for increasing rates beyond the need of revenue was political, and there is ground for the belief that the tariff issue swung Pennsylvania and Indiana into the Republican column in 1860, assuring the election of Lincoln.¹⁰⁷

The adoption of higher tariffs just at that time had grave international consequences, for it served further to alienate European sympathy from the North and turn it toward the seceding states. The high tariff was not clearly a cause of secession, for it was declared in the secession convention that "no tariff since that of 1832 had caused any desire for secession."¹⁰⁸ However, the Confederate constitution, adopted within nine days of the Morrill Tariff Act, declared for a policy of revenue tariffs and provided that no bounties could be granted on commerce and no protective duties laid.¹⁰⁹

Other war tariff acts, 1862-65. When the Morrill Act was passed, secession was already a reality. The pressing need of revenue by the North led to a succession of acts all increasing tariff rates. The principal acts after those of 1861 (March 2, to which some additions were made August 5, and December 24), were passed in 1862 (July 14), 1864 (June 30), and 1865 (March 3). Not until the last two years of the war (fiscal years 1864 and 1865) did they yield much more than the maximum under the act of 1846. In 1866, however, customs receipts jumped to about four times the prewar averages.

The abnormal demands of the war and fast rising prices had combined with various restrictions on commerce (by tariffs and by Confederate privateering) to make many kinds of manufacturing very profitable in the North during the war period. However, a staunch defender of high tariffs probably goes too far when he says: "It is not merely difficult, it is impossible, to estimate even approximately the effect of the heavy duties imposed on foreign goods by these several acts. . . . The condition of affairs . . . was such that all the direct effects of the tariff upon trade and manufactures were completely masked. The high duties were an inner and a useless barrier against importation, a second line of defense for the 'protected'

¹⁰⁷ French E. Chadwick, *Causes of the Civil War, 1859-1861* (1906), p. 126.

¹⁰⁸ The same, p. 140.

¹⁰⁹ The same, p. 256.

manufacturer, which he did not need so long as the outer breastworks were insurmountable."¹¹⁰ This statement implies that war risks had completely stopped importation. In fact, imports in the years 1862 to 1865 were (in value) hardly one-fourth below the average of the five prewar years despite the fact that average ad valorem duties were about two and a half times as great.

The compensatory "principle" introduced. Although every one of the war tariff acts was enacted to raise revenue, and was to be temporary, during the emergency of the war, the distractions of war and the efforts of interested persons resulted in rates' being fixed above the level that would yield the maximum revenue. Moreover, a new "compensatory principle" was introduced in the tariff act of 1862, that of increasing tariff rates to offset the added costs to domestic manufacturers of the numerous excise taxes levied by the Internal Revenue Act passed the same month. In the act of 1864 the compensatory rates were raised still higher, becoming in many instances more than equivalent to the burden of domestic excise taxation.

Within a year of the close of the war, the large revenues from all sources began to be in excess of disbursements; in the fiscal year of 1867 the surplus was \$116,000,000. A drastic reduction of taxation was both a possibility and a necessity, but the attention of the country and of Congress was distracted from the subject of the tariff by the burning political issues of the reconstruction era. Not so the attention of those chiefly interested in the retention of the high compensatory rates. By a succession of measures between 1866 (July 13) and 1872 almost the whole system of excise taxes excepting those on liquor, tobacco, and a few other articles, was swept away, leaving the compensatory rates untouched.¹¹¹ The result as to higher prices and profits for manufactures was the same as if new and higher restrictive rates had been imposed at the close of the war, which were then to remain practically unchanged for many years.

Retention of war rates. From 1867 until 1913 the struggle over the tariff issue fills a large part of our domestic political history. Strong drives were made to reduce the tariff in 1867, 1876, 1878,

¹¹⁰ Stanwood, *American Tariff Controversies*, Vol. 2, pp. 130-31.

¹¹¹ See Taussig, *Tariff History*, pp. 171-78, 195-200; and Ida Tarbell, *The Tariff in Our Times* (1911), pp. 28-80.

and 1888, but failed in every case. The movement in 1870 to reduce restrictive rates resulted only in the reduction of some revenue duties, such as those on tropical products. In 1872 the removal of strictly revenue duties on teas and coffee practically insured the continuance of high rates on manufactured products. However, a one-tenth horizontal cut of other rates was conceded by the protectionists to forestall more radical reductions. The former rates were restored three years later, in the act of March 3, 1875, by a "lame duck" Congress. The elections of 1874 had insured a majority in the House to the Democratic party pledged to tariff reductions, but had left the Republicans in control of the Senate. Although contrary to prevailing popular opinion, this action therefore was secure against reversal for some time.¹¹²

Ship subsidies, 1865-74. The close of the Civil War saw the revival of the shipping subsidy policy under the patronage of the high tariff party. The connection between restrictive tariffs and shipping subsidies is difficult to explain logically. It seems to rest on the belief that while imports are bad, exports are good and are to be encouraged at whatever cost. The first postwar measure of this sort was the act of August 29, 1865, granting a subsidy (supplemented by the Brazilian government) to a steamship company for a monthly service between New York and Rio de Janeiro. Its American proponents confidently predicted that this would increase the sales of our products to Brazil by many million dollars, at the expense of British manufacturers. This subsidy was paid for ten years and cost the two governments 2½ million dollars, without any traceable results¹¹³ in amount of commerce, as sailing vessels still carried nearly all freight. When Congress refused to renew the subsidy, the company suspended operations.

Beginning in 1865 subsidies were granted also to steamship companies carrying mails to Hawaii and the Orient.¹¹⁴ One of the worst scandals in our history developed in connection with the Pacific Mail Company. It carried on an active propaganda and succeeded

¹¹² Taussig, *Tariff History*, pp. 182-91; Stanwood, *American Tariff Controversies*, Vol. 2, pp. 178-91.

¹¹³ 45 Cong. 2 sess., H. rep. 346, *Ocean Mail Steamship Service between the United States and Brazil* (1878).

¹¹⁴ For details, see Meeker, *History of Shipping Subsidies*, p. 160 ff.

in getting Congress (October 1, 1873) to make an additional grant for a more frequent service. Within less than a year a congressional investigation¹¹⁶ revealed the secret payment of nearly a million dollars, partly to rig the stock market and the rest spent in devious ways which raised grave suspicion of bribery in Congress itself (though not clearly proven). Eager to get the malodorous subject out of its sight, both houses of Congress refused to renew the agreement. Thus, except for some minor matters, ended in disgrace and failure the first revival of the shipping subsidy policy following the Civil War.

The futile revision of 1883. The movement for "tariff reform" between 1872 and 1875 having been frustrated, the Democratic platform of 1876 declared for "a tariff for revenue only," and the candidate, Samuel J. Tilden, received a majority of the popular vote, but lost the election by the decision of a special electoral commission. Popular interest until 1879, however, was for a time diverted to currency questions, and several bills for tariff reduction died in committee. However, after 1879 prosperity was returning and receipts from both customs and internal revenue produced large surplus revenues which forced a consideration of the tariff with a view to its reduction. In 1882 a tariff commission was appointed. Although its chairman was a professional lobbyist for the Wool Manufacturers' Association, the commission, after long hearings, mostly from witnesses "whose business was directly affected by the tariff rates,"¹¹⁶ reported in December in favor of considerable reductions. It was a "lame duck" session of Congress in which both houses were favorable to a high tariff, whereas the congressional elections in the preceding month (November 1882) had returned a Democratic majority in the House favorable to the revenue principle. In prolonged congressional debates the commission report was lost to sight and a highly restrictive tariff bill originating in the House finally was enacted March 3, 1883. The internal revenue taxes were reduced considerably but the act "retained, substantially unchanged, the high level of duties reached during and after the Civil War."¹¹⁷

¹¹⁶ 43 Cong. 1 sess., S. rep. 286, *Subsidy to the Pacific Mail Steamship Company* (1874), and 43 Cong. 1 sess., H. rep. 598, *Subsidy to the Pacific Mail Steamship Company* (1874).

¹¹⁷ Stanwood, *American Tariff Controversies*, Vol. 2, p. 205.

¹¹⁸ Taussig, *Tariff History*, p. 250.

As neither party controlled at the same time both houses of Congress and the presidency for the next few years, the tariff issue was again deadlocked. Several unsuccessful attempts were made to reduce duties, notably in the Morrison bill of 1884, and in the Mills bill of 1888 following the views outlined by President Cleveland in his tariff message in 1885.

Reciprocity with Hawaii. The second reciprocity treaty touching tariff rates was that concluded with Hawaii.¹¹⁸ The motive on our part for this treaty was political and military, concerned with the defense of the Pacific, rather than economic. The danger for an independent Hawaii in its relation with other foreign powers was recognized both by the native government and by the United States. A treaty of annexation was negotiated with Hawaii as early as 1851, as were reciprocity treaties in 1855 and 1867, but all failed of adoption. At length the treaty of 1876 was put into operation (September 9) for the term of seven years.¹¹⁹

When this treaty came up for renewal in 1883 strong opposition to it developed in the Senate, even with the additional grant to the United States of a harbor in Pearl River.¹²⁰ However, with the personal support of President Cleveland (who on economic grounds was not in favor of reciprocity treaties of this type) the new convention was concluded in 1884,¹²¹ and it continued in effect until the annexation of the islands in June 1900, when Hawaii became a customs district of the United States.

The effect of the treaty of 1884 was greatly to stimulate the production of a few of the particular products of the islands which enjoyed the benefits of the higher prices in the United States resulting from the restrictive duties on like products from other countries. Of these articles sugar was the most important, and the financial benefits of this arrangement were reaped not by the public treasury but by the Hawaiian planters.¹²² It is estimated that the loss of revenue to

¹¹⁸ The first having been that with Canada, discussed above.

¹¹⁹ This treaty differed essentially from that with Canada in respect to the schedules of articles admitted free to the two countries: whereas in the former case the schedules were composed of identical articles, in the Hawaiian treaty they were mostly unlike products. Those admitted free of duty to the United States were the staple tropical products of the islands, whereas the much more numerous articles admitted free to the Islands were chiefly manufactures.

¹²⁰ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 114-16.

¹²¹ This treaty was not ratified until 1887. 25 Stat. L. 1399.

¹²² U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 115, 136.

the United States Treasury during the operation of the Hawaiian treaties was \$91,000,000, which went as a bounty to the island planters. The removal of the sugar duty by the McKinley tariff (effective from 1891 to 1894) greatly reduced this advantage, but it was in part restored later by the Dingley tariff of 1897. The low tariff members of Congress opposed this type of reciprocity on principle as not truly tending to freedom of trade, and it has always been opposed by American cane and beet sugar producers. Under the operation of this treaty nearly 80 per cent of the imports into the islands came from this country, and over 99 per cent of their exports came to the United States.¹²³

Restrictive policy and reciprocity between 1880 and 1889. Around 1880 began in the United States a movement, favored by the Republican and opposed by the Democratic party, for a commercial reciprocity policy of a somewhat different nature, a movement which was to continue until 1909 and to result in many futile negotiations and in numerous completed trade agreements of brief duration. The thought of reciprocity is so naturally associated with efforts toward greater freedom of commerce that it is paradoxical when the party standing for extreme restriction favors reciprocity, and the party favoring a general policy of freer trade opposes it. The explanation of this contradiction in our national politics is to be found in certain peculiar conditions of the period.

The Republican party, having long failed to remove the high compensatory duties imposed during the war, was feeling the pressure of a growing popular demand for a downward revision of tariff rates. How was this to be met without endangering the whole structure of high restrictive duties? Not daring to "go to the polls with a policy of unmodified protection,"¹²⁴ its leaders hit upon reciprocity as an ingenious concession. The established tariff policy was essentially one of favors to manufacturers by high duties on competing imports and low rates or free admission for the raw materials used in manufacture. Agriculture never had any substantial share in the benefits, most agricultural products being admitted free or at very low duties, and the few duties imposed upon farm products of the

¹²³ The same, p. 122 ff.

¹²⁴ Laughlin and Willis, *Reciprocity*, p. 113.

sort raised here being practically a dead letter because these commodities were on an export basis. Although a majority of the farmers of the North and West had continued to support the restrictive tariff party, dissatisfaction was growing among the farmers with the workings of a tariff policy which favored so largely the industrial regions and classes. The problem then of the high tariff leaders was to allay this agrarian discontent by making a show of reducing the tariff without lowering the rates on manufactures.

As subjects for reduced duties tropical products seemed to be the most nearly ideal, as being, it was thought, only slightly or indirectly (as substitutes) competitive with our farm products. The difficulty in this respect was underestimated. The countries with conditions most fully answering the requirements for reciprocity of this nature were those of the West Indies and of Central and South America. Our favored manufacturing interests, although opposed to reciprocity with industrialized countries, were willing to lower the tariff on the products of tropical and less developed countries which would buy manufactures in exchange. Thus is explained the paradox of the restrictionists at that time favoring reciprocity.

The party that had always stood for a "tariff for revenue" could not consistently endorse such a policy. Reciprocity of this nature is the antithesis of a policy of a tariff for revenue only, for it involves the free admission of purely revenue articles in exchange for the concessions by the other countries of lower rates on our manufactured goods which are protected at home by high import duties. Under this policy, ideal revenue items, such as tea and coffee, would be admitted free in order to enable our protected manufacturers to sell some of their products abroad (in some cases at "dumping" prices while monopoly prices were charged at home). The original revenue purpose of the tariff would thus be abandoned piecemeal, and customs duties would become wholly restrictive in purpose and effect.

In brief, this policy was pursued in fruitless negotiations throughout the administrations of Presidents Garfield and Arthur and Harrison (1881-85, 1889-93). An International American Congress met in Washington in 1889 in an atmosphere of general skepticism. Its discussions brought out plainly the fact that the high tariff policy

of the United States stood squarely in the way of any considerable reciprocity with the Latin American countries, who found their best customers in Europe as well as the lowest prices and best service for most of the things they wished to buy.¹²⁵ The only result was a colorless resolution recommending the negotiation of "partial reciprocity treaties among the American nations."

The McKinley tariff of 1890. It would have seemed rash to prophesy in 1883 that the next change in tariff legislation, to come seven years later, would be toward higher rather than lower duties, and at a time when revenues were superabundant. Again the tariff was made the football of politics. The politicians made a drive for higher rates when most of the favored industries would have been satisfied to keep the rates from being reduced. The fact that President Cleveland had made a tariff reduction a leading issue in his unsuccessful campaign of 1888 led the Republicans to champion an extremely opposite policy of higher rates.¹²⁶ Being again in control in both houses of Congress and in the White House, the restrictionists enacted the voluminous tariff act of October 1, 1890 (the McKinley Act).

This act raised not only a number of special rates but the average level of restrictive duties, and in principle "boldly proposed . . . a radical extension of the protective system."¹²⁷ It was a repudiation of the doctrine that the high war tariff was to be reduced whenever financial conditions made this possible, and it announced a permanent national economic policy¹²⁸ of intentionally restrictive, even prohibitive, rates.¹²⁹

The reciprocity policy of the McKinley Act, 1890. The McKinley Act was a new attempt to hitch up a reciprocity policy with a policy of high restrictive duties. The act contained a reciprocity clause (section 3) which was introduced at the insistence of James G.

¹²⁵ See the same, pp. 134-38 for quotations from the frank remarks of South American delegates.

¹²⁶ Taussig, *Tariff History*, pp. 255-56.

¹²⁷ The same, p. 283.

¹²⁸ Tarbell, *The Tariff in Our Times*, p. 206.

¹²⁹ A prohibitive duty of 70 per cent was imposed on tin-plate; sugar, a large revenue item, was put on the free list. The average rates on dutiable goods rose in the next three years about 5 per cent ad valorem (to 50 per cent), somewhat exceeding the highest previous recorded figure.

Blaine, then Secretary of State, with the support of Republican leaders who feared public reaction against an unmitigated high tariff policy. They sought again to hold out hope to the western farmers, then greatly distressed, that larger outlets for their products would be found by these means, although manifestly the chief benefits would come to manufacturers.¹⁸⁰ The new reciprocity policy was to use penalties rather than rewards, and administrative power was delegated to the President to carry out certain provisions of the act. Five important revenue items were put upon the free list, sugar, molasses, coffee, hides, and tea, and the President was authorized to remove them from the free list in the case of any country imposing duties which he deemed to be "reciprocally unequal and unreasonable."

Secretary Blaine promptly negotiated ten reciprocity agreements, the most important that with Brazil, and the penalty was imposed upon three countries (Colombia, Venezuela, and Haiti). Giving to so many important producing countries the right to sell us their sugar, molasses, coffee, and hides free of duty doubtless tended to reduce the price of these articles to the American consumers, which would not have been the case if the right had been limited to a very restricted number (as in the case of Hawaii, and later of the Philippines, admitted within our customs territory but not able to supply our whole national demand). Such a general "concession" of a free list approaches near to "free trade" for the importation of those articles, at the sacrifice of the revenue which had been received from those products.¹⁸¹

The Democratic position was that the McKinley reciprocity policy was "in intention and effect" not for reciprocity but for retaliation, that it provoked ill feeling in countries discriminated against, that it raised prices to domestic consumers, and that it was wrong in vesting in the President any authority or power to impose or release

¹⁸⁰ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 145-50, Taussig, *Tariff History*, p. 278, and Laughlin and Willis, *Reciprocity*, pp. 184-206, give a more detailed legislative history of the act.

¹⁸¹ It should be noted, too, that the act of 1890, while putting sugar on the free list, granted a bounty of two cents a pound to domestic producers, the amount of the former duty. This cut off some 60 million dollars of customs revenue and cost the treasury in addition some 6 or 8 million dollars for bounties. See Taussig, *Tariff History*, p. 277.

taxes by proclamation or otherwise.¹³² Accordingly, the tariff act of 1894 repealed the reciprocity section of the McKinley Act and put an abrupt end to the existing agreements of this series, which had been in effect for periods ranging from 27 to 41 months.¹³³ All the laboriously fashioned reciprocity treaties, except that with Hawaii, which was based on a different principle, were thus erased.

Ship subsidies versus free ships. Since the scandal of 1874 the ship subsidy policy had been abandoned, but the subject had come to present a new aspect. As long as wooden sailing ships had ruled the seas our shipbuilders, despite the higher prevailing wages and restrictive tariffs on some of their materials (cables, cordage, iron, sail cloth, etc.), could hold their own in competition with the world. But after iron (and later steel) steamships came into use, first in the passenger and mail services, and then more and more in freight service, ship owners and operators found the higher cost of ships built here behind the walls of the tariff an insuperable obstacle to successful competition in foreign carrying trade. The interests of most ship owners and of merchants engaged in foreign commerce were thus more clearly opposed to those of the shipbuilders and the subsidized manufacturers of shipbuilding materials. This situation was particularly marked in the period from about 1875 until near the end of the century. Ship operators who had no prospect of subsidies aligned themselves with the Democrats and a policy of "free ships,"¹³⁴ while certain larger companies which could command political influence in the effort to obtain shipping subsidies allied themselves with the manufacturing interests and the party of high tariffs.

The policy of subsidies came thus to be closely bound up with those of high tariffs and reciprocity (of a certain kind), the Republicans favoring all three, while the Democrats opposed all three.¹³⁵

¹³² Report of the Ways and Means Committee in 1893, quoted in U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, p. 157 ff. The Supreme Court had already sanctioned the constitutionality of the act—an interesting point in view of the later adoption by the Democrats of this feature in the Hull Reciprocity Agreements in 1934.

¹³³ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 157-63.

¹³⁴ That is, freedom to buy foreign-built ships without paying a tariff duty.

¹³⁵ The details of this history are too numerous and complicated for discussion here. They may be found in Meeker, *History of Shipping Subsidies* (to 1905); and

From 1877 to 1891 it was a drawn battle, the Democrats barely failing to put through a measure for free ships, while the Republicans when in power were unable to extend the subsidy policy.

In 1891 Congress passed the Ocean Mail Act, which with some modifications remained in force until 1928. The amount of the subsidies was much smaller than the advocates desired, but the total in 32 years was over \$26,000,000, an annual average of \$800,000. Half of the total was paid to the American line sailing to Southampton and Antwerp. Few contracts were even bid upon, and although the subsidies enabled the Atlantic service to be maintained, the payments were no "great stimulant to United States shipping."¹⁰⁶

The tariff act of 1894. Within a month after the McKinley Tariff Act went into effect, the congressional election of 1890 resulted in an overwhelming Democratic majority in the House (233 to 88), though the Republicans still maintained a majority in the Senate. The election of 1892 again returned a substantial Democratic majority to the House, and a considerable Democratic majority in the Senate, and gave Grover Cleveland his second term in the presidency. Thus for the first time since 1861 the Democrats, being in full control of the national law-making agencies, could enact a revenue tariff. But it appeared again that tariff votes are not always bounded by party lines, and that the local and personal interests of some members of Congress and of their constituents weigh more than party pledges. The tariff act of August 27, 1894, when it finally emerged after more than a year of congressional discussion, failed to redeem the promise of "tariff reform." President Cleveland refused to sign it, but regretfully allowed it to become law without his signature.

In the Senate the leading part in the defense of higher duties was taken by a small group of Democratic senators, led by Gorman of Maryland, who was then a very powerful figure in his party councils. Senator Gorman was able repeatedly to dictate his own terms by threatening to block the passage of any bill. In popular derision, the bill came to be called the Gorman bill, instead of the Wilson bill

U. S. Department of Commerce, *Shipping and Shipbuilding Subsidies*, Trade Promotion Series No. 129, by Jesse Saugstad (1932).

¹⁰⁶ Saugstad, *Shipping and Shipbuilding Subsidies*, pp. 62-63.

after its sponsor in the House. High tariff Republicans took advantage of the situation to gain numerous concessions for their constituents. Rarely had there been more "logrolling" in the enactment of a tariff act. In connection with the sugar duties, scandals came to light in the evidences of corruption by campaign contributions and of stock market speculation by members of Congress.

The tariff act of 1894 has often been called in political debate a "Democratic free trade act," yet it left the tariff in net effect still highly restrictive. The most substantial additions to the free list were raw wool and certain other agricultural products, and the purely revenue item, coffee. Considerable reductions were made in the rates on iron and other minerals, and on cotton textiles, woolens, and chemicals. On the other hand, numerous rates were increased, the most important of which were those on sugar, meat, and some iron products.

In the election of 1896, many voters strongly opposed to McKinley on this tariff issue voted for him because of his advocacy of the gold standard, although the Republican platform contained a tariff and reciprocity plank acceptable to the high tariff interests. But as the result of his election the high tariff forces gained full control of Congress. President McKinley urged revision mainly to secure needed revenue,¹³⁷ but the revision that followed was on restrictive, not revenue, principles.

Within little more than two weeks after its introduction the Dingley bill was passed by the House March 31, after very brief debate.¹³⁸ In large part it reverted to the features of the act of 1890 (President McKinley's own creation) undoing the moderate reductions made by the act of 1894. Thus the duties on raw wool and on hides were restored together with the system of compensating duties on woolens, silks, and linens, and increases were made in rates on coal, various metals, sugar, manufactures of steel, tin plate, etc. "The Act of 1897 pushed protection in several directions farther than ever before."¹³⁹ The average rate of duties collected on dutiable

¹³⁷ The Dingley Report covering this proposal is reprinted in Bogart and Thompson, *Readings*, pp. 762-63.

¹³⁸ Laughlin and Willis characterize it as "the barest farce of a debate." *Reciprocity*, p. 273.

¹³⁹ Taussig, *Tariff History*, p. 358.

goods in the first three years under this act rose to 50 per cent ad valorem, as compared with 40 per cent in the three years under the act of 1894.

This result of the election of 1896—a higher restrictive tariff—happened just as circumstances diverted attention from the tariff issue. As has been said: “The Dingley Bill, bad as it was, did not stir the popular mind.”¹⁴⁰ Business had begun a year before to recover from the low point of the depression; the country was soon involved in a war with Spain; and the issue of imperialism (annexation of the Philippines) was uppermost in 1900. Then came the era of vigorous domestic reforms under Theodore Roosevelt, who ignored the tariff issue. He declared that the question of railroad rates was a moral issue, but that of tariff rates was not—it was merely a matter of expediency. So the Dingley Act was destined to remain in force until 1909, longer by a year than any previous tariff act.

Attempted revival of Republican reciprocity, 1897. The authors of the Dingley Act again linked the policy of reciprocal tariff concessions with the policy of high restrictive rates. The history of this experiment has instructive lessons, but is too long and complicated to be related in detail.

In agreement with the platform pledge, President McKinley in his first inaugural address in 1897 urged the resumption of the reciprocity principle of the tariff act of 1890. Accordingly the Dingley Act contained two sections with more elaborate and varied provisions than had been tried before, authorizing penalties in the form of removal from the free list, and (a new feature) the actual reduction of rates by not more than 20 per cent. But each reciprocity treaty had to be not only ratified by the Senate but also approved by the House, a condition which wrecked the whole plan.

Some nine treaties (known as the Argol agreements) were concluded, all of which contained minor concessions that proved to be of slight effect. Under the authorization to reduce selected rates by as much as 20 per cent, the administration conducted negotiations for years, and President McKinley strongly urged the acceptance of these so-called Kasson treaties. But in the face of the strong opposition of the tariff interests, Congress refused approval. In his last

¹⁴⁰ Tarbell, *The Tariff in Our Times*, p. 252.

public utterance, his Buffalo speech of September 5, 1901, President McKinley said: "The period of exclusiveness is past. The expansion of our trade and commerce is the pressing problem. . . . Reciprocity treaties are in harmony with the spirit of the times, measures of retaliation are not."¹⁴¹ The hostility to reciprocity through tariff reduction, manifested by the manufacturers' convention meeting in Washington in November 1901, put an end to all attempts to extend reciprocity by this method. No action was taken in this matter by the administration of Theodore Roosevelt except to notify the French embassy in 1903 that efforts to secure ratification of the treaty negotiated in 1899 had been abandoned. This was the final proof of the logical and practical inconsistency in a policy of restricting commerce and at the same time encouraging it by removing restrictions.¹⁴²

Reciprocity with Cuba. A commercial treaty concluded with Cuba in 1903¹⁴³ stands quite apart from the other treaties negotiated under the Dingley Act in its origin and in its peculiar status ever since. At the close of the Spanish War, in 1898, Cuba came temporarily under the control of the United States. After years of disorder and revolution the island was in a desperate condition economically and politically, and public opinion supported the plea that our own peace and welfare required that special consideration be given to Cuban interests by tariff reciprocity.¹⁴⁴ The treaty of 1903 fixed no definite rates for either country, but provided for mutual reduction from whatever rates might be in force for other countries. The existing free lists were left unchanged; the rates on Cuban imports to the United States were uniformly reduced 20 per cent; and the Cuban duties on numerous products of the United States were reduced by amounts ranging from 20 to 40 per cent.

Cuba has continued to be granted a favored position in our tariff policy, the 1903 agreement with Cuba being specifically excepted in

¹⁴¹ *Messages and Papers of the Presidents*, Vol. 13, p. 6621.

¹⁴² For a more detailed account of the policy of reciprocity in the Dingley Act, see U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 198-261; and Laughlin and Willis, *Reciprocity*, pp. 300 ff.

¹⁴³ Proclaimed Dec. 17, 1903; this was supplemented by a treaty more strictly political in nature, proclaimed July 2, 1904.

¹⁴⁴ This view was expressed in 1901 by Mr. Elihu Root, then Secretary of War. U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 317-18.

the acts of 1909, 1913, 1922, 1930, and 1934 from the application of the regular tariff and therefore of the most-favored-nation clause.¹⁴⁶ Cuba has continuously been granted a lower (discriminatory) rate on its sugar imported into the United States. The tariff agreement with Cuba signed August 24, 1934 was declared by the State Department to stand "in a separate category" from other reciprocal trade agreements. It has been described as "simply an extension and elaboration of the reciprocity treaty concluded in 1903."¹⁴⁶ In view of the large investments of American capital in Cuba, it is impossible to escape the thought that the special tariff concessions to Cuba are simply a part of the general system of tariff favors. Part of the benefits go to American investors in sugar plantations (as with Hawaii before its annexation) and part to American manufacturers exporting to Cuba.

The Payne Aldrich tariff of 1909. The trend of thought expressed in 1901 by President McKinley, once the arch-protectionist, toward moderated tariffs, was shared by many men of both parties. This country after 1890 had entered upon a new stage of industrial development, importing relatively fewer manufactures and more raw materials, while exporting fewer raw materials and more finished products. Many manufacturers felt that the era of infant industries was definitely past, and were looking hopefully to an increase in their foreign sales. There was a general belief that restrictive tariff duties were abetting the formation of domestic industrial monopolies. All these influences combined to foster a growing discontent with the high restrictive duties and a popular demand for tariff reduction. The Republican platform in 1908 proclaimed this need, but declared that the tariff should be revised "not by its enemies but by its friends."

The Republican national platform of 1904 had stated a cost-of-production rule to give a scientific appearance to the process of fixing rates, but this had attracted little attention. In the national platform of 1908 the rule was restated more fully as "the true principle of protection" and it took a prominent place in the campaign discussion. There is no indication, however, that any attempt was made to

¹⁴⁶ Henry J. Tasca, *The Reciprocal Trade Policy of the United States* (1938), p. 34; William S. Culbertson, *Reciprocity* (1937), p. 66.

¹⁴⁶ Tasca, *Reciprocal Trade Policy of the U.S.*, p. 195.

apply the rule in the drafting of the act of 1909 or at any time since. The rates in that act were determined by the familiar methods of lobbying, pressure groups, local interests, and political favoritism. Senator Aldrich (Republican) of Rhode Island took in its enactment the part of defender of tariff interests which Senator Gorman (Democrat) of Maryland had played in the enactment of the tariff of 1894.

President Taft made a sincere, if not vigorous, effort to redeem his campaign pledge to lower the rates, but with small success. Rates on 600 items were reduced and on 300 were increased, yet the net result of the changes made by the act was nearly nil.¹⁴⁷ The public had been in a mood for tariff reduction, and the outcome caused widespread criticism and political effects.¹⁴⁸

Maximum and minimum rates in the tariff act of 1909. The Republicans, having tried and abandoned the plan of reciprocity by concessions, now adopted a plan patterned after that followed for some years by France and some other European countries. This plan provided for two schedules of rates, one of minimum rates "representing the normal measure of protection at home" and the other of maximum rates available to meet the discrimination by foreign countries against American goods entering their markets. The tariff act of 1909 made the rates of the dutiable lists the minimum tariff to apply when "the President shall be satisfied" that the country is not unduly discriminating against the United States (in a variety of specified ways) and accords to our products treatment which is "reciprocal and equivalent"; otherwise the maximum tariff was to apply, which was to be 25 per cent ad valorem, in addition to the minimum tariff. This arrangement was in essence the penalty form of reciprocity. It fixed so-called minimum rates as high as the extreme restrictionist interests demanded, with the threat to apply rates 25 per cent higher against imports from countries refusing to grant us most-favored-nation treatment.

All existing concessional treaties were abrogated at this time ex-

¹⁴⁷ Reductions included the rates on leather, shoes, coal, lumber, iron ore, pig iron and steel rails, and, most important of all, the placing of hides on the free list. On the other hand, the act was loaded with jokers and furtive increases of personal and local rather than general advantage. Taussig, *Tariff History*, pp. 400-408.

¹⁴⁸ See Frederick A. Ogg, *National Progress, 1907-1917* (1918), p. 39.

cept that of 1903 with Cuba, which was explicitly continued in force. The President was authorized to employ "such persons as may be required" to secure information to assist him in the discharge of his duties in this connection. Accordingly a Tariff Board was appointed in September 1909. It came to an end in 1912 through the failure of Congress to make appropriations for it, but was revived later. President Taft undertook prompt negotiations and was able to declare April 1, 1910 that the minimum rates were universally applicable. Friction with several countries occurred, however, with regard to various discriminatory rates and practices, and President Taft acknowledged (in his message in December 1910) that the tariff law of 1909 did not "secure the total elimination of discrimination against American products" in European markets.¹⁴⁹

Defeat of reciprocity with Canada 1910-11. Despite our high tariff effective against most Canadian products, and despite the retaliatory Canadian tariffs against our products, the trade between the two neighboring countries had continued to grow since the curt termination of the Canadian reciprocity treaty by the United States in 1866.¹⁵⁰ Our act of 1897, with its high rates barring out many Canadian products, had given further offense to Canada, which had retaliated in its tariff act of 1897 with restrictive duties and other measures directly aimed to discourage our imports.¹⁵¹ In 1908 a preferential arrangement was made between Canada and Great Britain, further discriminatory against American imports. But all these influences sufficed merely to slacken the pace, not entirely to stop the growth of commerce between the two countries so favorably placed by nature and circumstances that trade between them was mutually advantageous to the citizens of both.¹⁵²

The application of our maximum tariff to Canada would have inevitably started a "war of tariffs" with damaging effects in both countries. Negotiations serious and prolonged were therefore undertaken between the two countries with a view to concurrent legisla-

¹⁴⁹ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, p. 274.

¹⁵⁰ A much more detailed account of the incidents here briefly recorded is given in U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 363-81.

¹⁵¹ The same, p. 365.

¹⁵² See the same, p. 367, for examples of the advantage of mutual shipments of similar products because of the differing qualities of products and of the location of supplies along the 3,000-mile boundary line.

tion rather than to a treaty. An agreement was formulated distinctly more liberal in its terms than the then existing tariff laws of the two countries, and the necessary legislation was passed by our Congress. But this time it was the Canadian people who refused to approve reciprocity. Heated debates in Parliament were followed by a successful appeal to the country by the Conservative party opposing the treaty, the Conservatives winning 133 seats against 88 for the Liberals.

A not inconsiderable tariff concession was made to Canada as an incident to these negotiations. In anticipation of the acceptance by Canada of the ill-fated reciprocity arrangement of 1911, Congress passed an act admitting free to the United States pulpwood and paper when exported duty free from Canada. The courts later judicially declared that this law¹⁵³ was in effect as respected Canada despite the failure of Canada to accept the general reciprocity agreement, and that it extended also, automatically, to other countries entitled to most-favored-nation treatment by the United States.¹⁵⁴

V. ALTERNATING TARIFF POLICIES SINCE 1913

After 1909 public opinion moved more strongly in favor of a real downward revision of the tariff. The Democrats in 1913 came into full control of the government, and even before the election the Ways and Means Committee had been preparing a tariff bill under the competent chairmanship of Representative Oscar Underwood. Backed by President Wilson, the bill moved steadily to its enactment. The Democrats, far from advocating complete "free trade," refrained from advocating even an out-and-out "tariff for revenue only," but matched the Republican slogan of "equalizing the cost of production"¹⁵⁵ with another phrase only a little less evasive and indefinite—"a competitive tariff." The phrase seems to mean that the duty on an article should not be so high as to be prohibitive; but it says nothing as to how many foreign goods ought to be admitted.

Of course the ability of the various enterprises in an industry to

¹⁵³ *American Express Co. et al. v. United States*, 4 Court of Customs Appeals 146 (1913).

¹⁵⁴ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 411-12.

¹⁵⁵ See above, p. 579.

compete and survive varies according to location (near ports of entry or far in the interior), to differences of climate, to relative natural resources, to producers' skill, and to other conditions. However high tariff rates are, short of complete prohibition of imports, there are always "marginal" producers, less efficient or less favorably situated, who can plead that for them the rates are not high enough. The question is, just where is the line to be drawn in shielding the weaker, less efficient, domestic producers against the competition of imports? To that, neither "rule" gives any answer. The practical difference, however, between the two rules was that the Republicans were inclined to grant the highest claim that lobbyists demanded, and the Democrats were inclined to lower rates substantially unless it could be shown that an industry (or a substantial part of it) could not survive without it.¹⁵⁶

The Underwood Act and tariff reduction. The Underwood Act of 1913 was the first thoroughgoing and fairly consistent reduction of rates since the acts of 1846 and 1857. It was an almost revolutionary change from the tariff policy that had been pursued for 52 years.¹⁵⁷

The act of 1913 (signed October 3) had been in operation less than a year when the World War began in Europe. What the effect of the reduction of rates would have been under normal conditions cannot therefore be judged from the actual experience. Instead of a great increase in merchandise imports as compared with exports, the excess of merchandise exports over imports leaped up to the record average figure, for the seven years 1915-21, of 2¾ billion dollars. In the maximum year, 1919, it was nearly 4½ billions. European countries during this time were balancing these exports by borrowing heavily from the United States, by gold shipments, and by sell-

¹⁵⁶ Taussig, *Tariff History*, pp. 418, 480, 487; also Frank W. Taussig, *Free Trade, the Tariff and Reciprocity* (1920), Chap. 7.

¹⁵⁷ Most of the few increases of this act were made to correct evident errors in the old law; the decreases, though rarely extreme, were numerous, including the rate on raw sugar. Important additions were made to the free list, including metals, agricultural implements, coal, lumber, many agricultural products, and numerous manufactures in common use, and most important of all, raw wool (with which change went the abolition of the compensatory duties on manufactured woollens). For a more detailed discussion of the rates of this act, see Taussig, *Tariff History*, pp. 425-43.

ing back the large investments in American securities which they had long held. This was one more proof that international borrowing and lending, and political changes, may for long periods have far more to do with determining the balance of merchandise imports and exports than have tariff rates.

The average rate on dutiable goods the first year under this act was over 37 per cent, barely 3 per cent less than in the last years under the Payne Aldrich Act, but it fell steadily until in 1920 it was near 16 per cent, the lowest in over a century. Because of the greatly increased proportion of goods entering free, the average rate on all imports (free and dutiable) fell even more rapidly, to the minimum (in 1918) of only 5.8 per cent, probably the lowest since the first tariff act under the Constitution. This act continued in effect until September 22, 1922, though the Emergency Act of May 27, 1921 imposed high duties, mostly inoperative, on several agricultural products.

Merchant marine policy during the World War. The Mail Subsidy Act of 1891 was still in force in 1914. Repeated efforts to increase the subsidies had failed. The two main arguments for ship subsidies—the need of a merchant marine to supply auxiliary naval vessels in case of war, and the need of shipping to carry our own commerce in times of peace—were conflicting. The fast steamers, which alone would be useful as naval auxiliaries, cannot profitably carry most kinds of freight, and the slower steamers which can carry freight cheaply are of no use as naval auxiliaries in time of war. These facts were presented in Congress, and the drive for subsidies came to naught.

The outbreak of the World War at once caused a severe shortage of merchant shipping, and a great increase of cargo and insurance rates. Goods for export piled up in our ports. The Ship Registry Act, admitting to American registry foreign-built ships owned by American citizens, was passed August 18, 1914, and soon afterward was further liberalized.

President Wilson in his second annual message (December 8, 1914) gave his support to a new shipping bill then before Congress, using the familiar arguments of the subsidy-seekers. However, the shipping and ship-building interests opposed the plan as "socialistic,"

because it authorized the government to build the ships and operate them. The President's argument was seemingly one that should have appealed to subsidy-seekers and exporting manufacturers when he urged "transportation at reasonable rates . . . even where the carriage is not at first profitable; and then, when the carriage has become sufficiently profitable to attract and engage private capital, and engage it in abundance, the Government ought to withdraw."¹⁵⁸ That is, the taxpayers were to carry the costs of promotion and the shipping companies were to get the profits after the business was established.

The act of September 7, 1916 established a shipping board with power to create an Emergency Fleet Corporation to purchase, construct, and operate ships for foreign commerce, limited to five years after the close of the European war. The authorized expenditure was \$50,000,000, later enlarged to over 3 billion dollars.¹⁵⁹

The greater part of the tonnage obtained by the Corporation before the armistice was in vessels already under construction in American shipyards, which would have been equally useful for ocean carriage if they had been left in private hands. German vessels that had been in American ports were also taken over.

New construction was begun of some 7,000,000 gross tons of vessels. Many of them were made of wood or of steel and concrete, few of these were completed, and after the war they were worthless except as junk.

Postwar merchant marine policy. At the close of the war, the repeal of the emergency shipping legislation seemed in order, but instead the board was practically continued by the new Merchant Marine Act (June 1920) which created a new shipping board (known as the Lasker Board) of seven members. In the year 1921, when the new board took office, the tonnage employed in foreign trade under the American flag reached an all-time maximum of over 11,000,000 gross tons. It fell every year thereafter, to some 4,500,000 tons in 1935,¹⁶⁰ whereas world tonnage increased somewhat during the same time, and American vessels in coastwise and

¹⁵⁸ *Messages and Papers of the Presidents*, Vol. 16, p. 8018.

¹⁵⁹ Saugstad, *Shipping and Shipbuilding Subsidies*, p. 38.

¹⁶⁰ *Statistical Abstract*, 1924, p. 403; 1936, p. 408.

internal trade (with which the Shipping Board was not concerned) increased from 7,000,000 to 10,000,000 tons.

The new board was empowered to sell the government war-time fleet, to operate it, or to let it to private operators after competitive bidding, with a political "joker" giving preferences to persons having the support of domestic communities. A construction fund was established to be lent on advantageous terms to private shipping companies. This favor to one class was offset by a concession to the steel and other industries in the tariff act of 1922, reversing the policy followed since 1909 of admitting ship-building materials duty free. By 1928 some 1,200 ships had been sold at prices yielding less than one-tenth of their original cost. Vessels costing 516 millions were sold for 41 millions.¹⁶¹

National sentiment affecting the tariff after the World War. The campaign of 1920 which swept the Democrats out of power had turned almost entirely on the war-settlement issues of which the tariff was a small part. The business recession which began in May 1920 no doubt had an adverse effect upon the fortunes of the party in power, but was a minor factor in determining the result of the election. The decline in our exports following the cessation of the war and postwar lending to Europe caused a great drop in agricultural prices, and a quick growth of pro-tariff sentiment in the agricultural regions of the West and South such as had not been witnessed since the days of Henry Clay. Pending the enactment the following year of a more sweeping law, Congress passed an emergency tariff act on May 27, 1921, levying high duties on wheat, corn, meat, wool, and sugar. By accepting these seeming favors in the form of higher tariffs on farm products as the remedy for agricultural distress, the farmers became the allies of the high tariff industrialists whose demands they could neither refuse nor moderate in the enactment of the succeeding acts of 1922 and 1930.

The demand of the manufacturers for special increases of import duties to shut out foreign products was supported by the usual post-war plea of vested rights and desperate emergency. Always in a

¹⁶¹ 74 Cong. 1 sess., *To Develop an American Merchant Marine*, Hearings before (House) Committee on Merchant Marine and Fisheries on H. R. 7521 (1935), pp. 1097-98.

war period the previous normal course of production and commerce is profoundly changed, to the temporary profit of some industries and the corresponding injury of others. New industries, and new enterprises in old industries, spring into existence under abnormal war conditions. Such enterprises were given in 1920 the picturesque name of "war babies," and the old "infant industry" argument was repeated in their behalf with new variations, mingled with the usual pleas in support of a high restrictive tariff as a permanent policy.

There is a good deal of inconsistency in the course of the argument, at one point the situation being viewed as abnormal but one where fairness demands that temporary help shall be given, and at another point being assumed to be the normal ideal which, by the happy chance of war, has been attained and has only to be perpetuated.

The same war conditions which create "war profiteers" cause losses to other people who are war victims. The resumption of normal foreign commerce is one of a number of inevitable economic readjustments after a war, which cause inconvenience and loss to somebody. The prospective beneficiaries of postwar emergency increase of tariff rates were asking for protection for their war-time investments from which they presumably made war profits. This throws a continuing burden upon other citizens, including those who have been financial losers in the war.

In greater or less degree every war experience intensifies nationalistic feelings, fears, and hatreds, causing greater value to be attached to fostering war-essential industries and increasing the preparation for future wars. This growth of nationalistic feeling tending to heighten tariff barriers has been more marked in the period since 1920 than ever before, in this as in other lands.

As the greatest creditor nation in the world, the position of the United States at the close of the war was unique. More than any other nation she had it in her power to influence the tariff policies of the whole civilized world in the direction either of exclusion or of moderation. The forces which determine the balance of merchandise shipments were greatly changed. Ever since 1876 this country had been required to maintain a balance of merchandise exports to offset large interest payments due abroad, and other debtor items such as

American travelers' expenses in Europe, and immigrants' remittances to their home countries. Now the balance of these accounts was shifted to the other side. During the war Europe had sent us about one and a third billion dollars worth of gold. Here were the choices open to us: (1) to begin at once collecting the debts with interest, taking in payment either goods or gold; or (2) to go on lending our debtors enough to pay us the interest, merely postponing the collection of the debts, which would thus grow ever larger; or (3) to cancel the indebtedness, making the rest of the world a present of the goods which had been sent abroad to create the original debt to us.

Voluntary cancellation of the debts due us, public and private, could not be faced by Yankee thrift; nor was the plan of immediate collection to be permitted by those protected by the tariff, for that probably meant the importation of merchandise in large amounts. So political action was directed toward postponing what, paradoxically, was looked upon as the evil day when we would begin to collect interest on debts which we were unwilling to cancel.

The tariff walls were raised higher by the Fordney-McCumber Act of 1922, making it more difficult for foreign debtors to meet their obligations to us by sending us their products or by sending them to other nations which in turn would sell their products to us. The average duties in the act were raised above those in the acts of 1897 and 1909. Some rates (as those on chinaware, chemicals, and some other items) were put considerably higher, and in certain petty cases exceeded 300 per cent ad valorem. "So far as concerns the range of rates," it has been said, "the protective system was carried further than ever before."¹⁶² Senator McCumber made the sweeping claim that "every industry in the country is fairly and justly protected."¹⁶³ Gold continued to be sent to the United States in large

¹⁶² Taussig, *Tariff History*, p. 488.

¹⁶³ Other noteworthy features of this act were: (1) the continuance of the Tariff Commission (re-established in 1916) for a more detailed study of tariff problems; (2) the "flexible tariff" provision authorizing the President to raise or lower duties by not more than 50 per cent of the ad valorem rate, in the attempt to apply the cost-of-production rule; and (3) the adoption (in section 317) of the principle of unconditional most-favored-nation treatment, thus reversing what had been the almost uniform "American policy of conditional reciprocity in contrast with the European practice." Tasca, *The Reciprocal Trade Policy of the United States*, p. 116.

amounts, and at the same time the financial interests continued to lend abroad until 1929. Hence the sale of our manufactures was stimulated and industries boomed while agricultural exports continued to dwindle.

The tariff legislation of 1930. The tariff act of 1930, known as the Hawley-Smoot tariff, was due to none of the conditions usually preceding a general upward tariff revision. There had been no change of parties since the radical increase in 1922, there was no revenue deficit, and the country was seemingly in the full tide of prosperity when an upward revision was determined upon by the new Republican Congress assembling early in 1929, little dreaming of the financial crisis to come later in the year.¹⁶⁴ The tariff had not really been an issue in the 1928 campaign, for the Democrats had virtually abandoned the revenue principle and adopted the plausible Republican principle of cost-equalization.

The immediate impulse to upward tariff revision at this time came from the western farmers in normally Republican districts. By this time, they were disillusioned as to the expected benefits to them of the tariff acts of 1921 and 1922. As they saw it, the high tariff, enacted professedly to help the farmers, and which the farmers had helped to enact, had brought prosperity to the manufacturing and urban communities, but had done little to relieve the ills of agriculture. However superficial and incomplete was this view, it was in large measure warranted by the inflated promises of relief from a high tariff given to the farmers in 1921 and 1922. Now better organized and more to be reckoned with politically, they demanded "a fair share of the national income" and to this end proposed two new types of measures which they hoped would serve as an offset to industrial tariffs.

Even though vaguely, the farmers had always glimpsed the simple truth that tariff duties on imports could not raise the domestic price of products which are regularly exported. In 1926, they had brought forward an export debenture plan under which cash subsidies would be paid on agricultural exports sold in open markets abroad. One argument strongly urged against this plan was that the dumping of American farm products in foreign markets would un-

¹⁶⁴ Taussig, *Tariff History*, p. 490.

doubtedly arouse great resentment and probably retaliation. The measure did not pass in either house of Congress, and the attempt to attach it to the Agricultural Marketing Act of 1929 was defeated by the threat of presidential veto. Another device had been proposed by farmers as early as 1924 as a means of securing a tariff equivalent. This was embodied in a succession of "McNary-Haugen" bills. This type of measure was more strongly supported by agricultural interests than was the export debenture plan, and it was twice passed by Congress and vetoed by the President. The essence of the scheme was to impose a "processing tax" on millers, packers, spinners, and the like, which would presumably be passed on to consumers in the form of higher prices. Proceeds of the tax would be distributed to producers as "equalization" payments, which would put their returns on a basis equivalent to that of tariff-protected industries while the export portion of the given crop would move freely into foreign markets on the basis of world prices.¹⁶⁵ After this measure had been rejected by Congress in favor of the Agricultural Marketing Act of 1929, farmers continued their support of tariff tinkering as embodied in the act of 1930.

Farmers not satisfied with the act of 1930. The tariff act of 1930, known as the Hawley-Smoot tariff, failed to fulfill the farmers' hopes. In the campaign of 1928 no specific promises of increased rates on manufactures had been given, and Hoover's promise of "limited revision" had been generally interpreted to mean revision only in favor of agriculture. But the industrial-minded high tariff group in Congress had been in a position to secure agricultural support for effective increases in industrial rates in exchange for mostly ineffective increased rates on some agricultural products.¹⁶⁶ The rates were increased on nearly all textiles, china, watches and clocks, and on numerous small manufactured articles, and doubled on block aluminum.¹⁶⁷ All semblance of consistent opposition by the Demo-

¹⁶⁵ These measures are discussed more fully in Chap. XXIII.

¹⁶⁶ Some of these increased agricultural rates were inoperative because the commodities were on an export basis (for instance, pork products and most kinds of wheat). Some benefited only a few farmers (as the rates on sugar and long staple cotton); others, though affecting a larger number, gave them but little benefit (as eggs, butter, and vegetables). The duty on hides benefited cattle-raisers, but the compensating duties on shoes were a tax on all farmers. See Taussig, *Tariff History*, pp. 500-12, for some details on the agricultural rates.

¹⁶⁷ The same, pp. 512-20, gives more details.

crats ceased. The act was twice as long as that of 1913 and 40 times as long as that of 1816. The average rate of every one of the 15 schedules of the act was higher than that of the act of 1922, and the average rate on dutiable goods (the second year after it went into effect) reached the record figure of 59 per cent.

At the time this tariff of 1930 was under discussion, both parties in Congress professed belief in the equalization-of-cost principle as a scientific guide in the determination of rates. There is no evidence in the voluminous debates, however, that any consistent attempt was made to apply this or any other formula. In "this welter of argument . . . there was little in the way of guiding principles held by either the high or the low tariff groups." As to the Republicans, it appears that "the closest approach to a protectionist philosophy of the tariff was the idea that if the government could only make all individuals prosperous by means of tariffs, then the prosperity of the whole country was assured."¹⁶⁸ "In the later stages of the debate, any serious pretense that the bill was based on 'scientific' principles was dropped even by its supporters."¹⁶⁹ "The Democratic members of Congress, with the exception of a small group [chief among whom was Representative Cordell Hull], evidenced nothing that could be called tariff principles. Most of them . . . had temporarily placed in abeyance the traditional opposition of their party to protective tariffs."¹⁷⁰ "The record of voting on individual items furnishes much evidence in support of the cynical proposition that sound protection was that which raised the prices of things produced by one's constituents, and unsound protection that which raised the prices of the things made by someone else's constituents."¹⁷¹

The only principle—if such it may be called—by which rates were determined in the act of 1930 might be expressed as "protection all

¹⁶⁸ Frank Whitson Fetter, "Congressional Tariff Theory," *American Economic Review*, Vol. 23 (1933), pp. 413-27.

¹⁶⁹ The same, p. 417.

¹⁷⁰ The same, p. 416.

¹⁷¹ The same, p. 418. When the Hawley-Smoot bill had been passed by Congress, a statement which became known as "the economists' petition" was addressed to the President urging him to veto the bill. This petition had been circulated among the members of the American Economic Association, and came to the President with more than a thousand signatures. It gave evidence that the professional economic opinion of the country was practically unanimous in condemnation of this piece of economic legislation under the existing conditions.

around."¹⁷² This means that if restrictive tariff rates are good for one they are good for all; and (in final effect) no rate needed to keep out any kind of goods that anyone is trying to produce in this country is too high.

European retaliation provoked by the tariff act of 1930. Early in 1929 the first report of the restrictive nature of the bill which was to become the tariff of 1930 alarmed the countries of Europe. They saw in it a new threat to their economic stability, already precarious enough in their postwar conditions.¹⁷³ They began at once to offer their pleas and protests to our government, but to no avail.¹⁷⁴

The wave of resentment caused when the act was passed was followed by retaliatory action, making this supposedly domestic legislation, as has been said by an English economist, "a turning point in world history."¹⁷⁵ As another student of this phase of the question has said: "The often-quoted formal and official protests of thirty-three foreign nations to the United States Government sink into insignificance beside the general protest and indignation of the populations of the principal trading nations of the world as expressed through an outraged press, mass meetings, and resolutions of trade, industrial and labor organizations in the various countries."¹⁷⁶ The sudden stoppage of certain exports to America from Spain, Italy, France, Switzerland, and other countries upset their balances of international payments, and threatened the stability alike of their economic and of their monetary systems. Switzerland was very seriously injured by the exclusion of her watches from America,

¹⁷² Elmer E. Schattschneider, *Politics, Pressures and the Tariff* (1935), pp. 86-98, 283. This study shows how and why a high tariff policy, when it is widely extended, becomes politically well-nigh impregnable to attack in Congress. The practical politics of the tariff is based on the fact that those naturally opposed are usually unorganized, scattered, or passive. The favored interests are well organized to maintain the system. (See pp. 163, 288.) No one of them dares, for fear of retaliation, to oppose any rates favoring the others. It is thus, the study indicates, a gigantic spoils system, supported by logrolling for interested parties. It is not in any true sense a national plan made for the general welfare of the whole people. Still less can consideration be given to the repercussions of tariff changes upon world commerce, and to world political consequences.

¹⁷³ Joseph M. Jones, *Tariff Retaliation: Repercussions of the Hawley-Smoot Bill* (1934), p. 17.

¹⁷⁴ The same, p. 65.

¹⁷⁵ Sir Arthur Salter, *Recovery: The Second Effort* (1932), p. 198.

¹⁷⁶ Jones, *Tariff Retaliation*, p. 1.

which largely paralyzed one of her traditional exporting industries.

Countries that had been exporting to the United States tried numerous devices to redress their negative balances, such as increasing their use of tariff quotas, more or less insincere quarantines against our animal and vegetable products, exchange controls, and attempts to divert their purchases from the United States to other sources of supply.¹⁷⁷ In Canada the Liberal party, which had been receptive to more liberal reciprocal trade arrangements with the United States, was driven from power by public resentment in the general election of July 1930,¹⁷⁸ and the Conservative government quickly put through a higher tariff as an emergency measure (in September 1930) and adopted other devices even more effective than duties to exclude imports from the United States.¹⁷⁹ Great Britain, long the citadel of free trade, adopted a sharply restrictive policy in 1931, and in 1932 entered into the Ottawa Agreement with Canada, directed primarily against the United States, and giving preference to Canadian imports. This in turn (merely as a sample of the many unforeseen and unintended repercussions) was a blow to Danish trade with Great Britain, and drove Denmark into closer trade relations with Germany. Lesser effects of the same nature were felt by all the smaller countries of Europe. Austria, especially, suffered severely by our action.

Relation of the tariff of 1930 to the world depression. In the complicated economic and political conditions of Europe and North America it is, of course, impossible to appraise exactly even at this date the effects of the tariff act of 1930 on national and world affairs. That it contributed in no small measure to aggravating the economic and political troubles of the world cannot be doubted. The raising of tariff rates by the financial leader of the world, thus altering the course of its commerce with all other countries, presents problems very different from those which arise from similar action by a small country. Further, a great and sudden change has more

¹⁷⁷ See the same for many details of these measures. Our government also resorted to import quotas in retaliation or self-defense, the effect being to increase the restrictive effect of tariff duties, this being particularly marked in the case of sugar. See C. R. Whittlesey, "Import Quotas in the United States," *Quarterly Journal of Economics*, Vol. 52 (1937), pp. 37-65.

¹⁷⁸ Jones, *Tariff Retaliation*, p. 193.

¹⁷⁹ The same, pp. 195-97.

evil results than does a moderate and gradual alteration of long-time tariff arrangements. Also, changes which might be of slight moment in prosperous economic and settled political times may cause the gravest disturbances in such conditions as those of 1930, when financial collapse was facing many nations, when the spirit of nationality and the urge to economic self-sufficiency was already strong, and when the mercantilist fallacy that unemployment can be remedied and internal prosperity restored by raising tariffs, had the strongest appeal everywhere to the man on the street or in a parliament. A leading high tariff senator was but voicing much popular belief when he declared confidently after the tariff bill was passed: "Now the depression will be over in six weeks." The Hawley-Smoot tariff not only failed to end the depression here, but it probably intensified it everywhere by aggravating the policy of self-sufficiency, the mutual distrust, the tariff restrictions and non-intercourse which have interfered with foreign commerce throughout the world.

Domestic effects of our postwar tariff policy. It is evident that our high tariff policy has also been an important influence in intensifying some of our domestic difficulties, notably agricultural distress. Certain countries of Europe, less favored by abundance of agricultural land and other natural resources in proportion to density of population, and with much of their area devastated, might have been expected to buy from us those products in which we excelled and had a surplus, had we been willing to accept considerable amounts of their products in which labor was a large element.

In eight years under the acts of 1921 and 1922 our exports of crude foodstuffs fell 53 per cent, and under the act of 1930 they fell 75 per cent (from the new base) as compared with the preceding periods; and our exports of manufactured foodstuffs fell, successively, 55 per cent and 65 per cent, leaving the total exports of these two classes of farm products only one-eighth as large as in the five years before the passage of the "emergency" act of 1921 which was to have relieved the distress of agriculture. Partly this outcome may of course be attributed to the inevitable postwar adjustments and the later general world depression. Yet it is hard to escape the conclusion that the tariff legislation of this period accentuated rather

than ameliorated agricultural difficulties. It had the evil trait of commercial restriction and scarcity, whereas the measures that would truly have been helpful to get out of the depression were those making for greater economic freedom.

If the moderate Underwood tariff had been left unchanged after the war there is strong reason to believe that our large-scale-production industries, such as those producing automobiles and numerous kinds of machinery in which we excel, would have much more fully maintained or further expanded their foreign sales. Our imports of some kinds, as well as our exports, would have been larger, and doubtless many complaints (some exaggerated, some in part real) would have come from concerns in some of the industries which would have met the competition of these foreign goods. At the same time, other lines of manufacturing would have been more flourishing than they have been, and consumers would have had the benefit of lower prices. Agricultural exports would have been larger, agricultural prices in terms of manufactured goods would have been higher, and agricultural distress correspondingly diminished. These are the logical and practical probabilities; any exact estimate of these factors is, of course, impossible.

Mail subsidies and merchant marine policy after 1928. Before the end of the Coolidge administration the Republicans expanded the shipping subsidy policy. The Jones-White Mail Subsidy Act of May 22, 1928 was the culmination of active propaganda, mostly by the ship-building industry, hoping to get contracts to build ships. The Shipping Board was given wide discretion in the determination of the amount of subsidies. The construction loan fund was doubled, and other favors granted to private companies. Under circumstances which brought in Congress strong charges of favoritism, the board sold the one important line that it was actually operating to England and Northern Europe. Expenditures for mail subsidies rose to some \$30,000,000 a year, to run for ten years.¹⁸⁰

The latest chapter, as yet unfinished, in the history of our mer-

¹⁸⁰ John C. de Wilde, "Ship Subsidies and the Future of World Shipping," *Foreign Policy Reports*, Vol. 10 (1934), p. 7. For somewhat detailed statements of profits and losses of operating companies, and charges of questionable practices, see this report; also 74 Cong. 1 sess., *To Develop an American Merchant Marine*, pp. 1095-1111, and various congressional hearings from 1920 on.

chant marine policy began with the Maritime Commission Act of June 29, 1936, which transferred to a new commission of five members the powers granted in the acts of 1916, 1920, and 1928. For the first time the Democratic party espoused the policy of subsidies to private companies. The Wilson policy, as stated above, had been rather for government ownership and operation. On the analogy of recent tariff legislation, the mail subsidy policy now professed to follow a "scientific" formula for equalizing the costs of operating the American merchant marine with the costs of other countries.

The Commission, in its report to Congress in 1937, paints no cheerful picture of the burden the nation is taking upon its shoulders in its effort to tempt investors and enterprisers to go into the shipping business, where they cannot make normal profits without subsidies levied on other industries. It declares: "We are faced with the fact that the government will have to pay substantially higher subsidies than are now being paid." "The replacement requirements of American ship lines are enormous." "To replace all ships now approaching obsolescence . . . would cost in the neighborhood of 2½ billion dollars"—which the Commission says is "a staggering program," and "an obviously unwise expenditure."¹⁸¹

But in the year 1938 the Commission increased its activities and began a rehabilitation program to replace the ships that had been scrapped. The Commission bought and put into the South American service the three vessels of the Panama-Pacific Line, acquired under foreclosure proceedings all the ships of the Munson Line, and acquired the failing Dollar Line for around-the-world service. For the present, the American merchant marine is a mixture of government and of private ownership.¹⁸² The nation is involved in an enormous outlay to maintain a considerable merchant marine under the American flag. But the motive of ensuring an ample number of merchant ships for auxiliary use to the Navy in case of war so largely determines the public policy—regardless of costs—that normal economic judgment of the policy is irrelevant.

The trade agreement policy of reciprocity. There has been no general revision of the tariff system since the act of 1930. Though

¹⁸¹ United States Maritime Commission, *Economic Survey of the American Merchant Marine* (1937), pp. 82-83.

¹⁸² *The American Year Book*, 1938, pp. 516-26.

the Democrats did not challenge the high tariff policy in 1928, public resentment against the act of 1930 encouraged them to make tariff reduction a leading issue in the campaign of 1932. The implication was that vigorous action to reduce the tariff would be the first task of the party in 1933. However, the issue was lost to sight in 1933.¹⁸³ There were those who, with Cordell Hull, Secretary of State, were convinced that the most practical form of international co-operation and the best hope of bettering world conditions were the reduction of the great and growing artificial hindrances to world commerce.¹⁸⁴ What has been known as the "Hull reciprocity policy" was authorized by an amendment to the tariff act of 1930, approved June 12, 1934, and re-enacted and extended in 1940.

The preamble to the section authorizing the reciprocity policy promised that it would help relieve the depression, not by reducing prices but by developing "greater foreign sales" and thus "increasing purchasing power." Noticeably missing are any direct promises of benefits to consumers.

Principle of the leading supplier. The new reciprocity policy applies as its first working principle that of the leading supplier.¹⁸⁵ The leading-supplier principle is that the concessions of lower rates on our imports that normally will be most tempting to a foreign country are those on articles in whose production it excels, and which it is already selling to us in greater quantities than is any other country. Occasionally it occurs that some one country is the sole source of our imports of an article, or is the leading, but not the sole, supplier, and in still other cases countries ranking not so high among the suppliers may esteem a lower rate (or the binding of a low rate) to be of great importance to them.¹⁸⁶ In the negotiations

¹⁸³ See Tasca, *The Reciprocal Trade Policy of the U.S.*, pp. 92-97, on the retarding effects of the N.R.A. and the A.A.A. upon the early progress of the trade agreements program. Also on the so-called Hull-Peek controversy in which George N. Peek, a high tariff restrictionist, was given the office of "special adviser on foreign trade" in the N.R.A. The same, pp. 82-92.

¹⁸⁴ See words of Cordell Hull, May 22, 1936, as quoted in Culbertson, *Reciprocity*, p. 64.

¹⁸⁵ B. B. Wallace and H. V. V. Fay, *Recent Commercial Policy of the United States* (1936), pp. 46, 51, in the mimeographed American edition of an article prepared for the *Weltwirtschaftliches Archiv*.

¹⁸⁶ Each of 29 countries has one or more classes of commodities for which it is our leading source of supply. Such articles constitute from 48 to 98 per cent of the

the circumstances of each case are carefully studied with a view to assessing both the strength of the inducements given by a certain reduction, and the importance to us of the concession which may be gained in return. The practical advantage of this process of lowering tariff rates (when we desire to do so) over a merely unilateral reduction of our rates (as in 1846, 1894, and 1913) is obvious. It is much more effective toward the end of creating freer conditions in our own foreign trade, as well as in the world generally.

In marked contrast to the narrow list of articles on which concessions (or reductions) might be made under the acts of 1890 and 1897, the new reciprocity policy of 1934 made possible the offer of reduction of the rates on any article by not more than 50 per cent of the rate in the regular tariff as passed by Congress (a feature introduced in the act of 1922). In its earlier negotiations the State Department exercised with much moderation the power to reduce rates, hardly going beyond 10 or 15 per cent, but it gained courage as opposition proved to be relatively ineffective and evidences of public approval of the policy increased. When agreements had been concluded with 16 countries (near the end of 1937) concessions had been made generally to all non-discriminating countries on some 450 items. These reductions affected one-fourth of all dutiable imports, and reduced the average rate on *all* dutiable imports about 9 per cent.²⁸⁷ The average reduction on the articles affected was about 35 per cent. The result is neither startlingly large nor yet insignificant. Never could a policy of tariff moderation have been undertaken under more adverse world conditions.

The unconditional most-favored-nation principle; delegation of power to the President. Another principle of the Hull reciprocity policy borrowed from the act of 1922 is that when a reduction of rates is made it is extended without question, negotiations, or reciprocal concessions to all other non-discriminating countries. In

dutiable imports from these countries (the mean being 63 per cent). *Tasca, The Reciprocal Trade Policy of the United States*, p. 314; figures derived from 73 Cong. 2 sess., *Reciprocal Trade Agreements*, Hearings before (House) Committee on Ways and Means on H. R. 8430, p. 366; 75 Cong. 1 sess., *Extending Reciprocal Trade Agreement Act*, Hearings before (Senate) Committee on Finance on H. J. Res. 96, p. 385.

²⁸⁷ Statistical data from Oscar B. Ryder, "Foreign Trade Policy of the United States," *Political Quarterly*, October-December 1937.

making this change to the unconditional most-favored-nation principle in 1922 Congress was accepting the measured conclusions of the report of the Tariff Commission in the Wilson administration.¹⁸⁸ Our adoption of the unconditional form of reciprocity brought us into accord with the almost universal practice of other countries.¹⁸⁹

The Democrats learned also from Republican experience the advantage of giving to the President discretion to raise or lower duties within the range of 50 per cent, and also of making his action final, without requiring the approval of Congress.¹⁹⁰ By the end of the fiscal year of 1938 there were 16 agreements in full effect (including that with Czechoslovakia) and by early 1939 additional agreements had been made with the United Kingdom, certain British colonies, Canada, and the Netherlands.

In the exceedingly disturbed state of world politics and commerce it is impossible to measure with exactness the effects of these agreements upon the volume of our foreign commerce. It is self-evident that "other things being equal" our foreign commerce will be larger—both imports and exports—with a lower tariff than with a higher one. "Other things" are such as our loans to foreigners, the "flight of capital" to this country because of war scares, and changes in amount of money expended in travel abroad. It is a fundamental error to assume that the purpose and possible effect of reciprocity agreements (or of other changes in tariff rates up or down) is to reduce permanently the merchandise import balance, seeking the illusory ideal that we should export only, and never import. On this familiar mercantilist principle something will be said in the concluding pages of this chapter.

¹⁸⁸ U. S. Tariff Commission, *Reciprocity and Commercial Treaties*, pp. 383-456. On some inside history of the change in policy see Culbertson, *Reciprocity*, pp. 238 ff.

¹⁸⁹ The term "unconditional" is not to be taken quite literally, for certain exceptions and conditions have always been both claimed and conceded in practice. Such are cases of trade across contiguous boundaries or between countries having special political relations, e.g., the so-called Scandinavian clause, the Central American clause, the Ottawa agreement between Canada and the British Commonwealth, our concessions to Cuba. (Compare Tasca, *The Reciprocal Trade Policy of the U.S.*, pp. 128-29.) The principle retains, however, a very wide range of application with very great practical effects upon the process of tariff making.

¹⁹⁰ Note the failure of the McKinley reciprocity policy and the Kasson treaties because of the refusal of Congress to authorize the concessions. See above, p. 577.

Subsidizing farm and factory exports. Lately the government has embarked upon another novel policy of subsidizing foreign commerce. As is usual in efforts to stimulate commerce, the emphasis has been all on exports, with little said and nothing appreciable done about imports. The first Export-Import Bank was created in 1934 to finance orders of American goods from Soviet Russia (to the limit of \$100,000,000); and in the same year was created the second Export-Import Bank (liquidated and merged with the other in 1936) to handle certain financing for the Republic of Cuba.

The Export-Import Bank has been under the same management as the Reconstruction Finance Corporation, which has subscribed most of its funds. It is now authorized (by an act approved March 4, 1939) to continue operations until 1941, with a limit to its revolving fund of \$100,000,000. A considerable number of loans have been made to American exporting firms, and a few to foreign governments. In June 1939, \$20,000,000 was loaned to Brazil, as a means of meeting the competition of Germany's barter method of trade. The loans were made directly by large American banks and guaranteed by the Export-Import Bank, which shares in the interest payments. Similar loans have since been sought by other Central and South American governments.¹⁹¹ Most recently a loan was made to Finland.

The Export-Import Bank has been of only slight aid to agricultural exports, but from the passage of the original Agricultural Adjustment Act in 1933, numerous ways have been found for facilitating agricultural exports under devices which amount to export subsidies. The first of these efforts took the form of export diversion under the marketing agreement provisions of the act, starting with the North Pacific wheat export agreement. In an amendment to the Adjustment Act in 1935, it was provided that 30 per cent of tariff receipts on agricultural products should be made available (among other purposes) for the payment of "export differentials" on products marketed abroad, as a means of relieving "price depressing surpluses" in the domestic market. These "section 32 funds" have been rather vigorously used for this purpose. In August 1938, an export subsidy program for wheat was inaugurated with

¹⁹¹ For brief discussion of currency devaluation as a device for stimulating exports and discouraging imports, compare Vol. 1 of this study, pp. 182-86.

the objective of maintaining the annual volume of sales as nearly as possible at the 100-million-bushel level. This program (extended the following year) was developed unobtrusively with the aid of section 32 funds, and July 1939 a special export program for cotton was launched with these funds supplemented through a special appropriation.¹⁹²

Policing services to foreign and coastwise commerce. Some other activities of the federal government in relation to foreign commerce have been in the nature of an implementation of competition of the character described in Chapter III of Volume I. These may be conveniently grouped and designated as services in "policing" the ways of commerce, to make it easier and safer for persons and property. Such are the maintenance of lighthouses and coast guard stations, coast patrols, marine inspection, oceanographic work, quarantine services, and weather reporting. These activities of great public importance are of a kind that cannot well be left to private agencies, primarily because it is inconvenient and often impossible to collect the cost in due proportion from those who get the benefits. They are everywhere public functions.

Our federal lighthouse service was begun in 1789. It was long under the Treasury Department, but since 1913, along with steamboat inspection and coast and geodetic survey, has been under the Department of Commerce. The expenditure for these purposes in 1935 was over \$28,000,000. The coast guard and public health services, which are still under the Treasury Department, cost \$41,000,000 a year.

The annual cost of this group of services (maintained largely but not wholly as an aid to foreign commerce) is 23 times the average annual operating cost of the entire federal government in the first ten years under the Constitution and considerably exceeds the total annual cost of the whole federal government at any time before the Civil War. The need for these governmental services and the general diffusion of the benefits is hardly debatable under modern conditions, and probably the appropriations are less subject to the pressure of selfish groups than is any other cost of government in aid of commerce.

In considerable part the costs of these policing services are met by

¹⁹² For more detailed discussion, see Chap. XXIII.

tonnage dues and port charges imposed upon shipping (since about 1830 without discrimination against foreign shipping). They are in the nature of a price (rather than a tax) for services rendered to private enterprise in very rough proportion to benefits directly received, and, as costs of the business of transportation, no doubt tend to be diffused and passed on to the general public in the price of transportation. In part, however, these policing functions, being essential to the maintenance of a merchant marine and an aid to naval defense, may be justly maintained by taxation of a general nature.

VI. SOME LESSONS OF OUR TARIFF EXPERIENCE

The foregoing pages present a broad view of the relations of our national government to foreign commerce. What has been presented is an epitome of a voluminous history of tariff laws, reciprocity agreements, and shipping regulations with the accompanying public opinion and political interests. No other single issue of economic legislation, not even the money problem, has taken a larger place in our national politics or has evoked greater discussion in and out of Congress. If history has any lessons, the regulation of our foreign trade presents a wealth of material for the study of the relations of government to economic activity.

Shifting arguments for restricting commerce. Public opinion throughout the colonial period and for another half-century favored complete freedom of individual choice in foreign commerce. After the Declaration of Independence restrictions were justified solely as a temporary measure of retaliation against countries which stubbornly refused to trade freely with us. To this motive of retaliation were added, after 1789, that of encouraging infant industries (also to be only temporary), that of developing industries, otherwise unprofitable, needed for national defense, and the doctrine of "vested rights" for war-stimulated industries (for example in 1785, 1816, 1866, 1921). The rest of the world was moving toward freer trade in the years from 1815 to 1860, and the fear of war was everywhere receding. The old reasons being no longer pertinent, new and radically different reasons were devised in support of commercial restrictions as a permanent policy and as economically sound in principle—home markets, a "favorable" balance of trade, crea-

tion of high wages and protection against the competition of "pauper" labor, and, finally, the ostensibly scientific rule of cost equalization. As political conditions changed, each of these "reasons" was advanced by those seeking restriction of commerce to their own advantage (in occupations, industries, and sections) to convince the consumers that higher prices for the goods they must purchase would eventually benefit everyone in the nation.

Revenue versus restrictive purposes in the tariff. Our tariff experience has shown the inevitable conflict between the revenue and the restrictive purposes of the tariff. The phrase "a revenue tariff with incidental protection" carries the suggestion that the two purposes and results are in entire harmony, whereas they are mutually limiting. The "protection," that is, the stimulation of domestic production, occurs only at the cost of the public revenues.¹⁹³ Inasmuch as the demand for almost every kind of goods is more or less elastic, every tariff duty is incidentally restrictive; that is, it reduces the amount of goods of that kind imported and consumed. If a tariff rate is not high enough to make domestic production possible, there is reduced consumption (which may or may not reduce public revenue), but there is no "incidental protection."¹⁹⁴

Recent price theory, which more fully recognizes the complex interrelationship of prices through substitution of goods by both producers and consumers, makes clear that a tariff duty which raises the price of one kind of goods may give "incidental protection" to some article more or less similar, or even very dissimilar, in kind or use. For example, restricting the importation of bananas and other tropical fruits may in some measure increase the demand for apples

¹⁹³ See Winthrop M. Daniels, *Public Finances* (1899), p. 175.

¹⁹⁴ For example, a duty of 50 per cent on a woollen garment formerly costing \$1.00 abroad may reduce the imports from 1,000 to 500, and yield a revenue of \$250, but may not start any domestic production. But a duty of 75 per cent, raising the domestic price to \$1.75, and reducing the consumers' demand to 400, might make it possible for 200 units to be profitably produced here. This would be "incidental protection" to the domestic producers. For what formerly cost them \$400 the consumers then would pay \$700, of which \$200 would go to foreign producers, \$150 to the government, and \$350 to domestic producers (\$150 more than the foreign producers would take for the same amount of goods). But that does not mean, as is often assumed, that the domestic producers really profit by this excess amount; in fact they may make very slightly more than they would in other occupations from which they are tempted to transfer as a result of the tariff.

and other domestic fruits. It thus is hard to conceive of any customs duty levied solely for the purpose of revenue, which might not in some degree afford "incidental protection" to some domestic industry, compelling some consumers to take what they do not like so much, and making consumers expend more than before for some other goods. Thus at a cost to consumers some kinds of business are temporarily made more profitable, and there results a tendency for producers to transfer to them from other industries.¹⁹⁵

The gradual decline of the revenue purpose. The history of our tariff legislation gives abundant examples of the conflict between the policy of intentional restriction of imports to favor certain industries, and the fiscal purpose of getting the maximum revenue with the least intentional interference with freedom of commerce. The most ideal tariff for revenue would be one on things (such as tropical goods and certain minerals) which are highly valued but which it is almost or quite impossible to produce here. On the other kinds of goods, in varying degrees as the price is raised by tariff duties beyond a moderate level (the optimum revenue rate), the "incidental protection" increases and the revenue falls. The fiscal purpose is sacrificed to the restrictive purpose. The complete attainment of "economic independence" by a country through the development of domestic production of all kinds to the point where there are no imports must reduce the fiscal importance of the tariff to zero, and leave internal excise duties and other forms of internal taxation the only sources of public revenues.

This was the course of development in the high tariff era following the Civil War. The abandonment of the fiscal purpose was openly advocated when, in the act of 1872, coffee and tea were put upon the free list; and was nearly completed in the act of 1930. Lately it has been said by competent students of the tariff: "The United States today has practically no revenue duties."¹⁹⁶ Until the Civil War over 90 per cent of the federal revenue was derived from import duties; as late as 1913 it was still 50 per cent, but since the postwar tariffs (1921, 1922, 1930) it has fallen to about 15 per cent.

¹⁹⁵ See further on the capitalization of the factors sharing in tariff profits, pp. 612-13.

¹⁹⁶ Wallace and Fay, *Recent Commercial Policy of the United States*, p. 7.

Constitutionality of restrictive tariffs. The right of Congress to levy duties for revenue purposes is contained in the taxing clause of the Constitution;¹⁹⁷ but the constitutionality of levying duties for the express purpose of restricting commerce to favor certain domestic industries was bitterly questioned at the time of the nullification movement in President Jackson's administration. Strangely, however, this question was never unequivocally adjudged by the Supreme Court until 1928, when a unanimous opinion was delivered by Chief Justice Taft.¹⁹⁸ The primary issue decided in this case concerned the right of Congress to delegate to the President the power to increase or decrease duties (as was done in the tariff act of 1922). It was "contended that the only power of Congress in the levying of customs duties is to create revenue, and that it is unconstitutional to frame the customs duties with any other view than that of revenue raising." The Court declared: "Whatever we may think of the wisdom of a protection policy, we cannot hold it unconstitutional. So long as the motive of Congress and the effect of its legislative action are to secure revenue for the benefit of the general government, the existence of other motives in the selection of the subjects of taxes cannot invalidate Congressional action." The Court concludes with this dictum: "The fact that Congress declares that one of its motives in fixing the rates of duty is so to fix them that they shall encourage the industries of this country in competition with producers in other countries in the sale of goods in this country, cannot invalidate a revenue act so framed."¹⁹⁹

¹⁹⁷ Art. I, sec. 8, par. 1.

¹⁹⁸ *J. W. Hampton, Jr. and Co. v. United States*, 276 U. S. 394 (1928).

¹⁹⁹ The same, pp. 411-13. In a later case, *Board of Trustees of the University of Illinois v. United States*, 289 U. S. 48 (1933), where the main issue was whether the University of Illinois, as an instrumentality of the state, should be relieved of payment of the duties on scientific instruments, the Court, in a unanimous decision read by Chief Justice Hughes, extended the grounds on which rests the power of Congress to lay duties on imports. It derives not only from the taxing clause of the Constitution but from the commerce clause, that is, from the power to regulate commerce with foreign nations, "and the Congress may, and undoubtedly does, in its tariff legislation, consider the conditions of foreign trade in all its aspects and effects" (289 U. S. 58). This is an expression of faith surely not based on a careful study of the record. The Court implies that the taxing clause is purely superfluous in respect to the tariff, inasmuch as "the purpose to regulate foreign commerce permeates the entire congressional plan." The Court declares: "The revenue resulting from the duties 'is an incident to such an exercise of the power,' that is, the power to regulate foreign commerce (clause quoted from *Story on the Constitution*,

Thus no constitutional or judicial barrier is interposed to the use of intentionally restrictive duties, even to the extreme of prohibiting commerce, as an exercise either of the taxing power or of the power to regulate foreign commerce. The tariff may be used as Congress wills as an instrument of national planning or of industrial favoritism. The only ultimate check is public opinion as influenced by practical experience with the results.

This being the legal status of the tariff, it is fitted to be a powerful and versatile tool for national planning. To a great extent it has been so viewed and so used, from the first, however gropingly and ineptly. It is useless to question here the possibility of increasing the national wealth and general welfare by the merely negative method of restricting the natural course of commerce. Let it be assumed that with honest purpose and sufficient knowledge and skill certain desirable ends of national welfare may be attained in this way. But what conditions must be met and what difficulties must be overcome—in human nature, politics, and practical administration—if such a policy is to be successful?

Restricting imports necessarily restricts exports in equal measure. In the periods of high tariffs since the Civil War the truth has been seen that international commerce is a give and take; it is not, and cannot be, a one-sided action. Exports cannot, except temporarily, or as pure gifts, exceed imports in value. The credits and debits composing the balance of payments do not consist wholly of merchandise but include numerous other valuable services, invisible items—such as freight, insurance, tourists' expenses, new loans made and old loans repaid, interest accruing on debts, and other minor matters.²⁰⁰

In the period from 1870 to 1914 the large volume of interest payments due to foreigners, the expenditures by Americans in for-

sec. 1088). This is a realistic view of the high tariff policy as it developed after the Civil War; that is, it is restriction of commerce with merely incidental revenue.

²⁰⁰ The expressions "favorable" and "unfavorable" balance of trade, as applied to the balance of merchandise shipments only, are now seen to be misleading. The use of these terms in this limited sense has been shown to be exclusively American and very recent, whereas their older meaning, still current in Europe, is that of a balance of payments including all the invisible items. See Frank W. Fetter, "The Term 'Favorable Balance of Trade,'" *Quarterly Journal of Economics*, Vol. 49 (1935), pp. 621-45.

eign travel, the increasing payments to European shipping companies, immigrant remittances to their native lands, and similar items combined to make a balance of payments which was met by a large annual excess of merchandise exports from the United States. Since the World War, in the changed position of this country as the leading creditor nation, the balance of payments on other than merchandise account has shifted, so that total imports of all classes would have exceeded exports had not lending by American bankers to foreigners continued on a large scale. A country which lends abroad must eventually accept payment for interest and principal in physical goods or in services, unless interest and principal are cancelled by the creditor's gift or by the debtor's repudiation. The discussion of the war debts has helped to clarify ideas on this subject. If our exports are to continue in as large volume as before the World War, imports must be larger unless accruing credit obligations remain unpaid.

No group of producers for export wishes to have its business restricted, but high tariffs curtail exports in such roundabout ways and uncertain amounts that exporters are often unconscious of the relationship. The restrictive effects of import taxes upon exports are no doubt, by the substitution of goods, diffused among numerous exporters, but the loss, though slight in each case, is no less in the aggregate. The organized political resistance of exporters to higher import rates is notably less effective than is the support of those favoring restriction.

Exporting industries thus suffer doubly from import taxation: first, the individuals working in those industries must as buyers pay more for the "protected" goods; second, they cannot sell as much abroad and normally, therefore, they must sell at lower prices in the domestic markets, or sell less at unchanged prices.

Under the Constitution the Congress may restrict commerce by levying tariff duties only upon imports, not upon exports. Yet, as has just been seen, the final and total effect of restricting imports is that exports must be restricted in equal amount (value). The important practical difference between the two methods of restricting commerce is that imports are restricted by selecting and specifying the classes of goods which are to be more or less excluded, whereas

the classes of goods whose export is thereby restricted are unspecified and usually not even thought of (except vaguely) either by the makers of the tariff law or by those upon whom the burden is to fall.

Exporting industries unable to benefit by tariffs; "protection" ambiguous. It is axiomatic that classes of goods which are regularly exported in large quantities from this country—such staple agricultural products as cotton, wheat, corn, and pork products—cannot be substantially raised in price by import duties. Only such agricultural products as wool, sugar, and lemons, of which the domestic crop is less than the domestic demand at the price in the world market, can be subsidized in this way, the benefit inuring to a small proportion of all farmers, while the higher price they get is at least partially offset for farmers as a class by their own higher operating costs and by the higher prices that they, along with other people, must pay as consumers.

For more than half a century under the Constitution it was assumed on all sides that the need of restrictive tariffs was limited almost exclusively to manufactures of various kinds, extending to agricultural products only in a few special cases of "infant" agricultural production in the experimental stage, such as the growing of hemp and indigo. Hamilton and others after him understood the truth that high tariffs were essentially "bounties" paid to infant manufactures from "taxes" taken mostly from citizens engaged in the agricultural and other extractive industries of the nation. Such a view recognized (if not always quite clearly) that it was not possible immediately for all industries collectively to lift themselves by their bootstraps, though it was hoped that this might be done eventually. In the tariff scheme it has been pretty plainly seen that in the net balance of advantages, agriculture was mostly doing the pulling and lifting on the bootstraps of the favored manufactures. To be sure, so far as agriculture was concerned, it was urged that this ought to be done from motives of enlightened self-interest, as later developed in the various arguments for retaliation, military necessity, political stability of the new federal government, advantages of diversified occupations, infant industries, and home

markets. Because never fully convinced, even by the home market argument, the agricultural classes have on the whole been the chief opponents of high tariffs. In the light of this rivalry of interests the common use of the word "protection" in tariff discussion is seen to be misleading. Everybody is in favor of "protecting American industry," and of "protecting American labor," if this can mean that *all* industry and *all* labor are eventually and permanently to be benefited by the "protection" given to some of it. But it is different if "protection" to some industries means correspondingly burdening other industries, and if "protection" to a minority of laborers means that the cost of living of the majority of laborers is increased, and their real wages reduced.

The rivalry for tariff favors. The use of the tariff intentionally to restrict imports sets up a complex of rivalries. There is first the rivalry between those who are and those who are not directly benefited (or harmed) by the restriction; and there is further the rivalry among those who think they can benefit if they can persuade Congress to favor them.

The citizens who cannot directly benefit by import restriction are, broadly speaking, those who do not produce and sell products of a kind that is imported, or of a kind which competes directly with imports. This is the case of the large exporting industries and also of numerous forms of personal service trades and local industries. Tariff rates are ineffective to increase the prices of such goods and services, but they may diminish the demand for them and do serve to raise the price of many things bought by those who produce them.

Tariff making calls for some criterion of judgment in the selection of the objects of tariff favors. The self-interest and political influence of those asking for restrictive duties are not safe guides if the welfare of the whole people is to be attained. Though it may be abstractly possible that such a scheme might succeed if administered by an all-wise, unbiased Congress of experts, the history of our tariff legislation, especially since the Civil War, strikingly shows why it has not practically been possible. As a rule each tariff schedule and tariff measures as a whole have been determined piecemeal, by

the clamor of special interests and the pressure of powerful lobbies.²⁰¹ The assertion of one presidential candidate (General Hancock, in 1880) that the tariff was "a local issue" was much ridiculed during the campaign, but its practical truth has been admitted by men of all parties, in the sense that the votes of members of Congress on tariff bills when tariff favors are being handed out is determined not by any broad, well-considered plan, but by the importunities of each congressman's constituents. Tariff legislation easily becomes "logrolling," a form of the spoils system,²⁰² and through its favors a dole *de luxe*.

Ever since the nineties a new division of interest (sensed early by President McKinley) has been developing between different groups of manufacturers with respect to the restrictive tariff policy. Some industries excelling in mass production methods (favored by our advanced technical education and by our large area of domestic free trade) began to attain the export stage, and to find larger foreign outlets either in full competition or by monopolistic dumping. Such industries feel severely the multiplying foreign restrictions on commerce, many of which were designed, in retaliation against our tariff policy, to prevent the sale of the cheaper and superior American products in foreign countries. Our position as an independent and rather ruthless exponent of restrictive tariff policy had by 1921 become very vulnerable.²⁰³ Our severe restriction of imports was visibly causing retaliatory restriction of the profitable exports of our manufactures as well as of agricultural products. As a result, a considerable body of manufacturers has of late been ready to make common cause with other exporters, with the organized importers, and with consumers, in the support of a moderate tariff reciprocity program. Thus the situation has on the whole become more favorable for the trial of this method of revising the tariff by moderate successive reductions of particular items than it ever before has been.

²⁰¹ See on this general subject with special reference to the tariff of 1930, Schattschneider, *Politics, Pressures and the Tariff*; compare also Thomas Walker Page, *Making the Tariff in the United States* (1924).

²⁰² Frequent admissions to this effect are made even by some who are inclined to favor the "protective" theory on the whole, for example, Stanwood, *American Tariff Controversies*, Vol. 2, pp. 189, 191.

²⁰³ Tasca, *Reciprocal Trade Policy of the U.S.*, p. 117.

Want of guiding principles in tariff planning. In all our tariff making, as we have seen, there has been very little that in the most liberal sense could be called guiding principles.²⁰⁴ A partial exception can be made of the motive of military defense. Munition industries are not selected for tariff favors with the expressed purpose of making the country richer, but of making it safer from external enemies. It is an expense incurred to avoid greater losses. The military motive for restricting commerce thus is a thing apart from the other motives and arguments for a restrictive policy, but it has served to strengthen the popular appeal of a general policy of restricting imports as an economic measure.

This motive, however, has been mingled with the vested-right claim of industries stimulated by war conditions, helping to secure tariff favors not only for munitions, iron and steel, and shipping, but for less strictly military industries (as clothing and machinery). The military defense motive has been even more clearly evident in ship-subsidy measures than in tariff legislation.

The infant-industry doctrine makes some pretense of offering a guiding principle for tariff policy; but it goes no farther than saying that there are some industries which with moderate and temporary aid can become self-sustaining. It offers no criterion of selection as to the industries to be protected or as to the proper height of the restrictive rates, other than the usual method of rival pressures and political influence.

Nor does the "principle" of equalizing costs of production satisfactorily stand analysis.²⁰⁵ As numerous economists who have critically examined the equalization rule²⁰⁶ have pointed out, it would, if consistently applied, require ever higher rates on imports of every kind so long as any goods continued to enter the country. It is a rule of complete exclusion, of complete cessation of commerce. The

²⁰⁴ This, as has also been said, is because the tariff has been created by those favored. Adam Smith said in his day of the colonial policy so odious to our forefathers: "Of the greater part of the regulations concerning the colony trade, the merchants who carry it on, it must be observed, have been the principal advisers." *Wealth of Nations*, Vol. 2, p. 85.

²⁰⁵ See above, pp. 579, 582, 591.

²⁰⁶ Taussig, *Tariff History*, p. 364 and following; Frank W. Fetter, "Tariff Policy and Foreign Trade," as given in James G. Smith, ed., *Facing the Facts* (1932), pp. 89-92; A. C. Bunce, *Economic Nationalism and the Farmer* (1938), pp. 14-16; Philip G. Wright, *Sugar in Relation to the Tariff* (1924), pp. 119-32.

reason is simple. The mere fact that a thing is imported is proof that the cost of the imported goods is less than that of producing them in the importing country, otherwise no commerce would take place. To equalize (that is, to offset differences of costs by means of taxes) is to put an end to all motives to international exchange. It is to tax commerce out of existence.

The verdict of practical experience with this rule is as negative as is that of theoretical criticism. The cost rule gives no definition of costs, and no real comparison of costs is possible for tariff purposes. The expert Tariff Commission expended \$2,500,000 in a futile attempt to ascertain costs on three-tenths of one per cent of the commodities covered by the act of 1930 and then did not have the answers. It would have cost more than \$100,000,000 to make a similar study of all the items in the act.²⁰⁷

Marginal producers and the capitalization of tariff profits. Experience shows that the tariff rate granted to an industry is seldom if ever high enough to satisfy all members of the industry. So long as any imports continue, complaints are heard that the tariff rate must be raised to enable domestic producers to compete against the cheaper imports. A bit of not very involved economic analysis shows why this must be so, why the appetite for higher "protection" is insatiable. In short, it is because there are always marginal producers. With our varied conditions of climate, natural resources, location, markets, and individual efficiency, there are some producers in every industry who could, without tariff aid, operate with a modest but sufficient profit; and others who could make a go of it if the price of the product were only a little higher. A higher tariff barely sufficient to bring the excluded marginal group into

²⁰⁷ Schattschneider, *Politics, Pressures and the Tariff*, pp. 24-25, and *passim*. The authors of the Maritime Commission Act of 1936, making a sincere attempt to avoid previous errors, borrowed from the tariff legislation the notion that "the equalization of costs of production" was a scientific formula to guide in the subsidy policy. To this end two kinds of subsidies were provided: a construction differential subsidy and an operation differential subsidy. The Commission dispenses the construction differential subsidy by selling vessels to private operators at a price estimated to be the cost of building them in foreign ship yards, the government paying the difference between that amount and the actual cost. The operating differential likewise is the estimated excess of the "fair and reasonable" operating costs of American operators above those of their foreign competitors (with an additional subsidy to offset foreign subsidies, if any).

the industry at once discloses another marginal group who cannot make a profit at the prevailing prices. Their presence is an "unanswerable" argument that the tariff is still too low.

Those who could and did operate profitably with no tariff protection (or with less than the last increase) also benefit by an increase of rates, but still they are dissatisfied. A strange thing happens to their "costs"; they mysteriously increase in step with increasing product prices and profits. The producer sincerely believes and declares that the tariff is barely high enough to permit his business to survive. What has become of the increased profit to the intramarginal producers resulting from increasing tariff protection? Some asset has been re-valued and re-capitalized to take account of this change. Very commonly, no doubt, it is some marginal natural agent—minerals, lumber, fuel, water power, soil, or advantageous location, either for production or in marketing the product—to which the tariff has served to impart a higher value. A "fair return" on this capital value is thereafter accounted as a higher "cost" which must forever be protected by a restrictive tariff. In the most competitive industries a large part of the benefits of a protective tariff are appropriated (through the processes of financial reorganization and stock-market operations) by the owners of various natural resources. In the monopolized industries the benefit is likewise capitalized as monopoly privilege, and the tariff is still too low.

The list of difficulties and disutilities involved in any scheme of planning for national prosperity by means of restrictive tariffs is not exhausted but merely illustrated in the foregoing sections. Fundamental is the error of imagining that a country with no tariff restriction whatever, trading freely with all nations, would be forced into universal unemployment, glutted with imports given to it without a corresponding return of exports. There must be domestic production to pay for an equal value of imports. The real problem is to employ the natural resources and the entire labor power in a manner that will produce the maximum amount of goods. Freely exchanging these goods for others we prefer cannot reduce the real income of the nation, but can only increase it.

Risks of tariff changes. Our tariff policy has been one of uncer-

tainty and vacillation. Brief periods of low or moderate tariffs have been followed by other brief periods of higher duties, to be again replaced by lower rates. Rarely has a general tariff act lasted more than ten years, and the average period without material change either up or down has been a mere fraction of that. The result has been that a considerable element of financial speculation has been injected into every industry that directly or indirectly can be affected by tariff changes.

Thoughtful students believe that the instability of our tariff policy is one of its worst features, regardless of the abstract right or wrong of low or of high tariff doctrine.²⁰⁸ Business probably could adjust itself and get along with any stable long-time tariff policy better than the doctrinaires of either school can conceive, if only men could count certainly upon what the policy would be. If we were committed to a revenue tariff the risks of change would be reduced to a minimum. The struggle for restrictive tariff favors is a perpetual apple of discord in politics and a perpetual risk to all legitimate business.

The right to do harm to others by tariff legislation. In the present parlous state of world affairs it is worth while to remind ourselves in conclusion of the international aspect of the tariff problem. Tariff legislation has usually been looked upon as a subject of domestic jurisdiction, and both the legal and moral rights of each country at all times to determine its tariff policy and specific measures solely with regard to its own real or supposed interests have until very recently been little questioned. The aftermath of the act of 1930, however, has caused both foreign and American students to question whether under modern conditions of international commerce and the close interlocking of the economic and political interests of all advanced peoples, such a position is longer tenable. Even though in international law the technical legal right exists, we may ask ourselves whether a nation, any more than an individual, can properly take the law as its sole standard of decency and morality in its relations with its neighbors. Is it even enlightened self-interest for a nation in the dominant position of the United States with respect to world trade, either to determine its tariff

²⁰⁸ See Daniels, *Public Finance*, p. 167.

policy or to disrupt suddenly and radically the customary course of foreign commerce, in disregard of the grave material injury it will inflict upon other nations and of the effects it may have on international sentiments? The tension between the "have" and the "have-not" nations, the struggles for colonies and natural resources, the intensity of military rivalries, may in large measure depend upon the willingness of the more richly endowed nations to exchange their products on mutually advantageous terms with their less fortunate neighbors.

CHAPTER XXI

PUBLIC UTILITIES

In this chapter we discuss the controls exercised by governments, municipal, state, and federal, over the telephone, telegraph, electric power and light, and manufactured and natural gas industries. These industries, which constitute together a major part of the group of so-called "public utilities,"¹ find their common quality for the purposes of this study in the great similarity of their treatment by government. From an early date they have been generally regarded as "naturally monopolistic." Save at the beginning, when the fields were in the process of becoming occupied, direct competition has been rare, and where it existed precariously for a time operating conditions and practices tended in due course to bring about monopoly expressly sanctioned by public authority.

The general public could scarcely fail to be actively concerned over the conditions of supply in the case of industries as important as these. Given a monopoly of essential services, governmental activity to perform the regulatory tasks undertaken in other fields by competition would seem almost inevitable. This, in fact, has been the case. Government regulation has been a recognized and accepted feature of the supply of public utility services for so long and in such a degree that one no longer thinks of them apart from their governmental associations. Government control of the intimate affairs of the industries is almost axiomatic, and withdrawal of the government from the field on any considerable scale is only remotely conceivable.

Two major types of governmental action have been undertaken—government ownership and government regulation. All of the public utilities have been subject to a full measure of government reg-

¹ "Public utility" is a term of uncertain meaning and extent. In addition to the industries to be considered in this chapter, the water, urban transportation, and direct heating industries are regularly included within the public utility category, and railroads, inter-urban electric, motor bus and truck, airways, radio, pipe lines, warehouses, stockyards, and ice plants are frequently so regarded in that they are or have been subjected to "typical" public utility treatment, and sometimes even banking, insurance, milk, fuel, and packing are added to the list.

ulation, but only electricity and gas have felt the impact of a full-blown public ownership movement, and, of these, electricity alone has been made the subject of a vigorous program. Ownership and operation by the government of production and distribution facilities, whether for the purpose of furnishing services directly to consumers as an end in itself, or in order, by competition or example, to force or induce better service performance by private owners, will be dealt with briefly at the close of this chapter. It will be the principal task of the chapter, however, to examine the course, structure, and technique of government regulation of public utilities, a peculiarly American system—and certainly unique in the elaborateness of its manifestations—designed to preserve and to direct toward public ends the inventiveness, flexibility, and drive of private capitalism in the utility field.

The earliest controls over public utilities were found in state charters and municipal franchises conveying rights to occupy highways, and containing loose provisions restricting the utilities' freedom in the matters of price, adequacy, and quality of service. These were to some degree preceded and were later supplemented by occasional court judgments recognizing and enforcing common law obligations, and were followed by general state regulatory legislation and ordinance regulation by municipal councils. During the latter part of the nineteenth century state administrative commissions appeared, and by the close of the first decade of the present century the demand for continuous, flexible, expert regulation led to the establishment of numerous state public utility commissions possessed of mandatory powers. These commissions, with added functions, grown more positive and searching in their activities, occupying the field jointly in many instances with municipal councils and federal agencies, and circumscribed by a network of judicial limitations, are the most prominent feature of the present-day regulatory situation.

Whatever the form, the final aim of utility regulation throughout the years has been measurably constant. Regulation has been instituted because competition has been conspicuously absent, and the purpose has been, universally, to protect the consumer from exploitation by those in a monopoly position. Details and emphases

have varied, but, throughout, there has been a groping toward the attainment by regulation of a combination of prices, quality, and quantity of service roughly approximating that which might reasonably have been forthcoming if effective competition had been prevalent in the industry. Regulation could scarcely have set itself a lesser measure of consumer protection, and, on the other hand, it has never been sought openly to require the utility industries to be run on any other than a "paying" basis or to require that utility services be rendered to other than "paying" customers. There has been generally a realization of the need under private enterprise of permitting a return to utilities sufficient to induce the flow to them of necessary resources—resources which must be obtained in competition with the broad range of industries whose pricing policies are free from governmental restraint.

Just as the aims of regulation relate to the price, adequacy, and quality of utility service, so the substantive problems of regulation revolve about these matters, directly or indirectly. It is not difficult to realize this with reference, say, to a rate case, although even here many lines of inquiry may seem distressingly remote, but it is equally true that the control exercised over the accounting practices of public utility holding companies, to take an extreme instance, acquires meaning and form chiefly because of its bearing on the control exercised over the price and character of operating company service.

I. THE RATIONALE OF REGULATION

Against the background of competitive economics the situation in the public utility industries, with every significant feature of their operation subjected to close public scrutiny and authoritative regulation, stands in clear relief. The substitution of government action for competition as the regulatory force in the case of public utilities, in a general industrial milieu where competition is largely relied upon, is based upon a public belief that competition in the utility field is conspicuously ineffective. This is all the more clear in light of the fact that government is assigned no tasks with reference to public utilities beyond those which competition is expected to perform in the case of industry generally.

The classic explanation, essentially sound if qualified, of the supplanting of competition by government regulation in the public utility field emphasizes two factors: the natural tendency of public utilities toward monopoly, and the high degree of public interest attaching to utility services.² It is clear that, at best, the physical limitations of the streets, in, under, and over which mains and cables must be laid and strung, would literally prevent the appearance of any considerable number of competing gas, electric, and telephone companies in any given area, and that public convenience dictates an even stricter limit. Householders and business men are reluctant to have their lawn fronts and the streets in front of their places of business lined and cluttered with poles and wires, and the general public is unwilling to have its reasonable use of the streets blocked continuously by excavations necessary to lay and repair multiple lines of mains and cables. Public convenience requires limited competition, if, indeed, it does not demand monopoly from the outset.

The tendency toward unification of properties dictated by physical factors has been reenforced many times by the economic characteristics of the utilities industries. To engage in the gas, electric, or telephone business requires the outlay of a large amount of capital in a fixed, specialized plant for the production of a single kind of service for consumption within a restricted area. Surplus capacity—in some part of the system and at certain times—cannot be avoided, and the condition is bound to be aggravated by the presence of competition. As a result, demand sufficient to utilize more fully the surplus plant can be satisfied for much less than a proportionate additional expense, and it can be induced, normally, by a reduction in price. Where surplus capacity and competition exist, the tendency to cut prices below full costs, even to a minimum representing only out-of-pocket expenses occasioned by production of

² See Eliot Jones and T. C. Bigham, *Principles of Public Utilities* (1931). Among legal writers no one has stressed monopoly as the basis for regulation more than Bruce Wyman, *The Special Law Governing Public Service Corporations*, 2 vols. (1911). Wyman lists monopolies due to legal privileges; natural monopolies—based on restriction of supply, scarcity of sites, limitations of time, and difficulties of distribution (including the gas and electric industries); and virtual monopolies—based on cost of plant, service on a large scale (including the telephone, telegraph, and cable industries), and inadequacy of available substitutes.

the increased units of service, is difficult to resist. The alternative to price cutting may well be to witness the flow of patronage to one's competitors, and to accept insolvency as a consequence; the result of price cutting is frequently to achieve insolvency by selling service at prices below those which will enable total costs to be met. Exit from the business, agreements eliminating price competition, or formal merger under single ownership and direction are to be expected, in due course.

There is much evidence, too, to show that service by a single larger unit may in many cases be more advantageous to the consumer than service furnished by competing smaller companies. The peculiar efficiencies of large-scale production, at least within limits, in terms of lower initial cost of equipment and operating expenses per unit of potential output, and higher "diversity" and "load factors," need not be elaborated upon or debated here. It is true that the limits of the advantages of large-scale production are very real; that the advantages are realized more fully in some industries (electric) than in others (gas, and particularly natural gas); and that the benefits of economies realized in production may be of a quite different order from those resulting from large-scale distribution of the service.³ But it also seems extremely probable, although empirical proof is lacking, that the costs of utility service—and, hence, prices to consumers to the extent that costs find expression in prices—are substantially lower under present conditions of monopoly than they would be if similar service were furnished today by smaller competing concerns.

In the case of the telephone industry still another feature makes for a monopoly of service. Any person who has lived in a community served by competing telephone companies, and who has suffered either the inconvenience of being unable to reach a party

³ It is interesting, in this connection, to consider whether the telephone industry is properly to be classified as increasing or decreasing cost. As more subscribers are added, necessitating added connections, the cost per subscriber clearly rises. But it is also true that as more subscribers are connected, the nature of the resulting service, with reference to which the new unit cost should be calculated, becomes quite different. And see the discussion of the "call-mile-minute" as distinct from the "subscriber" as the significant unit of service, in Jones and Bigham, *Principles of Public Utilities*, p. 88 ff. See the same work, pp. 72-91 and citations therein for a treatment of utility costs under competition.

served by another "line," or the added cost of subscribing to two telephones, will understand the insistence of consumers generally that competition be supplanted by single-company service.

Even though a utility service is furnished in any community by two or more companies, the position of any consumer is not significantly different from that which he would occupy if he were served by a monopolistic company. He is both free and able to buy his groceries daily from any of many competing stores, but it is not possible for him to buy gas, for example, elsewhere than from the concern with whose distribution system his gas-burning equipment is at the time physically connected. Nothing short of desperation borne of excessive and long-continued abuse would induce him to incur the cost and inconvenience of changing companies, and of course, once the new arrangement had been made he would find himself once more removed from the current of active competition. It will be appreciated that these considerations and conclusions apply equally to the related question whether or not it is proper to treat as monopolistic the sale of gas (to continue the example) by the only gas company in the area, when substitute services (for example, electricity, coal, oil) are available in the usual way. The fact that some competition exists between gas and competing substitutes is significant for the substantive problems of rate regulation, but its presence does not make government control of gas rates any less necessary.

The telegraph industry calls for a special word. While considerations of large-scale efficiency, the dangers of competition, and the benefits of unified service have brought about concentration in the case of the telegraph, complete monopoly has never been realized in this industry in the United States.⁴ Today the industry is almost completely in the hands of two major systems which compete on a national scale—the Western Union and the International Telephone and Telegraph (Postal Telegraph) groups—and these are subject, as well, to some slight local competition from seven other small concerns.

In light of common knowledge of the part played by these in-

⁴ See 73 Cong. 2 sess., *Preliminary Report on Communication Companies*, H. rep. 1273.

dustries in the social and industrial life of every community and of the nation as a whole, no attempt will be made here to dwell on their importance. Commercially, industrially, and in relation to domestic life they are key industries beyond question, and from the point of view of national defense and the development of national culture, their significance is self-evident. The immediate concern of any individual with these services is, of course, a matter of "more or less." He finds it possible, however inconvenient, to live without electricity, gas, or a telephone in his home, and he may never in his life experience the luxury of sending a telegram; and the point will be made later that the demand for all of these "necessary" services is quite susceptible of stimulation by lowered prices. A great many communities, of course, are completely without one or more utility services. Further, it should be noted that society does not regard utility services as sufficiently important to warrant the provision of such services to everyone irrespective of individual ability to pay for them on a commercial basis. None the less, the individual's interest in the availability for his own enjoyment of electric, gas, and communication services is relatively very great, and this concern is augmented by his indirect interest in living in a society where these services are readily available for general social and industrial use.⁵

It has been easier to accept the intervention of government in the affairs of utilities industries because negotiations for street occupancy and eminent domain involve them at the outset in a governmental relationship more intimate than that enjoyed by other industries; and this fact also supports the proposition, frequently advanced, that since public utilities have been given important public rights they should be subject to special public regulation. Strictly, this proposition relates not to the need for or desirability of government regulation, but rather to the right of the government to regulate. It has had effect, however, on the question of policy.

Of such stuff, then, is the case made for abandoning regulation by competition, and incurring the effort and expense of government

⁵ Of course society's concern is related to the effects upon individual and national life of leaving the industry under the control of unregulated monopoly, not to the disaster that would confront society if it were to find itself deprived completely and permanently of utility services.

regulation: a driving tendency toward monopoly in industries of such importance that the public is aroused and, through its government, expresses a willingness to undertake a positive program to conserve interests that would probably be lost under uncontrolled monopoly—the whole rendered more palatable by reason of circumstances which involve the industries in unusual governmental contacts quite apart from regulation.⁶

The significant points of contact between public utilities and the public (as between all industries and the public), and, hence, the focal points of government regulation (as well as of the processes of competitive individualism) are the matters of the adequacy and quality of service, and its price. Just as these matters were the concern of the judiciary in private actions brought by aggrieved parties under the common law, so today they are the major concern of the governmental administrative agencies charged with the duties of positive regulation. The over-all task of public utility regulation is by inducement or compulsion to evoke and make continuously available for actual consumption the maximum amount and quality of utility service consistent with society's accepted pattern for the provision of goods and services generally from a limited stock of productive resources. Needless to say, this broad conception of regulation constitutes, at best, no more than an abstract, philosophic background for the day-to-day objectives and activities of regulatory agencies. Instituted and developed in the thick of the battle in answer to the call of immediately pressing conditions, rather than as an expression of broad, deeply held philosophic convictions, utility regulation has been concerned mainly with the restrictive duties of prevention, rather than the positive goals of promotion. It has been directed primarily to the prevention of "extortionate" or "un-

⁶ One word of warning should be sounded. A regulated industry, of course, is "different" from an unregulated industry in the fact of its regulation. But forces which make for regulation of any industries at any time are so uncertain and so much the product of shifting circumstances—so typically matters of opinion and policy—that it is a mistake to regard them as "inherently" and "naturally" operative in the case only of certain kinds of undertakings.

The discussion thus far has been concerned with the circumstances under which the government, supplanting competition as the regulator of economic activity in the public utility field, has undertaken to control the price, adequacy, and quality of utility services. The related question as to when, under the federal constitution, such regulation may be undertaken, will be touched upon later.

justly discriminatory” charges, with consideration always being given, of course, to the desirability of allowing rates sufficiently high to enable and encourage the rendering of service of the desired amount and quality (as vaguely felt and measured). Although its conceptions and vision have grown clearer and larger with the years, and despite the increased trappings and vigor of its mechanical operations, rate control is even today predominantly protective and restrictive in its viewpoint and processes. As currently practiced in a long and crowded line of adversary proceedings, the function of rate regulation is to keep the total burden of rates “low enough,” and to supervise the spreading of the burden in an “equitable” way among the several classes of consumers.

A similar situation exists with respect to the regulation of adequacy and quality of service. On rare occasions the government orders the construction of new or added facilities in line with an “undertaking” originally assumed by the utility; and currently, for the first time, the government is asserting leadership in redistributing the operating properties controlled by the country’s utility holding company systems, with a definite eye to the improvement of operating efficiency and the enhancement of service. But, in the main, here as in the field of price control, regulation largely takes the form of a control over utility operations in individual cases, in terms of restrictive minima; only recently, sporadically, and with hesitation has there been undertaken a program of positive regulation designed to achieve the optimum utilization of resources entrusted to its guardianship.

Any scheme of government regulation which operates within the framework of a generally competitive economy must be synchronized with the competitive mechanism and processes if gross maladjustments are to be avoided. Public utilities draw their resources—capital, materials, man-power—from the competitive markets governing society’s stocks of resources. It is important that utilities be in a position to attract enough from these stocks in competition with the rest of industry, and yet not be so situated that an inordinate amount of society’s scarce factors are drawn away from other employments; and it is important that the use of utility services be neither enhanced nor retarded inadvertently, relatively

to the use of other goods and services.⁷ The delays and rigidities which may come to characterize governmental price fixing are quite capable of contributing unhappily to cyclical disturbances and under-employment within the economic system. To the extent that a major aim of any economy is to achieve full, continuous utilization of its resources, it becomes one objective of utility regulation to establish conditions and standards of pricing conducive to the attainment of this goal, both immediately in the utility area and more widely through the impact of utility rates upon prices, spending, and investment generally.⁸ Regulation of public utilities is a part of society's total regulatory mechanism, dovetailing with other regulatory devices and, particularly, with the processes of competitive individualism, to achieve in its own sector, considered both individually and as a part of the total economy, major objectives in terms of allocation and full use of resources and division of product.

There remains the complication, the nature of which will be more fully developed later, that the competitive standard to which it is sought to adjust the processes of regulation may be quite incapable of identification or ascertainment. It is probably true that regulation can never achieve more than a rough approximation of the results which perfect competition probably would have worked out in these industries—that is, it must be regarded as a “make-shift” for a condition of competition which never has existed and never can exist—and society must be prepared to accept some degree of maladjustment as inevitable. Society may, of course, quite appropriately seek other than “competitive” ends. But it should

⁷ But see John Bauer and Nathaniel Gold, *Public Utility Valuation for Purposes of Rate Control* (1934), pp. 23-24. If over-all earnings of a utility are kept in line with the “competitive” standard, it is possible more freely (although not reasonably without regard for consequences) to permit other than competitive considerations to be expressed in individual charges. Taxes or subsidies are, of course, available as “correctives” of an over-all rate policy which is made to subordinate competitive criteria, and there may be temporary departures if it is known that later correction is contemplated.

⁸ See J. D. Sumner, “Public Utility Prices and the Business Cycle,” *Review of Economic Statistics*, Vol. 21 (1939), pp. 97-109.

It is not intended to suggest that the “rest of the economy” does not itself contain a host of “imperfections” and “rigidities” and there is no intention to affirm an identity of the processes and results of the actual workaday industrial system with those of a theoretically pure and perfectly competitive economy.

not depart from a program of harmonizing the processes and policies of public utility regulation with the larger competitive economy, without conscious purpose, and without seeking to ascertain the extent and implications of its departure.

II. THE STRUCTURE AND PROCESSES OF REGULATION

From the middle of the last century to the present the operative structure of public regulation of utilities has undergone continuous reorganization and revamping, both studied and sporadic, to meet the problems which have emerged from the ever-varying relationship of utilities to the public. Technical progress in the industry, and the changing character of our economic, social, and political life, have combined to produce a host of regulatory problems un contemplated when utility services first began. As new tasks have appeared, regulation has gone further and deeper into areas once free of government controls, and as new philosophies and practices have been given expression, and new agencies of regulation have been created, every branch and level of government—executive, legislative, judicial, and administrative, and federal, state, and municipal—has felt the impact. From crude, occasional, rigid efforts to afford a rough kind of protection against extortion, the aims of regulation have been expanded to comprehend a greater measure of protection, and at least to contemplate promotion; and the machinery of regulation has been recast toward the attainment of continuity, expertness, flexibility, thoroughness, and co-ordination of regulatory agencies with the areas of regulation.

A. Public Utilities at Common Law

Modern public utility regulation has its roots in the early law of public or common callings, and it is certain that if present-day statutes and administrative rulings were suddenly to be swept away, the courts would move almost automatically into the void thus created and resume their negative control, earlier exercised in sporadic suits at common law, over the prices, quantity, and quality of utility services.

The common law, as worked out and applied by English courts in suits brought by aggrieved parties to recover damages from per-

sons engaged in "common employments" for failure to perform in accordance with their "undertakings," built up a series of obligations to which every such enterprise or employment was made subject by reason of its legal status thus imposed, and quite irrespective of the presence or absence of any statutes or contractual commitments.⁹ It is probably the case that the distinction made by the early common law between "common" or "public" occupations on the one hand and "private" employments on the other did not rest upon the nature of "common" callings as kinds of occupations, but rather upon the fact that such a calling was operated as a "business" dealing indifferently with the public at large rather than with particular customers only. It was the conduct of the enterprise rather than the kind of service performed¹⁰ that prompted the courts to characterize a calling as "common," and to impress upon it the obligation to serve all comers. Other obligations or duties were added, but the class to which they applied grew smaller as the centuries passed until finally, of the old group, only common carriers and innkeepers remained. These came to be thought of as exceptional (as indeed they were in the prevailing philosophy of the nineteenth century) and were termed "public" businesses or callings.

Save in the case of the gas industry, which for a short period was regarded by the courts as not dissimilar to the ordinary run of competitive industries, there seems to have been no time when the public utility industries treated in this chapter were looked upon by the law as other than public or common callings.¹¹ This has meant, so far as privileges are concerned, that these industries typically

⁹ On the prevalence in early England of laws relating to business, with examples and citations, see E. A. Adler, "Business Jurisprudence," *Harvard Law Review*, Vol. 28 (1914), p. 135. And see H. Rottschaefer, "The Field of Governmental Price Control," *Yale Law Journal*, Vol. 35 (1926), p. 438.

¹⁰ E. A. Adler (whose articles, "Business Jurisprudence," cited above, and "Labor, Capital and Business at Common Law," *Harvard Law Review*, Vol. 29 (1916), p. 241, develop the theory followed here) enumerates a long list of "common" employments, few of which could conceivably have been exceptional either in the degree of their social importance or in their possession of any unusual tendencies toward monopoly.

¹¹ See Wyman, *Public Service Corporations*, Vol. 1, sections 94, 111, 112 (gas), 113 (electric plants), 133 (telegraph), and 136 (telephone), and cases cited. And see Y. B. Smith, N. F. Dowling, and R. L. Hale, *Cases on the Law of Public Utilities*, 2d ed. (1936), Chap. I, sec. 1.

have been given the right of exclusive service (late), public financial assistance, the power of eminent domain, and special privileges in the use of the public highways; and quite apart from statutory impositions have been made subject, in common law proceedings, to the general duty within the limits of their profession to serve all comers, and to the ancillary duties to serve adequately, at a reasonable price, and impartially.¹² Of even greater significance, perhaps, is the fact that legislative enactments (presently to be discussed) governing gas, electric, telephone, and telegraph rates and services have been held not to contravene the Fifth and Fourteenth Amendments. Despite the constitutional injunctions against governmental taking of property without due process of law and against denial of equal protection of the laws, the Supreme Court has never evinced the slightest disposition to regard these industries as other than affected with that "public interest" which marks them for inclusion in the small special group of "public callings" whose prices and services are amenable to public regulation.¹³

¹² Wyman, *Public Service Corporations*, sections 50 ff. and 330 ff. As Wyman puts it, "The duty placed upon everyone exercising a public calling is primarily a duty to serve every man who is a member of his public. Implicit in this primary duty, necessarily involved in its full performance are various requirements. Not only must all be served, they must have adequate service; not only must they not be charged extortionate rates, but there must be no discrimination practiced" (sec. 330).

C. K. Burdick, in "The Origin of the Peculiar Duties of Public Service Companies," *Columbia Law Review*, Vol. 11 (1911), pp. 514-31, 616-38, 743-64, points out that the duty to serve for reasonable compensation survived for common callings from a time when it was required of all services, and that the duty of no discrimination in the order of service is similarly old; but that the duties to furnish adequate facilities and not to discriminate in price are relatively recent in origin. They all derive from the primary duty to serve all comers.

¹³ "The transportation of property—business of common carriers—is obviously of public concern and its regulation is an accepted governmental power. The transmission of intelligence is of cognate character. There are other utilities which are denominated public, such as the furnishing of water and light, including in the latter gas and electricity. We do not hesitate at their regulation nor at the fixing of the prices which may be charged for their service." *German Alliance Insurance Co. v. Kansas*, 233 U.S. 389, 406 (1914).

In answer to claims that "due process" is violated by statutes fixing or authorizing the fixing of prices, the Supreme Court has held that price control is constitutional in the case of "public callings"—industries "affected with a public interest." The Court, relying on language extracted from Lord Hale's long forgotten 17th century essay on sea ports, stripped of its context and divorced from the factual situation which gave it meaning, has never been clear either on the content or the rationale of the "public calling" concept. In the leading case on the subject,

While it is true that public utilities were born into and have since remained in a regulated status at common law, the development of the industries and the increasing complexity of utility-public relationships, seemed early to call for an orderly system of regulation including definite, pre-stated duties and standards, raised from an individual to a broad public basis and enforced by means more specialized and effective than private lawsuits brought in ordinary

testing the constitutionality of an Illinois statute setting maximum charges for grain elevators, the Court quoted loosely from Lord Hale's irrelevant treatise: ". . . when private property is 'affected with a public interest, it ceases to be *juris privati* only.'" It added: "Property does become clothed with a public interest when used in a manner to make it of public consequence, and affect the community at large. When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created." (*Munn v. Illinois*, 94 U.S. 113, 126 (1876). And see B. P. McAllister, "Lord Hale and Business Affected with a Public Interest," *Harvard Law Review*, Vol. 43 (1930), p. 759; and W. H. Hamilton, "Affectionation with Public Interest," *Yale Law Journal*, Vol. 39 (1930), p. 1089.) In the sixty years since the *Munn* case, the Court has failed to set out criteria by which legislatures desirous of regulating particular businesses can determine in advance of litigation whether the businesses will impress the Court as being sufficiently affected with a "public interest" to lend "due process" to an otherwise unconstitutional operation. The presence of an historical precedent or an inherent tendency toward monopoly and great public importance seem to have characterized several of the enterprises which the Court has permitted to be regulated, and one writer has suggested "necessity" and "consumers' disadvantage" as the significant tests (Rexford G. Tugwell, *The Economic Basis of Public Interest* (1922)). Decisions in many cases will support some or all of these criteria, but while they may help in classifying and rationalizing past actions of the Court they furnish no clue whatever as to the future. Leading cases serve only to emphasize the uncertainty, and to demonstrate the "policy" character of the Court's decisions, i.e., a business is affected with a "public interest" if a majority of the Court feels that it should be regulated. ". . . the notion that a business is clothed with a public interest and has been devoted to the public use is little more than a fiction intended to beautify what is disagreeable to the sufferers," said Mr. Justice Holmes, dissenting in *Tyson & Brother v. Banton*, 273 U.S. 418, 446 (1927); and Mr. Justice Stone, also dissenting in the same case, added (451): "To say that only those businesses affected with a public interest may be regulated is but another way of stating that all those businesses which may be regulated are affected with a public interest." The question-begging character of the concept is well illustrated by Chief Justice Taft's classification of businesses "clothed with a public interest" in *Wolff Packing Co. v. Court of Industrial Relations of Kansas*, 262 U.S. 522, 535 (1923), as (1) those carried on under a public grant, (2) those recognized as such from earliest times, and (3) those which, "though not public at their inception, may be fairly said to have risen to be such."

Many of the "public calling" cases, especially in recent years, have been decided by a divided court, the division occurring on two issues not always explicitly recognized: (1) is it the task of the court, or of the legislature (proceeding care-

courts. The earliest controls beyond the common law were imposed through special legislative charters and municipal franchises.¹⁴

B. Control by Charters, Franchises, Statutes, and Ordinances

Early public service enterprises were incorporated by special legislative enactments, the charters granting not only the right to exist as legal entities with the customary corporate privileges, but

fully and without caprice) to decide whether, in a given industrial, social, and political situation, a business should not be subjected to public regulation; and (2) if the court is to decide, do the realities of the situation call for regulation or do they demand the preservation of "free individualism"? The decision in the latest case, *Nebbia v. New York*, 291 U.S. 502 (1934), suggests that after a lapse of several years the court may now be willing to concede a greater measure of finality to the will of the legislature, and, further, that it may at last have freed itself from the influence of Lord Hale's mystic phraseology. Regulation of milk prices was upheld, although "we may as well say at once that the dairy industry is not, in the accepted sense of the phrase, a public utility." "The statement that one has dedicated his property to a public use is, therefore, merely another way of saying that if one embarks in a business which public interest demands shall be regulated, he must know regulation will ensue." "The phrase 'affected with a public interest' can, in the nature of things, mean no more than that an industry, for adequate reason, is subject to control for the public good" (pp. 531, 534, 536).

Leading cases, the industries for which regulation was sought, and the decisions are: *Munn v. Illinois*, 94 U.S. 113 (1876), grain elevators, upheld; *Budd v. New York*, 143 U.S. 517 (1892), floating grain elevators, upheld; *Brass v. North Dakota*, 153 U.S. 391 (1894), grain elevators, upheld; *Noble State Bank v. Haskell*, 219 U.S. 104 (1911), banking, upheld; *German Alliance Insurance Co. v. Kansas*, cited above, fire insurance, upheld; *Block v. Hirsh*, 256 U.S. 135 (1921), building rentals (emergency), upheld; *Wolff Packing Co. v. Court of Industrial Relations of Kansas*, 262 U.S. 522 (1923), production of food, clothing, fuel, denied; *Tyron & Brother v. Banton*, 273 U.S. 418 (1927), resale of theater tickets, denied; *Ribnik v. McBride*, 277 U.S. 350 (1928), employment agency, denied; *Williams v. Standard Oil Co.*, 278 U.S. 235 (1929), gasoline retailing, denied; *Tagg Brothers and Moorhead v. U.S.*, 280 U.S. 420 (1930), livestock brokers (inter-state commerce), upheld; *New State Ice Co. v. Liebmann*, 285 U.S. 262 (1932), manufactured ice, denied; *Nebbia v. New York*, 291 U.S. 502 (1934), milk, upheld.

The fact that despite the sixty-year controversy over the "public calling" concept, the right of government to control the electricity, gas, telephone, and telegraph industries has never been contested before the Supreme Court testifies conclusively to the great bulk and force of opinion, both within and outside the industries, behind their regulation.

¹⁴ It is not intended in the foregoing to suggest that public utilities are regulated today because common callings were regulated at common law. The characteristics of public utilities would probably have produced some type of regulation quite apart from historical precedent, but it is undoubtedly true that regulation of public utilities in the United States came and assumed its particular pattern earlier than would have been the case because for centuries the common law had been familiar with a special category of "common callings."

also special privileges such as tax immunity, the right of eminent domain, and the right to use public property. Occasionally, early charters granted exclusive rights to operate in stipulated areas, although in the main monopolies were not established. These privileges were extended, it was said, to aid in the accomplishment of "governmental" purposes, and in return there were imposed upon the grantees such specific duties and obligations as were deemed necessary to protect the public.¹⁵ Inevitably, then, early charters of incorporation became vehicles of detailed and elaborate regulation.¹⁶ Such price restrictions as were imposed provided a ceiling for rates, by means either of a specified schedule of maximum charges or an arbitrary limit on net profits. Frequently the charter provided that construction or operation must begin by a stated time and that certain services must be provided by the grantee in order to bring all of the charter privileges into operation. Often the common law duties, such as that of serving all applicants at non-discriminatory rates, were spelled out in detail.

Regardless of the care or detail with which charter provisions were drawn, however, the results were rarely satisfactory for long. Attempts to write rigid terms of regulation in the face of multiple unknown contingencies were largely unsuccessful. The inflexibility of charter provisions in periods of rapid change led to disregard or violation of the terms by all parties. Nor was there any effective administrative machinery to keep informed of events or to attempt enforcement of charter stipulations; enforcement was sporadic and frequently ill-timed and influenced by considerations other than concern for public welfare.

The general situation was not greatly changed—certainly not markedly improved—by two major governmental developments that came with the latter part of the nineteenth century—the spread of general incorporation acts and the practice of delegating powers to municipalities to control the use of their streets, and hence, in a

¹⁵ This statement of fact is not to be taken as a commitment on the moot question whether certain businesses became "public" because special privileges were granted or, on the contrary, whether the privileges were granted because the businesses were "public."

¹⁶ For a discussion with examples of early public service corporation charter provisions, see M. H. Hunter, "The Early Regulation of Public Service Corporations," *American Economic Review*, Vol. 7 (1917), p. 569.

measure, the utilities whose operations involved such use. The net effect was simply to transfer many regulatory problems from the state legislatures to the municipalities with their heterogeneous array of councils and officials, and, not infrequently, to complicate the situation by bringing the diverse policies of these subordinate agencies into conflict with the contradictory charter policies of legislatures jealous of their powers.¹⁷ The problem was further complicated by the fact that the development both of regulatory policies and machinery had to be achieved in the confusing midst of the rapid growth of the cities, constant changes in the technical and financial features of its public utilities, and the disconcerting vagaries of American municipal politics. The perplexing problems of franchises and regulation were passed on to a succession of inexperienced local officials. Untrained, they could learn only by their own mistakes, and it was the task of each in turn to reduce to some kind of order the rank growth of charter grants, franchises, interpretations, and "understandings" from previous administrations. In addition, the prevailing doctrines of free competition and *laissez faire*, favorable to general incorporation acts, argued against aggressive regulation.

Municipal authorities progressed through several stages in establishing standards for the use of city streets. During the first half of the nineteenth century, promoters who undertook to provide transportation, gas, or water services were regarded generally as public benefactors, to be rewarded and encouraged by liberal franchises, often granted in perpetuity. Not infrequently the transactions were characterized by corruption of local officials, and the gaining of valuable privileges without compensatory obligations. Occasionally, where the value of franchise concessions was appreciated, franchises were offered on a competitive basis to the highest bidder—a practice which led sometimes to the payment of fantastic prices. Frequently the bid took the form of services to be rendered to the municipality, and the magnitude of the obligations assumed by the grantees seriously prejudiced any effective compliance with the terms of the franchise as a whole. Difficulties and controversy

¹⁷ See D. Wilcox, "Elements of a Constructive Franchise Policy," in Clyde L. King, *The Regulation of Municipal Utilities* (1912), pp. 137 ff.

were rife, and the effects of liberal grants at assorted prices, in terms of municipal corruption, high rates, and impaired service continued to be felt for many decades.

In many municipalities, competing utilities were allowed to use the streets. The policy of competition, effected generally through long-term or perpetual but non-exclusive franchises, was often applied to gas and electric companies. In fact, it is only within the present century that the essentially monopolistic character of public utility industries has found complete reflection in a thorough-going policy of exclusive grants. Where the franchises were for stipulated periods, rather than perpetual, added difficulties arose: short terms offered insufficient security to utilities to induce substantial commitments of capital, and gave rise to constant bickering and controversy; long terms deprived the public of its most effective weapon for compelling satisfactory service and, as the terms neared completion, all the controversy characteristic of short-term franchises ensued.

Charters and municipal franchises were rigid, whereas flexibility commensurate with the developing and ever-changing features of the utility problem appeared to be an obvious need. In an effort to anticipate all conceivable contingencies with reference to the whole range of regulatory problems—tenure, special privileges, taxation, extent and standards of service, rate levels and schedules, accounts, reports, procedures, and penalties—franchises were filled with a most complicated array of technical terms and conditions, many of which were capable of conflicting interpretation and all of which were potential sources of costly controversy. Needless to say, events produced far more contingencies than the makers of franchises ever contrived to foresee. But even where foresight, capacity, integrity, and diligence happened to be combined in the persons of local authorities, limited jurisdiction soon nullified their most inspired efforts. As utilities banded together into financial and operating systems spreading far beyond the boundaries of single municipalities, new problems of locality discrimination were heaped upon the undigested mass of problems already existing, and local officials found themselves incapable, both because of limited jurisdiction and by reason of composite accounts, absentee records, and the

intricacies of allocation, to cope with either the problems of regulation or the enhanced bargaining power of the growing utilities. The demand grew for informed, flexible, continuous, expert control by agencies possessed of a jurisdiction coextensive with the operating area of the utilities to be regulated, and an effective power commensurate with their jurisdiction. During the latter third of the nineteenth century, such an agency had been developing, and when, at the turn of the century the need was felt to be acute, the instrumentality of the administrative commission was at hand. The inadequacies of regulation by charters and franchises led slowly not only to change, but with certainty to the particular regulatory agency which has dominated the scene throughout the present century. Modern utility regulation, with its achievements and shortcomings, is, for the most part, regulation by administrative commissions.¹⁸

C. The Rise of State Administrative Commissions

The commission form of continuous administrative regulation on the basis of general standards laid down by legislatures developed steadily in the United States during the nineteenth century, and was employed increasingly after other measures and agencies had demonstrated their shortcomings. Commission regulation of banking was instituted in Massachusetts in 1838, and of insurance in 1854.¹⁹ Railroad commissions were established as early as 1839 in Rhode Island, 1844 in New Hampshire, 1853 in Connecticut, 1855 in Vermont, 1858 in Maine, 1867 in Ohio, and 1869 in Massachusetts. These were "weak" commissions; their chief functions

¹⁸ It should be realized that throughout the period prior to the rise of administrative regulation, when control was principally a matter of state charters coupled with municipal franchises, resort was had also to state legislative enactments relating to specific phases of utility operation, to municipal ordinances, and to litigation brought by individuals seeking judicial recognition and enforcement of the statutory or common law duties of public utilities. The difficulties (largely indicated above) inherent in these regulatory devices—charters, franchises, statutes, ordinances, and lawsuits—are obvious to present-day students of regulation, but it was only through long and painful experience that each of these methods came to be succeeded by others, and all in turn gave way at last to control by administrative commissions.

For examples of early laws and machinery of regulation see Hunter, *American Economic Review*, Vol. 7, p. 569.

¹⁹ See L.D. White, "The Origin of Utility Commissions in Massachusetts," *Journal of Political Economy*, Vol. 29 (1921), p. 177.

were to collect and disseminate information, and to offer recommendations to their respective state legislatures.²⁰ Despite their limited jurisdiction, however, and their lack of mandatory power, the work and experience of these commissions constituted a valuable and necessary foundation for the extension of jurisdiction and accretion of power which they were later to enjoy.²¹

The widespread discontent of farmers and small business men in the Middle West, consequent upon price declines, high interest rates, and high and discriminatory transportation prices in the late 1860's furnished the occasion and impetus for the first clear advance from the original concept of regulation by advisory commissions. In 1871, after several years of agitation, the Illinois legislature enacted statutes fixing maximum charges for the handling and storage of grain, and established the Railroad and Warehouse Commission to enforce the laws; and in 1874 the Commission was empowered to determine and fix reasonable maximum charges for transportation of passengers and freight for each railroad corporation doing business in the state. In 1874, the legislatures of Iowa, Wisconsin, and Minnesota passed maximum rate statutes applicable to railroads, and Minnesota set up a commission to enforce the statutory schedules. Georgia enacted a similar law in 1879, and in the same year the new state constitution directed the legislature of California to create a railroad commission with power to fix maximum rates.

Although the movement for state railroad commissions with mandatory powers lost some of its force in the period 1880-1900,²²

²⁰ See F. C. Clark, *State Railroad Commissions*, Publications of the American Economic Association, Vol. 6 (1891), p. 483.

²¹ See Clyde O. Ruggles, *Aspects of the Organization, Functions, and Financing of State Public Utility Commissions* (1937). And note "The Massachusetts Commission furnishes the most conspicuous instance of the purely advisory commission, depending upon investigation, the justice of its conclusions, and the force of public opinion for the enforcement of its recommendations; and by reason of its successful working under a novel plan and of the ability of its membership it has always made its influence widely felt." 49 Cong. 1 sess., S. rep. 46, *Report of the Senate Select Committee on Interstate Commerce* (1886), Part I, p. 66.

²² Continued low prices, the alleged slackening of railroad construction, active hostility to the new commissions, and the decision of the Supreme Court in *Wabash, St. Louis and Pacific Railway Co. v. Illinois*, 118 U.S. 557 (1886), followed by the creation of the Interstate Commerce Commission in 1887, were important factors in the decline.

the seed of administrative regulation was still active; it needed only to fall on the fertile field constituted by the gradually worsening local utility situation to take root and flourish. As a matter of fact, the process was shortly under way. In Massachusetts, the gas industry, faced by competition from improved and cheaper processes and from the electric industry, welcomed the establishment of a state gas commission empowered to give a final decision, on appeal from local authorities, on requests for permission to enter the industry.²³ The move to protect gas investments proved to be an opening wedge, and by 1896 the Commission had been given control over electric light companies and, in addition to very substantial inquisitorial powers and power to prescribe accounts and records, was authorized to investigate and hold hearings on rate and service complaints and to order reductions in rates or improvements in service. The Commission's "orders," however, were in the form of recommendations.²⁴

This period saw, as well, the institution of several investigations of the utilities situation, and these inquiries, together with intermittent and scattered delegations, once more, of regulatory tasks by state legislatures to state railroad commissions, culminated in the Wisconsin Public Utility Law of 1907 and New York Public Service Commission Law of the same year—the beginning of the modern era of public utility regulation.²⁵ Then followed a wave of

²³ See White, *Journal of Political Economy*, Vol. 29, pp. 189-91. And see J. H. Gray, "The Gas Commission of Massachusetts," *Quarterly Journal of Economics*, Vol. 14 (1900), pp. 509-36.

²⁴ See Irston R. Barnes, *Public Utility Control in Massachusetts* (1930), pp. 15 ff., and 96. See also J. H. Gray, cited above, at p. 519. In 1894 Massachusetts passed a strict, rigid, anti-stock-watering law. See J. B. Eastman, "The Public Service Commission of Massachusetts," *Quarterly Journal of Economics*, Vol. 27 (1913), pp. 699-707.

²⁵ There is no determinable pattern in the slow growth of railroad commission powers at this time, but the steady accretion had reached considerable magnitude by 1907. In 1905 plenary railroad rate-fixing powers and the power to define and enforce railroad service standards were granted to the Wisconsin Railroad Commission; and the jurisdiction and powers of the Indiana and Washington commissions were also extended in the same year. At this time, too, a New York legislative committee, for which Charles Evans Hughes was counsel, recommended the establishment of an administrative commission to regulate the gas and electric industries; and the legislature reduced electric rates in New York City and created a committee to investigate the price of New York City gas. In 1906 the price of gas was reduced on advice of the committee. In 1907, with Hughes as governor,

state legislation which resulted within the next decade in the establishment of commissions exercising varying degrees of control over local public utilities in well over half of the states. A considerable number of these laws were patterned substantially on the Wisconsin statute, which is one of the landmarks of American public law.

In addition to powers over common carriers (including telegraph), the Wisconsin Railroad Commission was granted jurisdiction over companies furnishing the public with telephone, heat, light, water, and power services.²⁶ The Commission was directed to establish valuations for "all the property of every public utility actually used and useful for the convenience of the public," and to keep itself informed of new construction, and was authorized to make revaluations on its own motion. It was required to prescribe a uniform system of accounts (utilities were forbidden to keep any other accounts) and to provide for examinations and audits; and, as well, to determine rates for annual depreciation allowances to which, together with Commission regulations respecting depreciation funds, utilities were required to conform. The Commission was authorized, further, to inquire into and keep itself informed as to the manner and method in which utility management was conducted. These powers, ancillary to very complete powers over rates and service, were substantial even if judged by present day standards, and they were almost revolutionary by the standards of their own time. They were essential, however, if the Commission was to perform effectively its duties under the rate and service sections of the act. Each utility was required to file its schedule of rates with the Commission, to conform strictly to its rates so published, and to refrain from changes in rates without ten days' notice. Upon complaint made against a utility by any mercantile, agricultural, or

New York's Public Service Commission Law was enacted, creating one commission with jurisdiction over utilities in Greater New York City, and another commission to control local utilities outside of New York City and all steam railroads in the state. See Laws of New York, 1907, Chap. 429; New York Public Service Commission, First District: *Report for the Six Months Ending December 31, 1907*, Appendix J; H. M. Pollock, "Public Service Commission of the State of New York," *Annals of the American Academy of Political and Social Science*, Vol. 31 (1908), p. 649.

²⁶ Wisconsin, 1907 Laws, Chap. 499. It will be noted that the name of the commission (not changed to "Public Service Commission" until 1931) falls far short of indicating its full jurisdiction and powers.

manufacturing society, by any municipal organization, by any 25 persons, or, indeed, the utility itself, as to any matter affecting its product or service, or on the Commission's own initiative, whenever it "shall believe that any rate or charge may be unreasonable or unjustly discriminatory or that any service is inadequate, or cannot be obtained," or that any other matter should be called into question, the Commission was authorized to undertake an investigation.²⁷ After investigation, and a finding that existing rates or practices were unreasonable, discriminatory, or substandard, the Commission was empowered to determine and fix reasonable rates and adequate standards which the affected utilities were obliged thereafter to observe and follow. Provision was made for appealing to the courts from any Commission order, but it was provided that in any such proceeding the burden of proof should rest upon the party seeking to set aside the Commission's determination. Municipalities were permitted to exercise substantial powers over the quality, terms, and conditions of utility service, but the Commission was free to intervene at any time and, after hearing, to void any ordinance or contract concerning these matters as unreasonable. The ground was cleared and the machinery set for continuous, positive, expert government control of public utility rates and services on a state-wide basis. Utility regulation as it is known today dates from this legislation.

Between the Wisconsin and New York legislation of 1907 and the Wisconsin revision of 1931 and the New York revision of 1934, the significant structural developments in the field of regulation were the extension (first rapid, then more slowly, but finally almost complete) of control by state administrative commissions generally throughout the country, and the assertion of dominance by the courts in the determination, by negative limitation, of the most important issues of regulation. Within the first ten years, 24 states created or revamped existing commissions, conferring on them broad jurisdiction and powers similar to, although typically less far-reaching than those of the Wisconsin and New York models. By

²⁷ No order affecting rates or practices might be entered without a public hearing, after notice. The Commission was empowered to compel attendance of witnesses and production of records. A full and complete record of all Commission proceedings was required.

the close of the state legislative assemblies of 1930 every state in the country except Delaware, together with the District of Columbia, Hawaii, the Philippines, and Puerto Rico, had established a regulatory commission. Of these, all but seven had jurisdiction over electric light, heat, and power utilities, all but six over natural gas, all but eight over manufactured gas, all but four over telegraph, and all but two over telephone utilities.²⁸ All but five state commissions had the power to regulate the service of gas and electric utilities (both in all but three cases), and the power to regulate electric and gas *rates and schedules* was possessed by an equal number (in two of these only natural gas, and in one other only electric rates). Commissions had authority to initiate complaints and start investigations in the matter of rates and service in 36 states, and proceedings could be instituted upon complaint of consumers in 42 states. Twenty-three states empowered their commissions (in widely divergent degrees) to control the capitalization of, and the issuance of securities by electric and gas companies, and 34 commissions were authorized to regulate the accounting practices of these utilities, and 27 to prevent the institution of utility services under any franchises or permits unless the commission should find such service required by "public convenience and necessity."

The last of the enumerated powers—that of determining that a projected utility service may not be instituted in a given municipality despite the formally expressed desire of the municipality that the service be undertaken—indicates the extent to which state regulation had superseded municipal control by 1930. It should be borne in mind, of course, that municipal control of rates and service was not extinct,²⁹ and that Commission powers over rates and service were not universally exclusive; in many instances municipalities retained powers of control subject to reversal by the Commission on complaint or on its own motion. An unusual—and not altogether effective—combination of controls was worked out in Ohio, where municipal councils were authorized to fix gas and electric rates by

²⁸ Information relative to the status of utility regulation in 1930 has been drawn almost entirely from Bonbright & Co., *A Survey of State Laws on Public Utility Commission Regulation in the United States*, 2d ed. (1930).

²⁹ See C. M. Updegraff, *Public Utility Regulation in Iowa* (1932), p. 105 ff., for a discussion of regulation by municipal ordinance and franchise in Iowa.

ordinance, which if accepted by the utility became a contract binding on both parties during the ordinance period; if unacceptable, the utility might appeal to the state commission for a determination of the reasonableness of the ordinance rate and the establishment of a higher rate if the appeal were upheld.⁸⁰

An interesting feature of the development of commission regulation was the manner of its adjustment to the difficult jurisdictional situation created in a large number of states by the presence of rate contracts between utilities and municipalities representing consumers, entered into prior to the establishment of the state commissions. During the era of rapidly rising prices and costs following 1914, many utilities, irked by contracts that held rates to pre-war levels, turned to the newly created commissions for relief. Municipalities looked upon these commissions with suspicion and, when they accepted jurisdiction and raised rates to levels consistent with prices in general, with open hostility. The success with which the conflicting jurisdictional claims were worked out and the substantive rate problem handled was something of a tribute to legal ingenuity as well as to the inherent soundness of the administrative device. It was held first that municipal powers, save in the case of states with "home rule" constitutions, were derived from the state legislatures; and the power to enter into rate contracts (that is, to contract away the sovereign right of regulation) was held not to reside in any municipality unless the state legislature had specifically conveyed the power in unquestionable terms. A large number of "contracts" were found, thus, to be of no legal effect. Further, where the power had been conveyed and exercised, it was held that the municipality had acted in the capacity of an agent for the state and, hence, if the two real parties in interest—the state and the utility—were willing, their rate contract might be revised or abrogated at will. Thus it was that even in those instances wherein municipalities had made "valid" rate contracts, state commissions

⁸⁰ This arrangement, a product of the adoption of a state commission law and a "home rule" provision in the state constitution in successive years, still obtains in Ohio. The state commission exercises exclusive control over the telephone and telegraph industries. See B. W. Lewis, "Commission Regulation and Home Rule in Ohio," *Journal of Land and Public Utility Economics*, Vol. 9 (1933), pp. 207-14.

so authorized by their legislatures found themselves in position to raise rates above the contract terms.⁸¹

Municipal franchise problems have persisted, but with the functions of rate and service control largely removed from municipal councils to state commissions, the character of the difficulties has shifted and their urgency has lessened.⁸² The "indeterminate permit," a promising device for dealing with the evils inherent in both short- and long-term franchises, was introduced on a state-wide basis by Wisconsin in 1907, and gained considerable attention and some currency in the succeeding decades. The indeterminate permit is a grant in perpetuity of the privilege of furnishing utility services to the public and of using public property in connection therewith, subject to the police power, the power of eminent domain, the power of termination for misuse or non-use, and the powers of amendment, alteration, revocation, and termination by public purchase upon payment of just compensation.⁸³ It is claimed for this device that, rightly conceived and constructed, it offers a workable, flexible combination of security for investment, continuous expert regulation of rates and service, and local control of matters purely of local import, with an alternative of public purchase always open at the pleasure of the municipality in the event of unsatisfactory service and inadequate regulation. By 1930, however, despite its endorsement in many quarters, the indeterminate permit had gained specific legislative enactment for electric and gas utilities in only two states. The institution of the indeterminate permit encountered substantial legal obstacles, as well as opposition on the

⁸¹ This "solution" did not apply in the case of "home rule" municipalities with contract powers or in situations in which the commission was not authorized by the legislature to interfere with contract rates. Leading cases on the problem are *Detroit v. Detroit Citizens' Street Railway Co.*, 184 U.S. 368 (1902); *Home Telephone Co. v. Los Angeles*, 211 U.S. 265 (1908); *St. Cloud Public Service Co. v. St. Cloud*, 265 U.S. 352 (1924); *Southern Utilities Co. v. Palatka*, 268 U.S. 232 (1925); *Railroad Commission of California v. Los Angeles Ry. Corp.*, 280 U.S. 145 (1929).

⁸² The functions of municipal franchises under state commission regulation of rates and service are to care for matters of local import such as use of the streets and free services not within commission jurisdiction, to set out certain rights of the utility, and to lend protection to its investment.

⁸³ This definition is substantially that set out in E. B. Stason, "The Indeterminate Permit for Public Utilities," *Michigan Law Review*, Vol. 25 (1927), p. 354, the classic treatment of the subject.

merits of particular legislative drafts, and from those who saw it as a device to surrender more power over local matters to incompetent and indifferent central authorities.⁸⁴

Indeed, by the close of the twenties, there had arisen a widespread, although scarcely violent, dissatisfaction with the working of state administrative regulation, set off against an attitude of complacency generally on the part of the state commissions.⁸⁵ There was a strong demand for the return to municipalities, particularly the larger centers, of regulatory powers which had been stripped from them during the full flush of commission ascendancy, and some scattered enthusiasm, as well, for municipal ownership.⁸⁶ The most articulate and powerful demand, however, and the one which bore the ripest fruit in the succeeding decade, was for extending and strengthening the machinery, processes, and spirit of state administrative regulation in the direction and degree dictated by the development of the utilities industries and the regulatory experience of the preceding twenty years.⁸⁷

⁸⁴ See F. X. Busch and C. M. Doty, *Vital Considerations Relating to Terminable Permits and Proposed Illinois Legislation* (1925); D. F. Wilcox, "The Indeterminate Permit as a Type of Public Utility Franchise," *Journal of Land and Public Utility Economics*, Vol. 2 (1926), pp. 327-42.

⁸⁵ "On every hand was heard the criticism of the public service commissions for their failure to make utility rates reflect the decreasing cost of operation due to inventions, technological developments, and increased economies; and for their failure to constitute a public instrumentality capable of protecting the consuming public against the power and resources of the public utilities corporations." (O. C. Hormell, "Public Utilities Legislation in 1929," *American Political Science Review*, Vol. 24 (1930), p. 109.) And "Among the principal reasons why regulation has reached practically a state of deadlock, has been the failure of the commissioners to see what is necessary to make the system effective. In the main, they have done next to nothing in setting out the problem and in bringing the facts and issues either squarely before the courts or before the legislatures for the purpose of establishing a workable system through legislation." J. Bauer, "Commissioners Survey Regulation," *National Municipal Review*, Vol. 18 (1929), p. 44. See also the strictures of ex-commissioner C. M. Reed, in *Proceedings of National Association of Railway and Utilities Commissioners*, Vol. 41 (1929), pp. 340, 344, 346.

⁸⁶ See Morris L. Cooke, *Public Utility Regulation* (1924), pp. 209 ff., and 276 ff.

⁸⁷ In 1929 official committees were appointed in several states to investigate the situation. The New York investigation was particularly thorough-going and complete. It resulted in four volumes (3,045 pages) of report, hearings, and exhibits, and the committee recommended 17 substantial additions to a public utilities law which was regarded already as an "advanced" piece of legislation. See *Report of Commission on Revision of the Public Service Commissions Law* (1930), Vol. 1, pp. 7-50; and note particularly the minority recommendations of Commissioners Walsh, Bonbright, and Adie, p. 241 ff., which go much further than those in the majority report.

As a device, administrative regulation made substantial progress in the years following 1907, and by 1930 was well entrenched. The very noticeable discontent with its working derived from the circumstance that the problems of regulation had developed in extent and intricacy even more rapidly than the machinery of regulation, and from the fact of ineffective administration and an attitude of "let well enough alone" on the part of a large number of state commissions.⁸⁸ It will be pointed out later that this last was due in substantial measure—although by no means entirely—to the role which the judiciary had decided to play in the business of regulation.

The slowing down of the advance of commission regulation in the twenties proved to be only a breathing spell; the spread and intensification of commission jurisdiction and powers in the decade just closing has been proceeding at a rate reminiscent of the days, 30 years ago, when the commission movement was first sweeping the country.⁸⁹ The movement has not been even, of course, and the resulting picture is far from symmetrical, but the effect has been to leave only a handful of state commissions conspicuously impotent, to round out the powers and facilities of the great bulk of commissions in a degree previously attained only by the more advanced, and to equip and empower a substantial number of commissions as completely as could be desired by the most enthusiastic proponent of commission regulation. While an account of the new legislation affecting utilities commissions during this period does not convey an accurate impression of the change in regulation—since many of the new powers remain unused in the hands of indifferent commissioners, and many commissions are making greater progress in regulatory practice under old general powers than some of their contemporaries are making under new specific grants—a

⁸⁸ Here, as elsewhere in this brief survey, it is impossible to offer statements covering 48 commissions in other than general terms. Obviously there are always exceptions.

⁸⁹ Paul J. Raver introduced his report on "Progress in Public Utility Regulation," before the National Association of Railroad and Utilities Commissioners in 1936 with the statement: ". . . one cannot view this chart without coming to a realization that commission regulation has received new life from our legislators during the past six years. . . . During the past six years we probably have had more new regulatory legislation passed than in any other similar period in our history." National Association of Railroad and Utilities Commissioners, *Proceedings of Forty-eighth Annual Convention* (1936), pp. 361-62.

survey of the new statutes will provide something of an index of the development of the regulatory mechanism. From 1930 to 1937, 29 state legislatures enacted laws affecting the organization of their state commissions, and 24 granted powers extending and strengthening commission control over local utilities. Six states completely revamped their laws, and six others subjected their utilities codes to substantial revision and enlargement. The legislation of 21 states bore directly on rates or valuation, but the most significant legislative activity was with reference to matters ancillary to rate regulation: 24 states dealt with phases of the holding company problem, 23 states with control over the issuance of operating company securities, and 7 with commission powers over payments of common stock dividends; 3 states required utilities to submit their operating budgets for commission scrutiny, 10 states enlarged commission powers over accounting and reporting, and 7 granted or extended specific powers over depreciation practices and records.⁴⁰ Space will not permit consideration of the details of these statutes, and the substantive problems with which they were concerned will be dealt with later. It may be noted, however, that the trend of regulatory legislation at the present time is in the direction of a complete acceptance of the administrative commission approach and reinforcement of its processes, inclusion within the regulatory fold of all aspects of utility operation which may affect rates and service, even indirectly, closing channels through which, in the past, regulatory efforts have been thwarted, and placing the entire regulatory process on a factual, business-like basis.

The following outline summarizes state utility commission jurisdiction and powers as of 1938:⁴¹

⁴⁰ Material for this period is collected in the Raver report, N.A.R.U.C., *Proceedings of Forty-eighth Annual Convention* (1936), p. 360 ff., and chart, following p. 402; articles by D. L. Marlett, W. H. Marple, and O. F. Traylor in *Journal of Land and Public Utility Economics*, Vol. 11 (1935), pp. 173, 290, 390; and surveys of state legislation on public utilities by O. C. Hormell in *American Political Science Review*, of which those in Vol. 28 (1934), p. 84 and Vol. 32 (1938), p. 1123 are particularly useful.

⁴¹ Derived from Bonbright & Co., *A Survey of State Laws on Public Utility Regulation* (1930), revised to July 1938 by Moody's Investors' Service: *Moody's Manual of Investments, Public Utilities, 1938*, p. 291 ff., and from P. J. Raver, in N.A.R.U.C. *Proceedings of Forty-eighth Annual Convention*, p. 360 ff.

	Conferred	Significantly Qualified	Not Conferred
I. Jurisdiction over Types of Privately Owned Public Utilities			
1. Electric light, heat, and power . . .	40	2	6
2. Gas	41	1	6
a. Pipe line operations	32		16
3. Telephone	46		2
4. Telegraph	45		3
II. Specific Laws Authorizing Regulation of Privately Owned Utilities as to:			
1. Accounting	39	1	8
2. Reports—operating and/or financial—to be submitted to the commission	39	1	8
3. Capitalization and issuance of securities	32		16
4. Consolidation and merger	36	1	11
5. Various phases of intercorporate relations	24		24
6. Depreciation	38		10
7. Rates and/or rate schedules	41	1	6
8. Revision of contract rates	39		
9. Certificate of public convenience and necessity	30	4	14
10. Permit construction of electric transmission lines	34		14
11. Assessment of costs of special investigations	11		37

The Pennsylvania Public Utility Law of 1937⁴² is a notable example of systematic strengthening of the powers of a state regulatory commission. The former Public Service Commission was legislated out of existence and a five-member Public Utilities Commission created. Commissioners are appointed by the governor, with approval of two-thirds of the senate, for ten-year terms and with salaries of \$10,000 for the regular members and \$10,500 for the chairman.⁴³ Commission expenses are to be borne by a general assessment on utilities, by groups. All privately owned utilities are placed under the direct jurisdiction of the Commission. Without a certificate of public convenience a proposed public utility may not begin to supply service. While in general every existing public utility which has been rendering service continuously since 1914 may continue to enjoy lawful rights which it then possessed, the

⁴² Pennsylvania, Laws of 1937, No. 286.

⁴³ The same, No. 43.

following rights are conditioned upon Commission approval: (1) right of a "foreign corporation" to conduct business within the state; (2) renewal of a charter or obtaining of additional franchise privileges; (3) beginning exercise of "any additional right, power, franchise, or privilege"; (4) dissolving or abandoning, in whole or in part, "any service, right, power, franchise, or privilege"; (5) beginning "the construction, installation or operation of any new plant or system," or the extension, improvement of, or addition to, an existing plant, and acquiring or transferring title to property; and (6) acquiring 5 per cent or more of the voting stock of any corporation.

In addition to the usual provisions as to reasonableness, filing, inspection of, and adherence to published schedules, rate discrimination, and the less frequent requirement of Commission approval for deposits, minimum payments, and ready-to-serve charges, the law provides that, on motion of a utility or on its own initiative the Commission may establish a system of rate adjustment by means of a sliding scale. It further authorizes the Commission to fix "temporary rates" capable of being revised from month to month, pending a final decision in rate proceedings. Such temporary rates "shall be sufficient to provide a return of not less than 5 per centum upon original cost, less accrued depreciation, of the physical property (when first devoted to public use)." If verified reports do not show original cost, the Commission may estimate such cost less depreciation. If, on the basis of the final rate order, the temporary rates are found to have provided less than a "fair return," the public utility shall be permitted to amortize and recover an amount sufficient to make up for the shortage. Burden of proof in all rate proceedings and matters relating to service is placed upon the utility. Broad powers are conferred upon the Commission to establish and enforce standards relating to adequacy and quality of service, and to require all service regulations and contracts of the public utility to be filed with the Commission.

Customary control over rates and service is strengthened by broad and detailed provisions covering accounting and budgetary matters, property records, depreciation, relations with affiliated interests, and security issuance and by statutory provisions designed to

encourage co-operation with federal and state regulatory authorities. The Commission may order changes to be made in annual depreciation charges, and may require any public utility to keep accounts showing currently the original cost of its property when first devoted to the public service, and the reserve accumulated to provide for depreciation. Similarly, the Commission may require any class of local public utilities to report and justify proposed expenditures in the field of operations and for "major contracts for the sale or purchase of facilities." Details of proposed expenditures for executive salaries, transactions among affiliates, lobbying and political contributions may be required. Items rejected by the Commission shall not be allowed in a rate proceeding.

All contracts between a utility and an affiliated interest must be filed with the Commission, and if the Commission finds that the amounts paid or payable thereunder are in excess of reasonable cost or that such services are not reasonably necessary and proper, it shall order such amounts to be stricken from the utility's books of account. Except for the absence of specific authority to limit or modify the utility's dividend policy in regard to common stocks, these provisions governing inter-corporate relations are as stringent as any of the recently enacted legislation directed at holding companies. Another provision authorizes the Commission to direct any public utility to award contracts for the construction, improvement, or extension of its properties to the lowest responsible bidder, after a public offering has been made. Every utility must file such pertinent information as the Commission may require before issuing securities or assuming liabilities, and the Commission may approve or reject the proposed transaction.

Other sections of the act relate to administrative procedure, enforcement provisions, judicial review of Commission orders, standards for the assessment of costs of regulation on public utilities, and confer upon the Commission ample authority to initiate investigations into the management and conduct of any public utility subject to its jurisdiction. The Commission is empowered to conduct joint hearings and "issue joint or concurrent orders in conjunction or concurrence with any official, board, commission or agency of any state or of the United States, whether in the holding of

such investigations or hearings, or in the making of such orders, the commission shall function under agreements or compacts between states or under the concurrent power of states to regulate the interstate commerce, or as an agency of the Federal Government, or otherwise.”

It is significant, however, that recently under a new administration, 365 staff members were dismissed, the Commission’s appropriation drastically reduced, and the salaries of many of the remaining employees substantially cut. Reduced personnel and funds have forced the Commission to drop complaints against 97 natural gas companies.⁴⁴

D. Regulation by the Federal Government

Possibly the most significant—certainly the most startling—occurrence in the field of utility regulation in the period since 1930 has been the sudden appearance of federal regulatory agencies on a major scale, keyed for effective action.

Electricity and natural gas. Until the passage of the Federal Power Act of 1935 the wholesale price of electricity moving in interstate commerce was subject to no special governmental regulation, and until the Natural Gas Act of 1938 the price of gas sold at wholesale across a state line was similarly uncontrolled. In a series of cases in the twenties the United States Supreme Court barred the efforts of state commissions to control the price at which gas or electricity might be sold by a company located in one state to a distributing company located in an adjacent state,⁴⁵ while preserving to the states the right to regulate the price of gas sold to local consumers even though the gas flowed with no intermediate change in ownership from out-of-state wells.⁴⁶ The hiatus in reg-

⁴⁴ *Public Utilities Fortnightly*, Vol. 23 (1939), pp. 877, 878.

⁴⁵ *Missouri v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924), and *Public Utilities Commission of Rhode Island v. Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927).

⁴⁶ *Pennsylvania Gas Co. v. Public Service Commission*, 252 U.S. 23 (1920). The rationale of the decision—that although the transaction is in interstate commerce it belongs to that group which because of its local character may be dealt with by states in the absence of congressional action—seems to have been broadened in a later tax case in which it was held that distribution of gas through a local distribution system is intrastate commerce irrespective of the origin of the gas. (*East Ohio Gas Co. v. Tax Commission of Ohio*, 283 U.S. 465 (1931).) Where gas is retailed by a local company to local consumers, the transaction is intra-

ulation thus created (or recognized)⁴⁷ was not large, absolutely, but it was growing in importance, and its effects were strongly concentrated in certain areas. Interstate movements of electricity had reached a volume of only 17 or 18 per cent of the total amount generated in the country by 1933 and 1934, but this represented a sharp increase and, as a matter of fact, more power crossed state lines at this time than was produced by all the central stations in the country twenty years earlier.⁴⁸ Of greater significance, a number of important cities were served by plants located in other states, and certain regions (New England and sections of the Middle Atlantic, Southern, and Pacific Coast states) were served by elaborate interstate networks. In the case of natural gas, approximately a quarter of the country's total production now flows in interstate

state commerce subject to state rate regulation even though the gas comes from outside the state through mains connected permanently with those of the local utility. (*Public Utilities Commission of Kansas v. Landon*, 249 U.S. 236 (1919).) Where gas produced within a state is mixed in a transmission main with gas from outside the state each retains its intrastate and interstate character respectively, for purposes of state control. (*Peoples Natural Gas Co. v. Public Service Commission of Pennsylvania*, 270 U.S. 550 (1926).) It is an unconstitutional interference with interstate commerce for a state to require of its natural gas producers that they grant consumers within the state a preferred right of purchase over consumers in other states, at least where gas is already moving in an established interstate current. (*Pennsylvania v. West Virginia*, 262 U.S. 553 (1923); reaffirmed 263 U.S. 350 (1923).) On the other hand, a state may levy a tax on electrical energy produced within the state even though it is to be transmitted in interstate commerce and it is claimed that the processes of generation and transmission are simultaneous. (*Utah Power and Light Co. v. Pfost*, 286 U.S. 165 (1932).)

⁴⁷ In light of what will be said later in this chapter relative to the dominant position of the courts in the structure of regulation, it should be noted here that while a decision as to whether a particular transaction is in interstate or intrastate commerce and, if the former, whether it is of "local" or "national" concern, and, if intrastate, whether it affects interstate commerce and, if so, whether directly or only indirectly, is largely a "policy" decision, the issue is one which the court cannot avoid under the Constitution. In many "due process" cases the court may quite appropriately rely on the judgment of the legislature or commission, but in commerce clause cases to rely on the judgment of a legislature is either to deny the judgment of another legislature or inevitably to permit conflicts between the judgments of constitutionally co-ordinate bodies. Further, any "gap" resulting from a commerce clause decision can always be closed by appropriate legislation. It should be pointed out, however, that many formal attacks on "jurisdiction" are really attacks on regulation *per se*; and that the effectiveness with which "gaps" are really closed may in fact depend upon which agency is held to have authority.

⁴⁸ 70 Cong. 1 sess., S. doc. 92, *Utility Corporations* (1935), Part 72-A, p. 72 ff; and Federal Power Commission, *National Power Survey, Interim Report* (1935) p. 46 ff.

and foreign commerce, with Texas, Louisiana, and West Virginia as the principal exporting states.⁴⁹

The wholesale price of electricity or gas is a constituent element in the retail rate, and with the wholesale price beyond the reach of state commissions and in the absence of any federal regulation at all, there existed a substantial breach in the regulatory structure. A partial corrective was supplied by a Supreme Court ruling in 1932 that where a local gas company procures its supply in interstate commerce by an agreement with an affiliated company, the state commission in fixing the local rate may inquire into the reasonableness of the interstate price.⁵⁰ But, while this ruling permitted a measure of protection against exorbitant charges and discrimination in a limited number of cases, a wide area still remained unregulated. Moreover, even where the state commissions had constitutional jurisdiction, the practical realities of multiple state inquiries into interstate records and properties located outside the state rendered the power largely without substance. Positive federal regulation was necessary if the objectives of state regulation were to be achieved.

By the Federal Water Power Act of 1920⁵¹ the Federal Power Commission created by the act was authorized to make investigations and to grant licenses to applicants who sought to construct power projects on streams subject to the jurisdiction of the United States. The act was designed to provide for a maximum of power development consistent with the interests of navigation and conservation. Licenses were limited to 50-year terms, at the expiration of which, at the pleasure of the Commission, the license could be renewed, or the properties could be taken over by the federal government or another designated licensee at a price equal to the "net investment" (not to exceed the "fair value") therein, as defined in the act. Preference among applicants was to be given to states and municipalities. The Commission was authorized to prescribe an accounting system for licensees, but its jurisdiction over power

⁴⁹ 75 Cong. 1 sess., *Natural Gas*, Hearing before (House) Committee on Interstate and Foreign Commerce on H.R. 4008 (1937), pp. 136ff.

⁵⁰ *Western Distributing Co. v. Public Service Commission of Kansas*, 285 U.S. 119 (1932).

⁵¹ 41 Stat. L. 1063.

rates, service, and security issues was contingent upon the absence of regulation in the states where the projects were located, or upon failure of the states to act jointly in the case of interstate business. The original commission consisted of the Secretaries of Agriculture, Interior, and War, but it was reorganized in 1930⁵² as an independent commission made up of five full-time members. It was this agency upon which the principal duties of the new federal regulation were laid by the Federal Power Act and the Public Utility Holding Company Act of 1935,⁵³ and the Natural Gas Act of 1938.⁵⁴

The main objectives of the Federal Power Act are to achieve a "planned coordination of the power facilities and resources of the nation,"⁵⁵ and through co-operation with the states as well as by independent action to supplement and strengthen state regulation in the matters of rates, securities, and accounts. The provisions of the act were to apply "to the transmission . . . and to the sale of electric energy at wholesale in interstate commerce" (Part II, sec. 201 (b)), but the exact scope of the Commission's jurisdiction with reference to the various phases of regulation is still quite uncertain.⁵⁶ The Commission was directed by the act to encourage voluntary interconnections and, with very substantial limitations, even to order the establishment of physical connections between utilities (Part II, sec. 202 (a) and (b)). This, with the power to prevent the disposition or merger of facilities or the acquisition of securities without its consent (Part II, sec. 203), gives the Commission substantial influence, at least potentially, over the physical and financial layout of the industry. Of more immediate importance, the Commission is given power to regulate the wholesale rates of

⁵² 46 Stat. L. 797.

⁵³ Title I of the Public Utility Act of 1935 (49 Stat. L. 803) is cited as Public Utility Holding Company Act of 1935; Title II (at p. 838) as Federal Power Act.

⁵⁴ 52 Stat. L. 821.

⁵⁵ See Federal Power Commission, *Fifteenth Annual Report* (1935) p. 1 ff. and *Sixteenth Annual Report* (1936) p. 1 ff. And see particularly L. V. Plum, "A Critique of the Federal Power Act," *Journal of Land and Public Utility Economics*, Vol. 14 (1938), pp. 147-61.

⁵⁶ Counsel for the Commission has estimated that the major activities of the Commission will affect 60 per cent of electrical utility assets. See Plum, *Journal of Land and Public Utility Economics*, Vol. 14, p. 148 ff.

electricity moving in interstate commerce, and in that capacity to enforce the requirements of the act with reference to the filing of rates and the prohibitions of the act against unreasonable and preferential charges (Part II, sec. 205). The Commission is authorized to control security issues where state regulation is absent (Part II, sec. 204), in a limited degree to determine and require adequate service (Part II, sec. 207), and to conduct investigations and determine costs of production and transmission even where it may not establish rates, and to ascertain the "actual, legitimate cost" of utility properties (Part II, sections 206, 208). The portion of the act dealing with "licensees" as well as interstate utilities empowers the Commission to prescribe systems of accounts and records (Part III, sec. 301),⁵⁷ and to determine and fix depreciation rates and accounts (Part III, sec. 302). In addition, the act establishes prohibitions against securities manipulation and gives the Commission power to break up interlocking directorates and managements (Part III, sec. 305).⁵⁸

An important part of the act, potentially, deals with joint boards and co-operation with state commissions (Part II, sec. 209). The Commission may undertake investigations at the request of state commissions and is required to make all of its reports available to them, to lend the trained members of its staff as expert witnesses to the state, to hold joint hearings and conferences, and to set up joint boards, chosen by the Commission from names submitted by the commissions (or by the governor if there is no commission) of such states as may be affected by any matter of interstate regulation, to be vested with the full authority of the Commission in the premises.

Three years after the passage of the Federal Power Act of 1935, the last jurisdictional gap in interstate rate regulation was closed

⁵⁷ This is one of the most significant features of the act. Through collaboration with the National Association of Railroad and Utilities Commissioners, the system of accounts adopted by the Federal Power Commission was embraced, with slight modifications, within two years by the regulatory commission of 27 states; and the Commission was able to report on June 30, 1938 that 90 per cent of the industry in the United States was operating under uniform accounts. Federal Power Commission, *Eighteenth Annual Report* (1938), p. 14 ff.

⁵⁸ Part III of the act contains several provisions strengthening the Commission in the performance of its licensing duties under the 1920 law.

by the enactment of the Natural Gas Act,⁵⁸ giving jurisdiction to the Federal Power Commission over the transportation and the sale for resale of natural gas in interstate commerce. The act was patterned on the earlier electric power legislation. Companies subject to the act are required to file schedules of rates; and the Commission, on complaint or on its own motion, is authorized to suspend filed schedules and to lower any rates which it should find unlawful (sec. 4 and 5). The Commission is given very considerable positive power over interstate wholesale service—to order an extension of facilities and the establishment of connections, and to prevent abandonment and duplicate construction contrary to the public interest (sec. 7). Natural gas companies are to keep their accounts as prescribed by the Commission (as well as any accounts prescribed by state commissions) and to charge depreciation and amortization only at such rates as the Commission shall determine. To the Commission's extensive powers of investigation are added specifically the authority to find the "actual legitimate cost" of natural gas properties (sec. 6), and to determine costs of production and transportation even in situations where it has no power to fix rates. All of its reports and findings are to be made available to state commissions, its experts are to be furnished to the states on loan, joint conferences with state authorities are provided for, and the provision for joint state boards contained in the 1935 legislation is duplicated in the Natural Gas Act.

Holding companies. The Natural Gas Act not only completed the legislative structure of direct rate making: it rounded out, as well, the machinery of federal regulation of the public utility holding company. It has been noted above that a large number of states passed holding company legislation in the period 1930-38; and the Federal Power and Natural Gas Acts dealt with a major immediate phase of the holding company problem. The federal government's frontal attack, however, was embodied in the Public Utility Holding Company Act of 1935.⁵⁹ Without passing here on the merits of the allegations, it may be noted that critics have maintained that the holding company, by reason of excessive and in-

⁵⁸ 52 Stat. L. 821 (1938).

⁵⁹ 49 Stat. L. 803 (1935).

tricate pyramiding, exorbitant fees and prices, "upstream loans," dividend exactions, capital "write-ups," and non-integrated systems, has been perverted in the utility field from an instrument for the enhancement of operating company service to a device for bleeding the operating company, confusing regulation, and mulcting the consumer.⁶¹

The federal holding company legislation grew out of an elaborate governmental investigation—a six-volume report, *Relation of Holding Companies to Operating Companies in Power and Gas*, by the Committee on Interstate and Foreign Commerce of the House of Representatives,⁶² and the Federal Trade Commission Report to the Senate, *Utility Corporations*,⁶³ comprising over 90 volumes. All electric and gas holding companies (as carefully defined)⁶⁴ are required to register with the Securities and Exchange Commission,⁶⁵ and to file declarations with the Commission relative to the proposed issuance or sale of any securities, which the Commission may permit to become effective only if all qualifying provisions are met. Holding companies are forbidden to borrow from utilities or subsidiaries, and to engage in any intercompany loans, to pay dividends, redeem their securities, or to sell any utility securities or assets in contravention of Commission rules and regulations. They are prohibited, too, from entering into service or sales contracts with utilities, and no subsidiary companies may engage in such transactions with utilities save in accordance with such terms and conditions as the Commission shall prescribe "to insure that such contracts are performed economically and efficiently for the benefit of such associate companies at cost, fairly and equitably allocated. . . ."⁶⁶

The act contains a full complement of ancillary provisions re-

⁶¹ See the discussion, pp. 725-28.

⁶² 73 Cong. 1 sess., H. rep. 827 (1934).

⁶³ 70 Cong. 1 sess., S. doc. 92 (1928).

⁶⁴ An interesting feature of the definition of "holding companies" was the provision that in addition to such companies as fell within the technical terms specified in the act, any person whom the Commission should determine exercises a sufficiently controlling influence over the policies of any utility or holding company should be subject to the act, as a holding company (Part I, sec. 2).

⁶⁵ Sustained in *Electric Bond and Share Co. v. Securities and Exchange Commission*, 303 U.S. 419 (1938).

⁶⁶ Sec. 13 (a) and (b).

lating to accounts and reports, political contributions, and "lobbying" by holding company representatives, and financial manipulation and "banker control." The most provocative and, potentially, the most significant sections of the act, however, deal with the reconstruction, under Commission direction, of holding company systems.⁶⁷ The Securities and Exchange Commission was directed "to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies . . . and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such . . . system and . . . companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system." Upon the basis of such examination the Commission was directed, as soon as practicable after January 1, 1938, to limit the operations of each holding company to a "single integrated public-utility system" (with named exceptions), such a system being defined as one whose utility assets are, or are capable of being, physically interconnected, and which may be economically operated as a single interconnected and co-ordinated system confined to a single area "not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation." Future acquisitions by holding companies of utility assets and securities were placed under Commission regulation.⁶⁸ The legislation of 1935 and 1938 leaves no significant interstate phase of gas and electric utility operation free from control (negative, at least) by the federal government, and opens the door for complete regulatory coverage for any state sufficiently interested to place its own regulatory house in order.

Telegraph and telephone. The communications industries have

⁶⁷ Secs. 9, 10, 11, 30.

⁶⁸ For a discussion of the possible conflict between the Securities and Exchange Commission and the Federal Power Commission in the matter of utility co-ordination and interconnection, see Plum, *Journal of Land and Public Utility Economics*, Vol. 14, p. 148 ff.

a relatively long history of federal control. The basis of federal interest is clear: "Telegraph communication is largely interstate, only about 25 per cent being intrastate. And while the bulk of telephone communication is intrastate, the interstate toll business is important in volume and the interstate and intrastate operations are inextricably co-mingled owing to the fact that the same telephones and much of the same equipment and personnel are utilized in furnishing both services."⁶⁹

⁶⁹ G. L. Wilson, J. M. Herring, and R. B. Eutsler, *Public Utility Regulation* (1938), p. 318. And see *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930); and Federal Communications Commission, *Proposed Report Telephone Investigation* ("Walker Report") (1938), Appendix No. 11.

The problems of radio regulation—far removed in character from those typically involved in the relation of government to public utilities—will not be considered in this chapter. In the field of radio communication, unlike the wire communication agencies, the medium through which transmission is effected is such that private individuals can neither lay claims of ownership, nor establish their rights by mere use of a given channel. Interferences caused by two or more transmitters in the same vicinity using the same or neighboring frequencies make intelligible reception impossible, and therefore destroy effective use of the medium. Governmental action appears necessary to achieve an orderly and socially desirable rationing of available frequencies. Authority must rest with Congress; the states are powerless to regulate radio transmissions, the direction and distance of which cannot be subjected to precise technical control.

The radio communication industry falls into two broad sections: wireless message communication and radio broadcasting. Technical operations, business organization, economic and social implications, and attendant problems of government control differ sharply in the two groups. In the radio message branch, two classes of service may be distinguished: communication of a specialized, emergency, or experimental nature (maritime and aviation services, geophysical explorations, military, police, and other governmental operations, and amateur and experimental work) and fixed, point to point communication. The legal obligations of common carriers are imposed only in the case of radio message service, where definite professions are made to the general public. In this section of the industry many problems are appearing beyond a mere rationing of channels. Regulation here is concerned with the active shaping of the developing industry, control over its rate of growth, and the positive task of fitting it into the existing system of wire communication facilities. In both domestic and transoceanic communications, radio transmission and reception have attained such a degree of technical proficiency, flexibility in use of equipment, and economy in rendering service that the troublesome problem of adjusting radio and wire facilities devoted to long distance message transmission has become imminent. Thus far, neither Congress nor the Federal Communications Commission has decided upon a definite regulatory policy, although there has been a congressional declaration of intent to preserve competition in the field, and to that end section 314 of the 1934 Communications Act declares it to be unlawful for existing wire agencies and radio message transmitting companies to merge or to identify in any way their common interests. Yet, in the domestic field, both the earlier Federal Radio Commission and the present Federal Communications Commission have refused to allow radio message com-

The Mann-Elkins Act of 1910⁷⁰ brought interstate operations of telephone, telegraph, and cable companies under the general supervision of the Interstate Commerce Commission. Rates were required to be reasonable and not unduly preferential, and the Commission was empowered, on complaint or on its own motion, to prescribe lawful rates and regulations: the companies were not re-

panies so to expand their facilities as to "skim the cream" from the richest domestic markets for long distance communication, to the detriment of the wire agencies and their nation-wide network.

Government supervision of the broadcasting industry is admittedly essential to its existence, yet, unlike the "public utility" industries treated in this section, the function of the regulatory authority is not to afford price protection to the consumer nor, save indirectly, to insure adequacy and quality of service. The delicate matter of censorship of program content, either by government or by private individuals occupying positions of control, is one of the most difficult problems which a democracy could be called upon to meet—but one which, in the very nature of things, cannot be avoided. In the United States the problem is particularly acute because the broadcast structure was well developed by private investment and operated for commercial profit before Congress was forced by the exigencies of the situation to intervene. It is the duty of the Federal Communications Commission to allocate the channels for broadcasting according to the undefined standards of "public interest, convenience, or necessity," and its only direct control over program content is to prevent offenses against public morals (sections 309, 316, 326, Federal Communications Commission Act, 1934). To insure that broadcasters can control the quality of programs offered, the common carrier concept is not applied. Difficulties arise because the Commission has to be more than a traffic dispatcher when two or more applicants petition for license privileges which can be granted to but one. Obviously, "technical factors" are not sufficiently sharp in practice to make a distinction between applicants; "public policy," as conceived by those in authority must be the final determinant.

For general treatment, see James M. Herring and Gerald C. Gross, *Telecommunications* (1936). The legislative background of radio regulation is treated by L. F. Schmeckebier, *The Federal Radio Commission* (1932). See "Administrative Control of Radio," *Harvard Law Review*, Vol. 49 (1936), p. 1333; and 73 Cong. 2 sess., *Preliminary Report on Communication Companies*, H. rep. 1273 (1934), pp. 109-227. For problems of allocation, see Federal Communications Commission, *Report on Social and Economic Data Pursuant to the Informal Hearing on Broadcasting*, Docket 4063 (1937). See also entire issue, *Annals of the American Academy of Political and Social Science*, Vol. 177 (1935). Legal and administrative problems of radio censorship are treated in law notes: *Yale Law Journal*, Vol. 39 (1929), p. 245; *Harvard Law Review*, Vol. 46 (1933), p. 987; and *Columbia Law Review*, Vol. 39 (1939), p. 447. For the marketing organization of broadcasting see Herman S. Hettinger, "Some Fundamental Aspects of Radio Broadcasting Economics," *Harvard Business Review*, Vol. 14 (1935), pp. 14-28, and the same, "The Marketing of Radio Broadcasting Service," Vol. 17 (1939), pp. 301-16. Political and social problems created by mass communication agencies are well treated by J. G. Kerwin, *The Control of Radio* (1934). See also Malcolm M. Willey and Stuart A. Rice, *Communication Agencies and Social Life* (1933).

⁷⁰ 36 Stat. L. 539.

quired, however, to file their rates and charges, and the Commission was without authority to suspend proposed rates pending investigation, and had no jurisdiction over through rates, joint rates and divisions, and security issues. None the less, the broad general powers of the Commission were probably more than enough to meet the regulatory situations that arose. The Interstate Commerce Commission, apparently, experienced little "embarrassment or difficulty . . . in applying the general provisions of the act, as well as many of its details" to interstate telephone and telegraph transactions, yet in the two decades preceding 1931 "a small number of scattered telephone proceedings and a slightly larger number of telegraph cases constitute the entire record of the Commission's activity."⁷¹ Lack of complaints rather than any basic inadequacy on the part either of the law or the Commission was responsible for the inactivity, but it was true that the Interstate Commerce Commission, preoccupied with the consuming task of regulating railroads, was not the most appropriate repository for the function of controlling the communications industry.

With the acceleration of federal regulatory activity which came with the "New Deal" there were brought together under the jurisdiction of a newly created Federal Communications Commission, the powers of the Interstate Commerce Commission over telephones and telegraphs, the powers of the Federal Radio Commission over radio and broadcasting, and the several miscellaneous powers over different aspects of communications vested hitherto in various bureaus and executive offices, as well as new powers suggested by years of experience in this and related fields.

The Communications Act of 1934⁷² vested in a seven-man Commission exclusive jurisdiction over the interstate phases of the telephone, telegraph, radio, and cable industries.⁷³ And to the positive powers formerly possessed by the Interstate Commerce Commission were added the authority to establish through routes and physical connections together with through charges and divisions, to suspend the operation of proposed rates pending investigation,

⁷¹ I. L. Sharfman, *The Interstate Commerce Commission*, Part 2 (1931), p. 110.

⁷² 48 Stat. L. 1064.

⁷³ Control over cable landing licenses and radio frequencies for government agencies were the only matters not transferred to the new Commission.

and to pass upon requests for permission to construct new lines and extensions. The Communications Commission was specifically authorized to make property valuations and in connection therewith to determine original cost of properties at the time of dedication to public use,⁷⁶ and, in the case of telephones, to proceed generally to such classifications as would permit a ready segregation of interstate properties and transactions (sections 213, 221). Typical powers over accounts, depreciation, and reports were given to the Commission. The act aimed at a workable synthesis of federal and state powers and activity rather than an assertion of federal supremacy; and to this end provided for joint conferences, and joint boards of the type later set up in the Federal Power and Natural Gas Acts.⁷⁸ The Commission was not given plenary power in the matter of inter-company transactions and contracts similar to that given later over gas and electric holding companies. It was ordered, however, to conduct an investigation into this field and to report its findings and recommendations for further legislation to Congress.

The entry of the federal government into the field of utility regulation came in direct response to definitely felt needs: to undertake tasks denied by the Constitution to the states, to supplement the activity of state authorities in matters over which they retained primary jurisdiction and to assist where states failed to use powers at least provisionally at their disposal, and to guide and co-ordinate in relations between the states or between the states and the nation. The indirect influence of federal activity upon the caliber of state regulation may come to be of greater significance than the actual exercise of federal power.⁷⁶ The pattern of regula-

⁷⁶ A restrained application of this power was sustained in *American Telephone and Telegraph Co. v. United States*, 299 U.S. 232 (1936).

⁷⁸ Sec. 410.

⁷⁶ This influence may work out through the setting of federal standards to which public opinion will force some of the state agencies to conform. On the other hand, the response of the state may be even more direct, as in the case of the Pennsylvania Commission which reduced intrastate tolls of an intrastate telephone company to conform to rates charged by an affiliated company using the intrastate company's facilities for interstate service. The interstate rates had been lowered under pressure from the Federal Communications Commission. See *Public Utility Commission v. Bell Telephone Co. of Pennsylvania*, 23 P.U.R. (N.S.) 173 (1938); affirmed by the Pennsylvania Superior Court in 5A. (2d) 410, 28 P.U.R. (N.S.)

tion may or may not change materially in the future; but it is safe to predict that the federal government will not play any lesser role than it now performs. Whether it will venture further into the regulatory area once occupied solely by the states is likely to depend very largely upon the demonstrated willingness and capacity of state agencies to perform effectively their present tasks, within the existing framework.⁷⁷

E. The Present-Day Commission

The public utilities commission, with its inclusive jurisdiction and its plenary powers to proceed on complaint or on its own motion to prevent rate extortion and discrimination and to establish

266 (1939). This case was appealed to the United States Supreme Court but dismissed for want of a substantial federal question, 84 Law ed. 412 (1940).

Not the least important of the recent activities of certain of the federal commissions have been the compilation, interpretation, and dissemination of information relating to utility prices and service, which can scarcely fail to be of use to any alert commission, state or federal.

⁷⁷ See B. W. Lewis, "The Bogie of Federal Regulation," *Public Utilities Fortnightly*, Vol. 12 (1933), p. 252. And see also J. E. Benton, "The Contrast Presented in Recent Federal Legislation between that Relating to Regulation of Public Service Enterprises and that Relating to Business Generally," N.A.R.U.C. *Proceedings of Fifty-first Annual Convention* (1939), p. 24: "Whereas the [federal] statutes . . . providing regulation for business generally, have extended that regulation without seeking to protect state power, and indeed have resorted to fiction and artful pretense to extend Federal regulation outside interstate commerce, into fields of activity which have heretofore been regarded as beyond the reach of Federal power, these statutes, regulating public service enterprises, enacted since the Transportation Act of 1920, exhibit no design to encroach upon the reserved power of the states. On the contrary, in notable instances these statutes, instead of pushing the exercise of federal power to extreme limits, have carefully refrained from asserting federal control with respect to transactions which were unquestionably interstate in character, for the plain purpose of avoiding any disturbance of State authority" (p. 34, and citing, at pp. 36-37, the Communications Act, sec. 221 (b); the Federal Power Act, sec. 201; and the Natural Gas Act, sec. (b)).

Space will permit no discussion of the employment of interstate compacts (under Art. I, sec. 10 of the federal constitution) as a means of dealing locally with problems of regional regulation beyond the jurisdiction of single states. See National Resources Committee, *Regional Factors in National Planning and Development* (1935), Chaps. 6, 7.

The subject of national regulation should not be dismissed without reference to the National Association of Railroad and Utilities Commissioners (composed of representatives from 47 state and 4 federal commissions), whose work in recent years in studying, formulating, and promoting wide adoption of improved regulatory measures is one of the brighter phases of the current scene.

reasonable rate levels and schedules; to control the institution, the quality and amount, and the cessation of service; and to delve with mandatory authority into accounts and depreciation, security issues and inter-corporate relations, and financial and operating policies, is an important agency in present-day economic and political life. Its internal structure and its status in relation to other governmental agencies invite examination.

The typical state commission is composed of three members, 37 states having commissions of this size⁷⁸; and with few exceptions the members give full time to their official duties.

The method of selecting commissioners varies, the governor (usually with the advice and consent of the senate) making the choice in 26 states, and the electorate by popular vote in 17 states.⁷⁹ There is a slight trend toward executive appointment. Twenty-eight states have statutory terms of office of six years; in eleven the term is four years; and in the other states terms range from indefinite (two states) and ten (two states) to two years (two states).⁸⁰ In all but five states the terms of office are staggered.

It is obvious that the effectiveness of regulation depends in a large measure upon the ability, active interest, and courage of the commission membership. It is of interest, then, to examine the background and qualifications of state utilities commissioners, to the extent that information is available. The qualifications imposed by statutes are extremely general. Usually there are residence requirements (in a few instances specifying the districts within the states from which the commissioner must come), and a few states set standards of minimum age. Technical qualifications are rare: three states require their commissioners to be "competent persons," and there is an occasional provision that the appointee must have legal training, or be experienced in law, railroad operation, rate making,

⁷⁸ Eight commissions have five members; two have only one; and one has seven. The Federal Power Commission has five members and the Federal Communications Commission seven.

⁷⁹ Election by the legislature, and appointment by other boards or officials are other methods in use. Members of the Federal Power and Federal Communications Commissions are appointed by the President with the consent of the Senate.

⁸⁰ Ruggles, *Aspect of State Public Utility Commissions*, p. 23. Terms of Federal Power Commissioners are five years, and of Communications Commissioners seven years, staggered in both cases.

etc. As a matter of fact, a considerably greater number of commissioners are drawn from the legal profession than from all other occupations combined. Business men, bankers, engineers, farmers, journalists, and government employees contribute commissioners from their ranks—a few from each group.

Negative restrictions—in terms of political and utility connections—are common. It is usually provided that no officer, employee, or agent of a public utility may serve on the commission, and that no commissioner may hold utility securities or have any other pecuniary interest in the regulated industries. Other provisions designed to filter the relations between utilities and commissioners prohibit the latter from accepting gifts or emoluments from designated industries, and from soliciting from or recommending to any utility the employment of any person. Of greater interest, but certainly of lesser effect, are the provisions designed to maintain a semblance of political balance—not more than a bare majority of commission members may be affiliated with the same political party (seven states)—and to protect commissioners from political contamination. Commissioners may not participate in political campaigns or serve on political committees (ten states), or hold offices of profit or position within a political party (two states); and no former commissioner may hold any public office for a period of two years after leaving the commission (two states).⁸¹ Although the personal contacts and tests which one would like in order to be certain are necessarily lacking, it is safe to assert that to date attempts to insulate regulation from political activity have been largely fruitless. State utility commissionerships are still regarded too frequently as political jobs to be awarded to deserving workers in the party, and more often than not are used by the incumbent as a stepping stone to “higher” political office, or to a more lucrative legal practice or position with a public utility. There have been few state commissioners who, prior to their appointment, have had more than a casual interest—not to mention special ability

⁸¹ The Federal Power Act and the Communications Act both prohibit the appointment as commissioner of any person with a direct or indirect pecuniary interest in the industries under the Commission's jurisdiction, and stipulate that no more than a bare majority of Commission members shall be appointed from the same political party.

or training—in the field of regulation.²³ That the public utilities commissioner's office is typically not a "career" office is indicated by statistics on length of service, which show that not only is the average of the actual terms of service of commissioners somewhat less than the average of single terms provided by law (46 states), but that in eight states average service has been less than one-half term, and in eighteen more states it has been less than a full single term.²⁴

Unchecked power of removal of commission members by the governor is established in 16 of the 28 states with appointive commissions, and in four more of these states the action of the governor must be approved by the state senate or council.²⁵ Impeachment and removal by court action are the common methods employed to dismiss elective commissioners. Security of tenure has lessened slightly for commissioners since 1930, consequent upon the general trend toward the increase of executive powers. While the state statutes list a large number of "grounds for removal," most of which are little short of offenses against the community and bear only slight relation to any special competency required of a commissioner, it is apparent that the significant feature of the tenure situation is the power of removal itself—the formal grounds may in actual experience easily merge into "at the pleasure" of the removing agent.²⁶

The legislature, as distinct from the chief executive, plays its distinctive part in public utility regulation by formulating and enacting regulatory laws, and appropriating funds for the use of the utilities commission. The extent to which legislatures have con-

²³ As one writer puts it: "On the books, as well as in practice, political affiliation is the real badge of the [Ohio] commissioner's office. The position is frankly admitted by all to be a political job. . . ." I. S. Rosenbaum, "Public Utilities, A Treatise on the Public Utilities Commission of Ohio," *Ohio Jurisprudence*, Vol. 33 (1934), pp. 153, 194.

²⁴ Ruggles, *Aspects of State Public Utility Commissions*, p. 23.

²⁵ Other methods in these states include removal by the legislature, by courts, and by boards or departments.

²⁶ Neither the Federal Power Act nor the Communications Act makes specific reference to the removal of commissioners. It was held in *Humphrey's Executor v. United States*, 295 U.S. 602 (1935) that Congress may make a member of an administrative commission (Federal Trade Commission) as distinct from an executive officer (postmaster) irremovable by the President save for causes specified by Congress.

ferred authority upon and named tasks to be performed by commissions has been detailed above: it remains to learn what financial provision they have been willing to make to support this authority and to facilitate the discharge of these duties. It has been demonstrated widely by experience that adequate statutory powers are of little use unless sufficient funds are available for their effective administration.⁸⁶

Thirty-five commissions reported a total expenditure of \$8,027,180 for the fiscal year ending June 30, 1936.⁸⁷ While this would mean an average expenditure of \$229,300 per state, four commissions (New York, Pennsylvania, California, and Illinois) spent a total of \$3,647,034, leaving an average expenditure for the remaining commissions of \$141,300—a small figure when it is recalled that typically the funds must be used to support the regulation of motor buses and trucks and railroads, as well as gas, electricity, and communications. Available data suggest that legislatures were slightly more generous in the middle thirties than at the peak of "prosperity." Thirty-seven states reporting the amount available for commission expenditure, 1928-34, showed an increase in 20 cases, a decrease in 14, and no change in 3. Thirty-three states reported a 29 per cent average increase in total regulatory disbursements in 1934 over 1928.⁸⁸ Any apparent generosity, however, was more than offset by the increased duties heaped upon the commissions during this period. An appropriation to cover the entire range of commission activities for a year equal only to a fraction of the amount which any large utility company would devote to a single ordinary rate case is bound to confine the scope and character of commission regulation within very narrow limits. The record of most states in this respect is not impressive.⁸⁹

⁸⁶ See the discussion and the resolution passed by the National Association of Railroad and Utilities Commissioners in 1935, calling upon state legislatures to make adequate appropriations for regulatory commissions. N.A.R.U.C., *Proceedings of Forty-seventh Annual Convention* (1935), p. 416.

⁸⁷ N.A.R.U.C., *Proceedings of Forty-ninth Annual Convention* (1937), p. 203.

⁸⁸ Ruggles, *Aspects of State Public Utility Commissions*, p. 68.

⁸⁹ For instance, in a recent gas rate dispute the City of Cleveland and the company are understood to have spent nearly \$2,000,000. However unnecessary this expenditure may have been, it was in no sense unusual, yet it is more than the Ohio Public Utilities Commission was allowed to spend for an entire decade of regulatory activity.

States have adopted a variety of methods to raise funds for regulatory purposes. In 35 states reporting revenue sources in 1935-36, 54.4 per cent of the total commission funds came from the general revenue of the states, while 45.6 per cent was derived from regular or special assessments upon utility companies. Assessments upon utilities took various forms: assessments or fees levied upon all utilities (or all of a given class) and upon particular utilities to cover costs of special investigations, and special fees for particular types of proceedings.⁹⁰ The controversy over "utility assessments" continues unabated, but there is discernible a definite tendency on the part of legislatures to resort increasingly to this method of raising money to support commission activity.⁹¹ The reader will bear in mind that all taxes and assessments paid by utilities are included in the estimates of operating expenses to be recovered with other costs in rates fixed or approved by the commissions.

The wide variation in the financial support accorded by the state legislatures to their respective state commissions finds reflection in the diversity of salaries paid to commissioners and in the wide differences in the number of employees on their several staffs. Salaries paid to 160 state commissioners in 1938 ranged from \$2,000 (Mississippi and Vermont) to \$15,000 (New York). Twenty-four states paid their commissioners less than \$5,000 annually; and in only eight states were salaries higher than \$7,000. The average salary (\$5,400) represented a slight increase from the average salary of 1930 (\$5,280), 16 states having increased and 11 states having decreased the level of commissioners' compensation.⁹² Considering the character and importance of the issues brought before commissions and the type of commissioners which

⁹⁰ N.A.R.U.C., *Proceedings of Forty-ninth Annual Convention* (1937), p. 218 ff.

⁹¹ Ruggles, *Aspects of State Public Utility Commissions*, p. 61 ff., reports (1937) that since 1930 at least 25 states have passed laws relating to the financing of their regulatory bodies: seven states provided for assessments on particular utilities to cover costs of special investigations, and nine states added to or revised general maintenance assessment statutes. One state repealed both special and general assessment laws. Two states established general assessments for special purposes, and four states revised earlier laws to produce a combination of general maintenance and special investigation assessments. Other laws affected procedures.

The federal commissions are supported entirely from general revenues.

⁹² Information from *Bonbrights Utility Regulation Chart*, revised to 1938 by Moody's Investors' Service.

the adjudication of such issues demands, the salaries offered by the states throughout the country appear inexcusably low.⁹³ Only the federal commissioners (\$10,000) and the members of the Pennsylvania (\$10,000), New Jersey (\$12,000), and New York (\$15,000) commissions can be said to enjoy compensation approaching that received by executives, experts, and attorneys regularly appearing before them.

This condition carries over into appropriations for staff members. In 1935, the number of permanent staff members ranged from 279 attached to the New York commission and 213 employed in Wisconsin, to none in Vermont. Eighteen of 36 reporting commissions on which Professor Ruggles collected information⁹⁴ had less than 30 permanent staff members, and the median commission of the entire group boasted 24 members on its staff. Engineers predominated on the permanent staffs, and received a median annual salary of \$2,500; for accountants and statisticians the median salary was \$2,450, and for rate employees, \$2,468. It is difficult to believe that the business of regulation can be carried on effectively with staffs so small, or that regulatory talent competent to cope with the experts on public utility rolls can be attracted regularly and held by salaries so meager.⁹⁵

The extent to which the activities of a public utilities commission are conditioned by the legislature and the executive raises the whole question of administrative independence. The administrative commission is a hybrid agency, combining functions of the sort

⁹³ This is not to argue, of course, that all present incumbents are paid less than their qualifications demand.

⁹⁴ Ruggles, *Aspects of State Public Utility Commissions*, p. 35 ff. A table on page 40 gives valuable data on employee appointments, experience and education, and tenure. It may be added here that while the "leading" commissions employ civil service examinations in the selection of expert personnel (258 of 279 members in New York, and all members in Wisconsin), 29 of 36 reporting commissions required no civil service examinations.

⁹⁵ "The compensation of a large percentage of the workers in the lower grades of the service is below the standard of reasonable health and comfort fixed by governmental agencies, while the pay of a great many of the professional and skilled employees is barely on the border line and in many instances below such a standard. . . ."

"The foregoing facts may account for the transition of valuable and experienced talent from public to private service, too often to the disadvantage and loss of the State." New York State, *Report of Commission on Revision of the Public Service Commissions Law*, Recommendations of Commissioners (1930), p. 319.

typically performed in the past by legislatures, executives, and courts. It is designed to infuse expertness and efficiency into governmental regulatory operations whose positive processes are apt otherwise to be somewhat impeded by the traditional American doctrine of "separation of powers." Administrative powers and duties are determined by the legislature; the task of the commission in legal theory is to determine the existence of facts, upon the basis of which it is to bring the declared policy of the legislature into operation. Its decisions in specific cases should reflect expert, dispassionate deliberation, uninfluenced by factors or forces outside the evidence before it; it may properly be more aggressive than a court only in that it may institute proceedings on its own motion and may concern itself actively with the obtaining and presentation of evidence. So much for theory. In practice the commission, by means of the substantive content which it reads into legislative terms and with which it fills the gaps in the statutory framework, inevitably plays a major part in the determination of public policy; and, on the other hand, the legislature with its control of appropriations, and the executive through his power of appointment and removal (to the extent that it is unrestricted) are, not infrequently, unable to resist the temptation to press for desired decisions in particular cases. The relationship is one of mutual give and take, not all of which is comprehended within the theories of administrative law and governmental practice usually advanced.

The independence of the administrative commission is thrown most dramatically in issue in the relationship of the commission to the judiciary. It is not always appreciated that the courts occupy a most strategic position in the structure of regulation—the more so because their status is a matter of self-determination.⁹⁸ Behind the active machinery of public utility regulation lies the federal constitution, embodying at any moment, however flexible and responsive to opinion it may be over a period of time, a set of conditions within whose fixed terms the regulation of that moment must proceed. Over the years the Constitution is an integral and

⁹⁸ ". . . while unconstitutional exercise of power by the executive and legislative branches of the government is subject to judicial restraint, the only check upon our own exercise of power is our own sense of self-restraint." Mr. Justice Stone, dissenting in *United States v. Butler*, 297 U.S. 1, 79 (1936).

mutually adjustable part of the whole regulatory process, but with reference to any immediate cause it stands conspicuously above and dominates the determination. Whether an industry (and which of its phases) may be regulated, whether the federal government or the state shall control, what branches or agencies may participate, what form and procedure of regulation may be adopted, what rules and standards may be employed in reaching decisions on substantive problems, and with what effect and finality the regulatory agency may speak—all these, constituting regulation itself, must be referred to the arbitrament of constitutional interpretation by the judiciary.

The "due process" clauses of the Constitution—forbidding the federal government and the states to deprive any person of his life, liberty, or property without "due process" of law (Fifth and Fourteenth Amendments)—bear clearly on the "processes" by which administrative commissions undertake to limit the profits and dictate the activities of public utilities, and, indeed, save in the matter of special practices employed to make possible a reasonably speedy determination of the mass of cases heaped increasingly upon commissions already buried beneath an avalanche of work, and to make the fullest use of qualified staff members, the course of "due process" in a procedural sense is well mapped and regularly followed.⁹⁷ The proposition that action affecting the rights of public utilities may not be taken without due notice and an opportunity for a full and fair hearing with all evidential facts spread openly upon the record is so well accepted that only rarely is it violated in commission practice.⁹⁸ Much of the work of any public utilities commission is done informally; the great bulk of complaints are settled through personal contact or correspondence, and never reach the status of formal cases. Many lines of commission activity

⁹⁷ Current procedural issues revolve principally about the place of the trial examiner in administrative procedure and the "conflict" between the Commission's "prosecuting" and "judicial" functions in cases instituted on the Commission's own motion. See *Morgan v. United States*, 298 U.S. 468 (1936); 304 U.S. 1 (1938); and *U.S. v. Morgan*, 307 U.S. 183 (1939); and "Report of Committee on Progress in Public Utility Regulation," N.A.R.U.C., *Proceedings of Fiftieth Annual Convention* (1938), p. 273. And see p. 669, below.

⁹⁸ But see *Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292 (1937); and *Wisconsin Telephone Co. v. Public Service Commission*, 287 N.W. 122 (1939).

(e.g., control of security issues) involve adversary proceedings only rarely. The trial of a rate case, on the other hand, proceeds typically on all fours with the trial of any suit at law: the trappings and atmosphere are identical, and the procedure varies only in that the rules of evidence are somewhat relaxed⁹⁹ and that the commission is permitted (indeed, expected) to supply evidence to supplement that tendered by the parties. A full record is made and the commission's findings are supported by a written opinion.

There is no opportunity here to consider fully the proposition frequently advanced that there is a necessary and dangerous inconsistency between the position of the utilities commission as an aggressive defender of the public interest (prosecutor)—instituting cases on its own motion and supplementing the weak resources of municipalities with its own staff and facilities—and its position as an impartial trier of facts (judge). It may be suggested, however, that if the commission's primary function be regarded as the positive administrative task of setting rates to serve the long-run economic interests both of sellers and consumers, rather than the task either of prosecuting the utility or of adjudicating an immediate controversy between opposing parties, and if the function of the utility and the municipality as adversaries be looked upon as the task of assisting the commission to make its determination, the alleged inconsistency is dissolved.¹⁰⁰ It is true, as well, that some such conception as this would make it possible in utility regulation to gain the clear advantages of the "adversary litigation" approach (specifi-

⁹⁹ See Harold M. Stephens, *Administrative Tribunals and the Rules of Evidence* (1933): ". . . with a few exceptions, legislatures and commissions lean far toward, if they do not embrace in full, the so-called popular view . . . to the effect that 'the jury trial rules have had their day' even in the courts, and that to transplant them to new fields would be 'an error amounting to folly.' The courts themselves . . . have, with exceptions, sustained the commissions" (p. 92). The rules most commonly rejected by commissions are the "hearsay rule," the "best evidence" rule, and the "opinion" rule. See also *Miller v. Midway Telephone Co.*, 3 Wis. P.S.C. 63, 71 (1932).

¹⁰⁰ And see the argument offered by J. M. Landis, *The Administrative Process* (1938), built around the proposition that ". . . the fact that there is this fusion of prosecution and adjudication in a single administrative agency does not imply the absence of all checks. It implies simply the absence of the traditional check" (p. 98).

Current devices to deal with the alleged conflict are the appointment of "public counsels" to assist municipalities (three states have such counsels), and the division of commissions into judicial and prosecuting branches.

cally, the full development of facts and the precise centering of issues), and at the same time to be rid of the expense, delay, and needless controversy which accompany the typical rate case "lawsuit."

A final requirement of "due process," of great significance for commission practice, is that "if the owner claims confiscation of his property will result [from a commission order fixing maximum rates], the state must provide a fair opportunity for submitting that issue to a judicial tribunal for determination upon its own independent judgment as to both law and facts; otherwise the order is void because in conflict with the due process clause."¹⁰¹

On the *procedural* side, the institution of judicial review of commission findings and orders has been of immense service; whatever it may have produced in the way of red tape has been more than offset by the wholly desirable protection which it has afforded against arbitrary action. The Supreme Court's holding that the right to a fair hearing—"one of the rudiments of fair play"—cannot be compromised on the "footing of convenience or expediency, or

¹⁰¹ *Ohio Valley Water Co. v. Ben Avon Borough*, 253 U.S. 287, 289 (1920). This is a far cry from *Munn v. Illinois*, 94 U.S. 113, 134 (1876) where the Court, upholding the right of the legislature to set maximum rates, said: "We know that this is a power which may be abused; but that is no argument against its existence. For protection against abuses by legislatures the people must resort to the polls, not to the courts." Continued resort to the courts, however, was rewarded. Within ten years the Court was saying, by way of a dictum: ". . . it is not to be inferred that this power of limitation or regulation is itself without limit. This power to regulate is not a power to destroy, and limitation is not the equivalent of confiscation." (*Stone v. Farmers' Loan & Trust Co.*, 116 U.S. 307, 331 (1886).) And eight years later, granting a decree restraining enforcement of commission-fixed railroad rates, the Court said: ". . . it is within the scope of judicial power and a part of judicial duty to restrain anything which, in the form of a regulation of rates, operates to deny to the owners of property invested in the business of transportation that equal protection which is the constitutional right of all owners of other property." (*Reagan v. Farmers' Loan & Trust Co.*, 154 U.S. 362, 399 (1894), foreshadowed by *Chicago, Milwaukee and St. Paul Railway v. Minnesota*, 134 U.S. 418 (1890).) It was then only a step to the decision in *Smyth v. Ames*, 169 U.S. 466 (1898) which, as will be disclosed later, plunged the Court into an intimate consideration of minutiae along the whole broad front of substantive regulation.

One prolific source of delay and confusion in the matter of review was eliminated by the Johnson Act (48 Stat. L. 775 (1934)), which forestalled the flow of appeals from state commissions to federal district courts (there to have the entire record made anew), by providing that no such appeals should be taken where the rate order "has been made after reasonable notice and hearing, and where a plain, speedy and efficient remedy may be had at law or in equity in the courts of such State."

because of a natural desire to be rid of harassing delay,"¹⁰² will not be seriously disputed. But the Court, by substituting its own notions of policy for those of legislatures and of informed commissions in the field of substantive regulation, has imposed a heavy burden of cost, delay, uncertainty, and controversy upon the progress of utility regulation. In the policies upon which it has insisted and, above all, in the mystic language with which it has clothed the rationale and the scope of its decisions, the Court has not served well the cause of wise, effective regulation. There is no occasion here to survey the range of judicial attitude toward commission findings, that is, whether findings of fact will be upset where there is *no evidence* (or less than a scintilla) to sustain them or only where there is *insufficient evidence*; whether "negative" orders are more sacrosanct than "affirmative" orders; whether findings of fact, although subjected to examination, will be sustained more readily than rulings of law; and whether "jurisdictional facts" are to be singled out for the Court's exclusive determination. The nature and, if a term may be coined, the "intensity" of the review which the courts will undertake or require will depend, in the last analysis, upon the willingness of courts to accept Mr. Justice Stone's pointed injunction that "courts are not the only agency of government that must be assumed to have capacity to govern,"¹⁰³ and to subordinate their own views on issues of public policy to those of agencies which they recognize as "appointed by law" and "informed by experience," and moved by a desire for justice equal to their own. If the comments in the present and following sections suggest that the structure, processes, and policies of commission regulation leave much to be desired, it is submitted, none the less, that the way of broad, sustained improvement is clear, and that it does not include increased dependence upon judicial control of policy.¹⁰⁴

¹⁰² *Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292, 304-05 (1937). "There must be due notice and an opportunity to be heard, the procedure must be consistent with the essentials of a fair trial, and the Commission must act upon evidence and not arbitrarily," Mr. Chief Justice Hughes in *Railroad Commission of California v. Pacific Gas and Electric Co.*, 302 U.S. 388, 393 (1938).

¹⁰³ Dissenting in *United States v. Butler*, 297 U.S. 1, 87 (1936).

¹⁰⁴ However, see American Bar Association, "Report of the Special Committee on Administrative Law," *Annual Report*, 1938, Vol. 63, p. 331 ff. But see John Dickinson, *Administrative Justice and the Supremacy of Law in the United States*

III. THE SUBSTANTIVE PROBLEMS OF REGULATION

An account of the historical growth of public utility regulation and of its present scope and structure still leaves untouched the very stuff of regulation—its substantive problems. The pages that follow will be concerned with the manner in which regulation deals with the problems that have prompted and conditioned its development.

A. The Quantity and Quality of Service

The immediate interest of public utility consumers is that just enough service of the right kind shall be forthcoming at prices no higher than are necessary to evoke such service. Price, adequacy, and quality of service are mutually interdependent, and the standard of correctness for each partially constitutes and is itself derived from the standards for the others. While it is true that under private ownership the "right amount" and the "right quality" of service are dependent upon the appearance of the "right price," it is equally true that in a monopoly situation it may be necessary to take direct action to insure that services will in fact become available and continue to be supplied even when these prices occur. The present section will consider the direct control of service; the section that follows will consider rates as a condition of service.

It has been remarked earlier in this study that the public's first concern seems to lie in the prevention of too much service. Public

(1927); Sharfman, *The Interstate Commerce Commission*, Part 2, Chap. X; Landis, *The Administrative Process*, Chap. IV; *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38 (1936); and *New York and Queens Gas Co. v. McCall*, 245 U.S. 345 (1917). And note the following from Mr. Justice Frankfurter's concurring opinion in *Driscoll et al. v. Edison Light and Power Co.*, 307 U.S. 104, 122 (1939): "The determination of utility rates . . . does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment. These are matters for the application of whatever knowledge economics and finance may bring to the practicalities of business enterprise. The only relevant function of law in dealing with this intersection of government and enterprise is to secure observance of those procedural safeguards in the exercise of legislative powers which are the historic foundations of due process." A recent "Report of Special Committee on History of, and Current Developments in Regulation" in N.A.R.U.C., *Proceedings of Fiftieth Annual Convention* (1938), p. 353, offers several recent Supreme Court decisions affirming commission rulings on various items as evidence of the Court's willingness to sustain a broad administrative discretion. But the point to be made is that the Court insists upon examining each of these items on its (policy) merits.

permission in the form of a franchise has always been required as a condition precedent to the furnishing of gas, electric, and communications services to the general public, and, more recently, the securing of a "certificate of convenience and necessity" from the state commission has been required not only for entry into, but also for major extensions within, the field. The purpose, of course, is not so much to forestall a surplus of service as to maintain those conditions of monopoly, reflecting the significant characteristics of the industries, under which alone it is believed the proper quantity, quality, cost, and continuity of service can permanently be had. In these industries the public has made up its mind: with rare exceptions only one privately owned company furnishing a given utility service will be allowed in any service area.¹⁰⁸ The requirement that permission be received before major extensions are undertaken is designed to prevent not only invasions of pre-empted territories, but also speculative ventures which, if misconceived, would undermine the financial stability of the utility and threaten the quality of service throughout its system. The requirement is productive of few controversies: commissions are usually quite content to rely on managerial judgment.

Public control of service takes on a positive aspect in orders requiring service extensions which involve capital commitments beyond those the utility is willing to make. Despite the fact that such action constitutes an extreme occupation of the realm of management, it is clear that no phase of monopoly regulation could be more in character. Reduction or non-expansion of service, whether through lethargy or a desire to maximize profits, is the worst evil of monopoly; effective rate control may be expected to remove the excess profits arising from any program of service curtailment; but it is the role of positive regulatory action that it be substituted for the spur of competition in eliminating business timidity and sluggishness. A utility may not be wholly unwilling to make a service extension but, since no one else may enter the field, it may prefer

¹⁰⁸ The competition of public power plants with private plants, to be discussed later, is in a different category. To anticipate slightly, the competition is really between two systems of control—public ownership, and private ownership under regulation.

to wait until it can be more nearly certain of profits; direct regulation will call the delay into question if, in fact, it does not order the extension. A utility company furnishing both gas and electricity may slacken its promotion of one service in order to facilitate its promotion of the other; a wholesale company may be indifferent to the needs of a distributing company, or a large distributing company may not care to be bothered by a program of interconnections in which some of its fellow concerns or the public are greatly interested. It is in situations such as these that administrative inquiries and orders have their place.

As a matter of practice, most of the "extension of service" complaints made to commissions are handled by informal negotiation; relatively few complaints achieve the status of formal proceedings. A potential consumer writes that a gas company refuses to furnish service to his home located only 400 feet from the company's main; a delegation of farmers visits the commission to ask that the telephone company serving the nearest town be required to bring its lines to them; a real estate promotor, through his state senator, presses the commission to order the power company to extend service to his suburb development. The commission will write to the parties and it will confer with them; it will send its engineers to investigate; it will explain and induce, threaten, and cajole; and in the great majority of cases (frequently by a compromise under which the consumer will underwrite a portion of the investment) it will achieve the satisfaction or the exhaustion of the parties. If not, the case will go to a formal hearing and decision.

The standards of adequacy are loose, and although the applicable law can be stated tersely, its administration by commissions and its interpretation by courts are far from exact. A public utility is deemed at law to have made an "undertaking" to serve the public, and if within the area of its profession there are consumers clamoring for service which the company will not furnish, it is appropriate that a determination be made relative to the enforcement of the undertaking. The mere refusal of the utility to serve is not decisive, nor is the desire alone of consumers to receive service; the test lies in the reasonable probability that the extension will be self-supporting. If such a probability appears, the commission will order an ex-

tension within the "natural" limits of the utility's undertaking, and the courts will sustain the order.¹⁰⁶

Commission concern with service extensions on a large scale has related particularly to the provision of electric power in suburban and rural areas.¹⁰⁷ The desire of farm dwellers for electric service coupled with the high investment costs per consumer in sparsely settled areas, together with a general lack of understanding among the parties, have produced a knotty problem for farmers, power companies, and commissions alike. The majority of companies and commissions have dealt piecemeal with the situation over the years. Several utilities, however, have entered vigorously upon rural construction, the National Electric Light Association and miscellaneous farm organizations and governmental departments have given active consideration to the problem, and a considerable number of state commissions have worked out fixed plans for joint sharing or

¹⁰⁶ "The court will not substitute its own judgment as to what extensions are reasonable for the determination of the commission. . . . But it will consider the advantages to result to the public from the extensions ordered; it will also consider the investment required to make the necessary additions to property, the cost of furnishing gas in the added territory, the effect of the new service upon the company's income as a whole; and, if it appears that the power to regulate was so used as to pass beyond the exercise of reasonable judgment and to amount to an infringement of the right of ownership, the order will be held invalid as repugnant to the due process clause. Under the guise of regulation, the State may not require the company to make large expenditures for the extension of its mains and service into new territory when the necessary result will be to compel the company to use its property for the public convenience without just compensation." (*Woodhaven Gas Light Co. v. Public Service Commission*, 269 U.S. 244, 248 (1925), affirming a commission order requiring a 16-mile extension of gas mains.) Of course "the fact that it is a public utility does not necessarily cast upon it the duty of serving the public at large. This duty is not to all men, but to a certain public limited by its profession." (*Oklahoma Natural Gas Co. v. Corporation Commission*, 88 Okla. 51, 53; 211 Pac. 401 (1922).) But "corporations which devote their property to a public use may not pick and choose, serving only the portions of the territory covered by their franchises which it is presently profitable for them to serve and restricting the development of the remaining portions by leaving their inhabitants in discomfort without the service which they alone can render. To correct this disposition to serve where it is profitable and to neglect where it is not, is one of the important purposes for which these administrative commissions, with large powers, were called into existence. . . ." *New York and Queens Gas Co. v. McCall*, 245 U.S. 345, 351 (1917).

¹⁰⁷ It is still too early to attempt any definitive appraisal of the effect upon public utility service of the administration of sec. 202 (a) and (b) of the Federal Power Act, and secs. 9, 10, 11, and 30 of the Public Utility Holding Company Act. See pp. 651, 655, above. Some consideration will be given to "interconnections" and "integrated systems" later in this chapter.

covering of rural line investments—by meeting the terms of which any group of farm consumers can demand that service extensions be made.¹⁰⁸

Just as a public utility may not institute service without governmental sanction, so, typically, it may not suspend or abandon service once undertaken, without seeking permission from the government. Occasionally a utility, such as a natural gas company, finds it impossible to continue service because of complete exhaustion of supply; more often, however, the utility seeks to be relieved of its obligation to serve because the enterprise as a whole or in some of its branches or divisions is unprofitable.¹⁰⁹ Where a utility is losing money on its entire operation, and it is reasonably certain that only losses will accrue in the future, the state may not deny a request to

¹⁰⁸ Typical plans involve paying for deficits in connected load, guaranteed monthly payments (to be reduced in amount as new customers are added), bearing by the customer of construction costs above a certain stated amount to be borne by the utility, all financing to be done by consumers (to be refunded as additional customers begin taking service), guaranteeing by customers of minimum annual revenues, etc. See Federal Power Commission, *Electric Rate Survey—Rural Electric Service*, Rate Series No. 8 (1935), Chap. 2. And see the *Annual Report of the Illinois Commerce Commission: 1935-1936*, pp. 24-37; *1936-1937*, pp. 64-73; *1937-1938*, pp. 55-61.

It has remained for the federal government to provide the greatest stimulus to rural electrical development through the Rural Electrification Administration, created by Executive Order in May 1935, and made a permanent agency by the Rural Electrification Act of 1936 (49 Stat. L. 1363). The R.E.A., financed by government appropriations, was authorized to make loans at low interest rates, preferably to states, political subdivisions, utility districts, non-profit associations, or co-operatives, to finance the construction and operation of generating plants, transmission and distribution lines, and the installation of wiring and appliances, in areas not receiving central station service. Construction loans were to be self-liquidating in 25 years. The R.E.A. up to March 1, 1940 allotted over 269 million dollars to finance rural electrification, and of this amount actually paid out over 197 million. About 575 projects were in operation at this date, and they served over 4,500,000 meters. (Information from the R.E.A.) See D. L. Marlett and W. M. Strickler, "Rural Electrification Authorities and Electric Cooperatives," *Journal of Land and Public Utility Economics*, Vol. 12 (1936), pp. 287-301, for a survey of state legislation and activity in this field.

¹⁰⁹ Rarely, in these days, a utility may threaten to discontinue service as a maneuver in a rate controversy, to frighten a recalcitrant city council. Of course a utility may suspend service to an individual consumer because of failure to pay an overdue bill, although the law is clear that this means of coercion may not be employed if the bill is honestly in dispute. Commission rules will govern the situation. For a curious case of a public attempt to force abandonment, involving a conflict of municipal, commission, and court authority, see *Geneseo v. Illinois Northern Utilities Co.*, Illinois Commerce Commission, No. 26345 (1939).

abandon the enterprise as a whole.¹¹⁰ On the other hand, the mere fact that a utility is losing money on a single branch or division of its service gives it no constitutional right to abandon the branch in the face of a finding by the state that public convenience requires continuance of the entire service; and this is true even though the system as a whole is making less than a fair return.¹¹¹ Where the utility is making an over-all fair return it would seem to be poorly situated to complain of losses on any of its branches (customers served by the profitable branches would appear to be the real losers), but the courts have uniformly accepted the utility as the real party in interest—although denying the right to abandon the unprofitable branch. It should be noted in closing this discussion that the economic measure of “unprofitability” is quite different in abandonment proceedings from that in extension cases: a projected investment with a prospective income less than a fair return on the full capital commitment is “unprofitable”; whereas a utility should neither ask nor be allowed to abandon an enterprise already undertaken if it can be made to produce a fair return on the salvage value of its property.¹¹²

¹¹⁰ *Railroad Commission of Texas v. Eastern Texas Railroad Co.*, 264 U.S. 79, 85 (1924). “. . . the company may discontinue operation and get what it can out of the property by dismantling the road. To compel it to go on at a loss or to give up the salvage value would be to take its property without the just compensation which is a part of due process of law.”

¹¹¹ *Fort Smith Light and Traction Co. v. Bowland*, 267 U.S. 330 (1925). *Brooks-Scanlon Co. v. Railroad Commission of Louisiana*, 251 U.S. 396 (1920), frequently cited *contra*, is not in point since it dealt with an unprofitable railroad operating in conjunction with a profitable lumber business. It is probably the case that unless bound by the specific terms of its franchise, a company furnishing two distinct kinds of utility services, e.g., gas and electricity, may insist upon its right to abandon either, if losing money, without relinquishing its right to continue with the other. See *Broad River Power Co. v. South Carolina*, 281 U.S. 537 (1930).

¹¹² With the growth of interstate movements of gas, electricity, and communications services it may be expected that the future will bring something of the same conflict between federal and state authorities over abandonment that characterized the railroad field until federal supremacy was established. To date the issue has not been raised with reference to the “local” utilities. See *Texas v. Eastern Texas Railroad Co.*, 258 U.S. 204 (1922); *Colorado v. United States*, 271 U.S. 153 (1926); and *Transit Commission v. United States*, 284 U.S. 360 (1932); and for interstate problems raised in a single extension case see in order: 19 California Railroad Commission 740 (1920); 20 C.R.C. 937 (1921); 190 Cal. 214 (1922); 264 U.S. 331 (1924); 100 I.C.C. 421 (1925); 30 C.R.C. 151 (1927); 142 I.C.C. 489 (1928); 34 Fed. (2) 228 (1929); 280 U.S. 52 (1929);

In controlling the quality of service, commissions have been confronted with the task of drawing standards effectively integrated with the rate structure, sufficiently definite to serve as a basis for positive orders and yet flexible enough to allow the use of technical progress in the arts, and adapted to local conditions; and of refraining, withal, from trenching so greatly upon the domain of managerial discretion as to impair the effectiveness of private initiative in the functions which remain assigned to it. Certain broad classifications of standards, such as those relating to metering and billing and personal discrimination are common to all utilities. Commissions have concerned themselves with the matter of interrupted service, establishing regulations and requiring reports in an effort to reduce inconvenience, expense, and hazard to the consumer; and all phases of safety in the supplying of utility services have received the attention of and positive action by state and local regulatory agencies. Quality standards in electric service, designed to reduce variations and discontinuities in voltage potentials and in alternating current frequencies, and to promote efficient utilization of electric equipment, have been generally established, as have standards of heating value, purity, and pressure in the case of gas service, in the interest of safety and efficiency. State commissions have established standards of construction for telephone lines and cables, but the promulgation of telephone service standards has been limited to a few states.¹¹³

In the main, it is assumed that utilities will comply—and more than comply—with state service standards, as a matter of enlightened business policy.¹¹⁴ General routine inspections are rare.

209 Cal. 460 (1930); and *Atchison, Topeka and Santa Fe Railway Co. et al. v. Railroad Commission of California et al.*, 283 U.S. 380 (1931).

For a discussion of discontinuance of service see O. P. Field, "The Withdrawal from Service of Public Utility Companies," *Yale Law Journal*, Vol. 35 (1925), p. 169; and F. P. Hall, "Discontinuance of Service by Public Utilities," *Minnesota Law Review*, Vol. 13 (1929), pp. 181, 325. For a survey of commission activity in this field see E. Nichols, *Public Utility Service and Discrimination* (1928), Chaps. 3, 13, and 14.

¹¹³The Wisconsin commission, for instance, made early recommendations relative to the elimination of transmission interferences, limitation of subscribers to be connected on given lines, maintenance of lines and equipment, reserve equipment, accurate and rapid handling of calls, etc. *In re Investigation of Standards for Telephone Service in the State of Wisconsin*, 15 Wisconsin R.C. 1 (1914).

¹¹⁴But note the experience of the Wisconsin commission when it relaxed its

Here, as in the case of service extensions, commission action arises almost entirely in response to individual complaints, and the great bulk of proceedings are of an informal character.¹¹⁸ Upon rare occasions, a commission will reduce a utility's allowable rate of return in a rate case as a penalty for rendering conspicuously bad service, or permit a return higher than usual in recognition of extraordinary efficiency.¹¹⁹ But, for the most part, contemporary regulation proceeds as though the price of service were sufficiently positive in its operation, with a minimum of supplementary action, to induce or compel adequate service of proper quality.

B. The Price of Service

Although the adequacy and quality of public utility service concern the public as fully as the price, it is with reference to the latter that most of the active work of commission regulation takes place, and about which the really colorful controversies of regulation revolve. To many, the regulation of public utilities means nothing, save incidentals, beyond the regulation of utility rates. Largely because the function of government regulation of rates has been conceived to be primarily protective in character—the guarding of the consumer against the extortionate exactions of rapacious monopolies—the activities bound up in rate regulation have taken on a most distinctive cast and direction. The processes of rate regulation are built around a core of a trial-at-law, and the earnings of the util-

inspections of manufactured gas heating values for two years. Statement by Chairman Kronshage, N.A.R.U.C., *Proceedings of Forty-fifth Annual Convention* (1933), p. 401 ff.

¹¹⁸ Out of a total of 3,552 formal gas, electric, and telephone cases disposed of by the Ohio commission, 1911-30, only 153 grew out of service complaints. E. T. Hellebrandt, "The Development of Commission Regulation of Public Utilities in Ohio," *Journal of Land and Public Utility Economics*, Vol. 9 (1933), pp. 395-409. A survey of the work of any of the better financed and more fully staffed commissions, however, will disclose considerable activity in the positive control of service. See, for example, the annual reports of the New York Public Service Commission since 1930.

¹¹⁹ See Nelson L. Smith, *The Fair Rate of Return in Public Utility Regulation* (1932), pp. 70 ff., 194 ff.

On control of service generally, and service standards, see Nichols, *Public Utility Service and Discrimination*; C. S. Morgan, *Regulation and the Management of Public Utilities* (1923); and National Bureau of Standards, *Telephones Service*, Circular No. 112 (1921); *Standards for Electric Service*, Circular No. 56, 2d ed. (1923); and *Standards for Gas Service*, Circular No. 405 (1934).

ity rather than rates *per se* constitute the focal point of regulatory attack.

It is customary for purposes of analysis to break the subject of public utility rates into two inextricably interrelated parts: the level of rates and the pattern of rates. This procedure is satisfactory if its limitations and implications are understood. The "level of rates" deals with the determination of the total amount which the utility is to be allowed to receive in return for the service it furnishes to its whole body of patrons; the "pattern of rates" is concerned with the distribution of the total burden of payments among the several classes of consumers.¹¹⁷ It will appear as the discussion proceeds that another closely related phase—the actual setting of prices for service—should probably be treated apart from the level and the pattern of rates, in order that such important considerations as rate-making technique, cyclical timing, demand elasticities, etc., can be given the emphasis of separate analysis.

The level of rates. The determination of rate levels has been so dominated by the Supreme Court that any analysis of principles and survey of commission practice may well be built around a selection of cases decided by that body. The leading case on the level of utility rates, *Smyth v. Ames*,¹¹⁸ dealt with a statute fixing the maximum charges of railroads, and was decided several years before commission regulation of gas, electricity, and communication rates really got under way. Administrative rate making for these latter industries inherited and has been molded completely in the tradition of the principles enunciated in that early case. It has been argued on many occasions that administrative rate authorities are restrained by the rate rulings of the Supreme Court only in that they may not fix rates so low as to be "confiscatory," but that, above the level of "confiscation," they have complete freedom to establish rates at any point and by any method which impresses them as "reasonable." In point of fact, however, the level of "bare nonconfiscation" has been set by the Court at a point so high that few considerations, if any,

¹¹⁷ It is to be understood, of course, that any change in the level of rates can be effected only by changes in the rate pattern, and that the structure of rates will influence the demand for service and, hence, the output, the total costs, and the total revenue.

¹¹⁸ 169 U.S. 466 (1898).

have ever suggested the establishment of "reasonable" rates on any higher level. Thus, the principles laid down by the Supreme Court in setting the lower limit permitted by the Constitution have operated in practice to dictate, at least ostensibly, the level of rates or earnings to be fixed by rate commissions as a matter of administrative discretion.¹¹⁹ The implications for effective regulation of the doctrine of review which has permitted judicial predilections full sway in the furthest reaches of rate making will appear constantly in the discussion which follows.

In *Smyth v. Ames* the Supreme Court made the first announcement of its now famous rule¹²⁰ that "the basis of all calculations as to the reasonableness of rates . . . must be the fair value of the property being used . . . for the convenience of the public." But on the determination of "fair value" for the purpose of testing the validity of government-prescribed rates, the Court was distressingly vague:

. . . in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property.¹²¹

Unfortunately, the facts of the case permitted the Court to declare the rates invalid without a definite finding on the "fair value" of

¹¹⁹ Compare opinion by Mr. Justice Brandeis in a concurring opinion in *Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276, 289, 296 (1923). See also B. W. Lewis, "Reasonable" and "Barely Non-confiscatory" Rates," *Cornell Law Quarterly*, Vol. 15 (1930), p. 573.

¹²⁰ The common law requirement that rates be "reasonable" found expression in judicial determinations arising out of suits between individual consumers and "public callings" respecting particular charges, and hence afforded no occasion for the development of a standard for the general level of rates.

The rule of *Smyth v. Ames* was anticipated by several constitutional cases of the preceding decade. See *Chicago and North Western Railway Co. v. Dey*, 35 Fed. 866 (1888); *Reagan v. Farmers' Loan and Trust Co.*, 154 U.S. 362 (1894); *Covington and Lexington Turnpike Co. v. Sandford*, 164 U.S. 578 (1896); *San Diego Land and Town Co. v. National City*, 74 Fed. 79 (1896); and *Cotting v. Kansas City Stock Yards Co.*, 82 Fed. 850 (1897).

¹²¹ 169 U.S. 466, 546-47 (1898).

the railroad properties or, more important, any suggestion as to how the conglomerate array of irreconcilable "considerations"—some of them completely irrelevant to the matter in issue—could possibly be molded into a coherent, internally consistent "value" figure.

Since 1898 valuation, that is, the determination of "fair value," has occupied the leading role in the drama of rate regulation. The rationale of "fair value" is this: Under the federal constitution and in the interest of continuing service, those who furnish public utility service must be remunerated; rates which produce utility income sufficient to cover all costs incurred in rendering service are lawful and will be effective in evoking service. Costs must be taken to include all operating expenses, taxes, and depreciation, and a "fair return" to those who have supplied capital for the undertaking. The Supreme Court has said that the capital employed is to be measured at its "fair value," and that a "fair rate of return" on "fair value" is the touchstone of compensatory rate making. But it should be borne in mind that "fair value" is, after all, only a part of the rate-making problem.¹²²

It should be clear that "fair value" for rate-making purposes is not identical with ordinary "market" or "commercial value," since "market value," based on prospective earnings, cannot appropriately be employed to determine what those earnings should be.¹²³ For the same reason the market value of a utility's securities cannot be accepted as its value for rate-making purposes.

That the "value" of property is to be *determined*—not *found*—and that a given piece of property at a given time may quite appro-

¹²² In this connection, it will be well, later, when the controversy between reproduction cost and prudent investment is under review and the argument that use of a reproduction cost measure of "fair value" will tend to bring utility rates into line with the general level of prices is being weighed, to remember that operating expenses have nearly twenty times as great an effect as an equal volume of "fair value" upon the level of utility rates, and that, irrespective of the measure adopted for "fair value," operating expenses are always reflected in the rate level at current figures.

¹²³ Note the following from Chief Justice Hughes, speaking for the majority in *Los Angeles Gas and Electric Corporation v. Railroad Commission of California*, 289 U.S. 287, 305 (1933): "In determining that basis (fair value), the criteria at hand for ascertaining market value, or what is called exchange value, are not commonly available. The property is not ordinarily the subject of barter and sale and, when rates themselves are in dispute, earnings produced by rates do not afford a standard for decision."

priately have as many different "values" as there are different purposes which the values determined at that time are intended to serve, has long been recognized both in law and in public policy.¹²⁴ The "value" of a utility property for purposes of rate making may differ sharply from the contemporary values of the property for the purposes, respectively, of condemnation, voluntary purchase and sale, taxation, capitalization, reorganization, insurance, etc. Value in each of these instances will be dictated by considerations pertinent to the purpose and project in hand. The value of property appropriated by eminent domain, for example, looks primarily to the fact that the owner of the property is now to be entirely severed from ownership and its earnings, and by the receipt of a single value amount is to be so reimbursed as to leave unchanged his economic relations with the rest of society. Value for rate making, on the other hand, must reflect a policy of establishing rates and earnings for the future in harmony with the function and structure of prices generally; it must not be a derivative of earnings, and it must contemplate quite openly, if regulation is to serve any positive purpose, a *change* in the relative earning position of the owner of utility property.¹²⁵ Further, the return to utility owners is a function of the rate of return as well as of "fair value," and it is possible, whenever it is thought advisable, to compensate in the rate of return for any factors which, for whatever reasons, may have been withheld from inclusion in the established "fair value." The value of public utility

¹²⁴ Compare David Friday, "An Extension of Value Theory," *Quarterly Journal of Economics*, Vol. 36 (1922), pp. 197-219; Robert H. Whitten, *Valuation of Public Service Corporations*, 2d ed., revised by D. F. Wilcox (1928), Vol. 1, Chap. IV; James C. Bonbright, *The Valuation of Property* (1937), Vol. 1, Part I.

¹²⁵ See R. L. Hale, "Conflicting Judicial Criteria of Utility Rates—The Need for a Judicial Restatement," *Columbia Law Review*, Vol. 38 (1938), pp. 959, 967-68.

The term rate "value" is almost a misnomer. A concept which springs from commission offices and judicial chambers rather than from the market place, and which is the creator rather than the creature of earnings, might better be termed a rate "base" than a "value." See the recent acceptance of the term "rate base" by the Supreme Court in *Railroad Commission of California v. Pacific Gas and Electric Co.*, 302 U.S. 388 (1938), over the dissent read by Mr. Justice Butler, and note the suggestion that even the term "rate base" should be discarded in favor of "earning base," in M. G. de Chazeau, "The Nature of the 'Rate Base' in the Regulation of Public Utilities," *Quarterly Journal of Economics*, Vol. 51 (1937), p. 298. The objectives sought by the suggested change are wholly desirable, but it is questionable whether the change would materially hasten their achievement.

property for tax purposes, to take another example, is determined by considerations pertinent to the tax and appraisal programs of particular jurisdictions, and, since utility taxes are regularly allowed in full as operating expenses to be covered explicitly by rates, any discrepancy between tax value and rate value is a matter of indifference.

Of the galaxy of factors listed by the Court in *Smyth v. Ames* as properly to be taken into account in determining "fair value," original cost and present cost have survived, to become in each instance the core of a militant theory of valuation, each battling with the other for the exclusive favor of rate regulatory agencies. The irony of the situation is that while these two theories have held the center of the stage in both academic and professional debate, the victory in practice has gone to a method which combines, without theory or purpose, the wholly irreconcilable features of original cost and present cost. Of these latter theories of valuation, as distinct from the "hybrid" fair value which has prevailed in practice, present (reproduction) cost has won substantial, although waning, support from regulatory agencies, while original cost (actual prudent investment) has had all but unanimous backing in academic ranks and in late years has been gaining adherents in court and commission circles.¹²⁶

Before putting the rival claims of reproduction cost and prudent

¹²⁶ The case for prudent investment is ably put in Whitten, *Valuation of Public Service Corporations*; Mr. Justice Brandeis, concurring in *Southwestern Bell Telephone Co. v. Public Service Commission*, 302 U.S. 388 (1938); J. C. Bonbright, "The Economic Merits of Original Cost and Reproduction Cost," *Harvard Law Review*, Vol. 41 (1928), p. 593; New York State, *Report on Revision of the Public Service Commission Law* (1930), Vol. 1, p. 334 ff.; and Bauer and Gold, *Public Utility Valuation*; see also *Brief of Federal Power Commission, amicus curiae*, in *Railroad Commission of California v. Pacific Gas and Electric Co.*, 302 U.S. 388 (1938); and also in *Driscoll et al. v. Edison Light and Power Co.*, 307 U.S. 104 (1939). Reproduction cost has received its best theoretical defense from F. G. Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," *Harvard Law Review*, Vol. 37 (1923), p. 173; H. G. Brown, "Railroad Valuation and Rate Regulation," *Journal of Political Economy*, Vol. 33 (1925), pp. 500-30; and W. J. Graham, "Public Utility Valuation," *Journal of Business of the University of Chicago*, Vol. 7 (1934), No. 2. The most comprehensive treatment of valuation for all purposes is Bonbright, *The Valuation of Property* (1937).

It should be noted that in cases involving conservatively capitalized utilities, the stock and bond account is sometimes employed temporarily as a rate base. See *In re Wisconsin Telephone Co.—State-Wide Case*, 2 Wis. P.S.C.R. 106 (1932). See also the practice of the Massachusetts commission, referred to later in this section.

investment to the triple test of equity, economics, and expediency, it should be pointed out that the almost universally accepted program of basing utility rates upon costs is subject to certain economic infirmities irrespective of how the costs may be measured. The usual contention is that utility rates which express the cost of service will synchronize with prices based on costs in the rest of the economic system, and will, thus, perform properly, absolutely, and relatively the allocation function which all prices, as interdependent phenomena of a price-guided economy, are supposed to perform. The objective is unimpeachable, but it will be appreciated that the free movement of factors and prices which must serve as the necessary condition of such harmony exists precariously and with reference only to that small portion of public utility expenses and investment which, at any time, is free and uncommitted, whereas in public utility rate making it is the practice to set rates which are designed to produce a return upon all committed capital save that which is obviously not "used and useful." Before public utility rates based upon costs may be said to be "proper," functionally, there must be assumed an equilibrium of demand, prices, and costs (including a capital investment of exactly the correct amount and kind), in the actual and continuing existence of which, in the case of any single public utility, there is not the slightest reason to believe. Whereas in competitive industry the presence of a relatively high or relatively low return is taken to indicate a condition either of under- or over-investment, in the case of regulated public utilities such a return typically suggests merely that rates (based on cost) should be altered sufficiently to produce the required change in the return on existing investment—the magnitude and kind of which are not subjected to question.¹²⁷ In the utility field, fixed, immobile capital bulks large. The forced correspondence of rates to committed costs, however such costs may be measured, cannot therefore in the case of public utilities be accepted functionally as the equivalent of the tendency of market prices, in the area of competitive industry, to revolve about prospective costs.

¹²⁷ See B. W. Knight, "Control of Investment versus Control of Return in the Regulation of Natural Monopolies," *Quarterly Journal of Economics*, Vol. 44 (1930), pp. 263-85; and M. G. de Chazeau, *Quarterly Journal of Economics*, Vol. 51, p. 298 ff.

The force of these propositions is not to suggest that cost should be discarded as the basis for the level of public utility rates. The point, rather, is simply that costs do not serve automatically as a guide to the correct allocation of public utility resources. Reliance upon costs does serve, however, to keep utility prices somewhere within the range of (that is, not "too far" removed from) standards relied upon almost universally in our private enterprise economy, and, as well, within an acceptable area of "fairness" to utility owners and users. It remains now to consider whether the basic costs so employed in utility regulation, and the resulting rates, will be fairer, more economic, and more expedient if they reflect conditions of actual, original construction, or of hypothetical present-day reconstruction.

The use of reproduction cost as the measure of fair value involves the ascertainment by engineering appraisals of the cost to reconstruct the existing used and useful property, as of the date of the rate controversy, under existing conditions, employing present methods, and paying prevailing prices for labor, land, and materials. Reproduction cost appraisals require years to complete in the case of sizable properties, and qualified engineers representing the contending parties regularly arrive at estimates which differ by millions of dollars. The method is admittedly characterized by heavy expense, delay, lack of precision, and endless controversy.

The prudent investment (actual, original cost) method entails the ascertainment of the amount actually, honestly, and prudently spent in constructing the existing used and useful property. The source of the funds is usually regarded as immaterial, although occasionally it is sought to exclude from the valuation those portions of property which were constructed from public gift or subsidy, and, very infrequently, even to exclude portions of property constructed from reinvested earnings. The method stresses records and accounts as against estimates or appraisals. It involves the difficulty, diminishing as the years advance, of getting more than an estimate of the actual cost of older properties, and of making the necessary cost adjustments where properties have changed hands. The expense of reconstructing adequate cost and property records is not to be dismissed lightly, but the expense of maintaining such records

is relatively slight. The proposition that the prudent investment method is clearly superior to the reproduction cost method in the matters of speed, expense, and precision is scarcely open to argument.

It is argued in favor of reproduction cost that the owner of public utility property is entitled as a matter of fairness to a return on the current value of his property; that only in this way will the dollar invested in utility property bring a more nearly constant return in terms of purchasing power. If, between the time of original investment and the date of valuation, the level of prices generally has changed, his "real income" will be held constant only if his dollar income is correspondingly changed.¹²⁸ It may be answered, however, that to base earnings upon the increased value of the property which is made to reflect a rise in the price level, is really to give no help at all to those (bondholders and preferred stockholders) who have furnished most of the utility's capital, and to direct the entire extraordinary gain into the hands of common stockholders who receive all residual income. Something over 70 per cent of the capitalization of the public utility industry is in the form of fixed-return securities,¹²⁹ a condition largely attributable to the fact that utilities enjoy the security of monopoly under regulation. The effect of basing earnings upon reproduction cost is to concentrate upon the holders of common stock the whole gain resulting from the value increment arising over the entire capitalization when the price trend is upward, and greatly to endanger, if not completely to destroy, the equity of the common shareholders when the movement of prices is sharply downward. Just as regulation is not likely to permit the latter exigency to develop as a mere incident of a falling

¹²⁸ It should be noted that this consideration calls, logically, for a return to the public utility owner that varies with an index of general purchasing power, rather than with changes in the cost of reproducing his public utility property.

¹²⁹ See "Legal Appendix" by J. A. Austin, in 70 Cong. 1 sess., *Utility Corporations*, S. doc. 92 (1935), Part 73-A, pp. 141, 155. To the same effect see Bauer and Gold, cited above, pp. 389-90. It is probably the case that the capitalization of the telephone industry presents a different over-all picture. The preponderant method of financing the associated companies of the Bell system is by capital stock: "With the exception of 1920, common stock equity has usually represented more than half of the total liabilities of Associated Companies. Long-term debt seldom has exceeded 25 per cent of total liabilities." Federal Communications Commission, *Proposed Report Telephone Investigation* (1938), p. 492.

price level, so public policy need not support the magnifying of profits produced by a fortuitous rise in prices.¹⁸⁰

Reproduction cost can present no claims superior to those of prudent investment on the score of equity. Any scheme of compensation is fair provided only that it was reasonably anticipated at the time of investment. While the reproduction cost method has been used on many occasions and has been paid lip service even oftener than it has actually been made the basis of rates by regulatory commissions, it has never been held out to prospective investors in American utilities as the consideration for their contributions to utility capital, either by legislatures or by courts. There has never been a time since 1898 when the expectations of public utility investors had reason to encompass more than that the Supreme Court would support compensation at any time on the basis of its then current theory of valuation. Incidentally, the prospect which the use of a prudent investment base would present to utility stockholders during periods of changing prices would be no less fair or inviting than that regularly contemplated by all holders of fixed-return securities.¹⁸¹

Utility rates based on reproduction cost would appear to be somewhat more closely aligned with upward and downward movements in the general level of competitive prices than rates based on prudent investment, and hence to be better suited than prudent investment rates to carry out the economic functions which prices are sup-

¹⁸⁰ See the opinion of Commissioner Meyer, speaking for the majority of the Interstate Commerce Commission, in *Excess Income of St. Louis and O'Fallon Railway Co.*, 124 I.C.C. 3, 30 ff. (1927).

¹⁸¹ Many proposals have been developed to overcome the objection that it would be unfair to use the prudent investment method at this late date in view of the investments which have been made under the belief that the method could not, constitutionally, be imposed. These proposals usually distinguish between investments made prior to the stated date of "switchover" (to which reproduction cost or some other "lawful method" is to be applied) and all subsequent investment (which is to be taken permanently at its face figure into the rate base). These are, of course, schemes for alleviating the shock, real or simulated, of the transition ultimately to a complete prudent investment base. (See *Excess Income of St. Louis & O'Fallon Railway Co.*, cited above; Bauer and Gold, *Public Utility Valuation*, Chap. 18; and E. M. Bernstein, *Public Utility Rate Making and the Price Level* (1937), Chap. 10 and citations therein.) The rate bases contemplated by these proposals are usually termed "split inventory."

posed to perform.¹³³ This apparent advantage, however, is neither great nor important. It has been pointed out above that utility rates at best are almost inevitably out of line with the price structure in the rest of industry. It should be noted here that if it be desired to approximate competitive prices the valuation standard should be, not the current cost of reproducing the exact property now in use, but the cost of replacing the service by the most modern and economical plant and system.¹³³ But such a standard would be so completely subject to imagination, speculation, controversy, and uncertainty in its ascertainment as completely to invalidate it for practical purposes. As a matter of fact, prudent investment figures are not always so far removed as may be imagined from the level of reproduction cost: the investment in a going utility property as it stands on the date of any rate investigation is a composite of many separate investments made over a long period of years; and the process of deterioration and replacement of the several parts of the plant, together with system expansion, operates to keep the investment figures in the general vicinity of current price levels.¹³⁴ Fur-

¹³³ The contention, simply put, is that utility rates based on current costs (both operating and capital costs) will synchronize with prices which tend to express current costs elsewhere in the economic system. A variation of the argument is that the economic value of capital goods is a reflection of the current prices of the products which the capital goods are being used to produce; hence, variations in the *general* level of prices should be reflected in changes in the values of utility properties, and current utility rates (prices) should then be derived from these changing values. It seems clear that to vary the capital value of a specific piece of property because prices in general have changed, and then to employ this value to determine the rates (prices) of the services produced by this property is so to reverse the logic of causation as to render any achievement of the sought-for harmony wholly fortuitous.

¹³⁴ In discussing the logical relation of reproduction cost to public utility rates, J. M. Clark points out that the three pertinent hypotheses—reproduction cost as an index of normal competitive value; as a measure of “worth” (cost of replacement); and as a measure of return to stockholders varying with the price level—all seem to call either for a calculation of the “cost of a modern substitute plant” or for “prudent investment multiplied by an index of *general* price changes,” rather than for the usual engineering estimate of the cost of rebuilding the present plant. John M. Clark, *Social Control of Business*, 2d ed. (1939), p. 306 ff.

¹³⁵ On the assumption that the property of a utility is retired at a uniform rate, that depreciation is calculated on a straight line basis, and that the net investment is expanding 5 per cent annually, Bernstein estimates that “if the average length of useful life of the property were ten years, 20.9 per cent of the property in a prudent investment valuation would be valued at the prices of the current year,

ther, if it is desired more completely to vary the dollar compensation of utility owners during periods of changing prices, the change can be effected quite simply by raising or lowering the rate of return to be allowed on the prudent investment base,¹⁸⁵ and there is every reason to believe that both the net return to owners and the utility rates resulting from such action would be as nearly "economic" as returns and rates derived by the more ponderous procedure of a reproduction cost appraisal. As a matter of fact, the delay involved in arriving at a reproduction cost determination militates against the likelihood that reproduction cost rates can ever closely approximate current prices in periods of rapid change; and the cost and uncertainty which inevitably accompany the use of reproduction cost make both utilities and consumers reluctant to enter upon rate proceedings—thus forestalling the frequent rate changes that should be made if utility rates are to reflect variations in the level of prices in general.

It should be borne in mind that any really cataclysmic changes in the general price level could not be handled effectively, in the case of public utility rates, by employing either reproduction cost valuations or variable rates of return on prudent investment. If general price increases, for instance, should occur suddenly and on a tremendous scale the situation probably would call for the bold application of an emergency percentage increase directly to the rates themselves, without resort to any time-consuming intermediate procedure.

The conclusion, then, to which one is forced, is that reproduction cost and prudent investment are both makeshift devices to assist in setting utility prices that are "fair" as between owners and users, and in bringing utility prices into some kind of rough, over-all harmony with the level and long-run trends of prices in general; and that neither has a preponderant advantage in the performance

and 77 per cent of the property would be valued at the prices of the five most recent years. If the average length of useful life of the property were twenty years, 12.6 per cent of the property would be valued at the prices of the current year, and 52 per cent of the property would be valued at the prices of the five most recent years." Bernstein, *Public Utility Rate Making*, p. 124.

¹⁸⁵ An increase in the rate of return from 6 per cent to 12 per cent will achieve the same increase in compensation as would result from raising the "fair value" from \$10,000,000 to \$20,000,000.

of these functions. This leaves the choice one of practicality in terms of ease, expense, and expediency. On these counts reproduction cost has a notoriously bad record. It is not too much to say that in terms of cost, delay, uncertainty, and the arousing of animosity and contention, the performance of the reproduction cost method falls little short of a public scandal; by far the greater part of the grotesque and costly ponderosity which characterizes modern rate regulation is to be attributed directly and solely to the reproduction cost approach. There is no occasion here to recite details of the maneuvering in a typical rate proceeding.¹³⁶ The months and years spent by contending parties, commissions, and courts over such hypothetical factors as pricing, conditions of construction, labor performance, overheads, intangibles; the huge sums paid to engineers and accountants and other professional experts, directed in their claims and counter-claims by high-priced attorneys skilled in the art of rate case strategy; the highly charged, politico-legal-mystic character of the whole performance—this is all accepted practice under the reproduction cost method, yet it seems far removed from the essential business of setting the price of a single service in a single community under conditions of simple monopoly.¹³⁷

Conversely, on all points relating to expediency the prudent investment method promises an almost revolutionary improvement in the process by which over-all rate levels are established. The origi-

¹³⁶ See C. E. Troxel, "Chronology of Two 'Old Age' Rate Controversies," *Journal of Land and Public Utility Economics*, Vol. 14 (1938), p. 99; Felix Frankfurter, *The Public and Its Government* (1930), Chap. 3; *Brief of the Federal Power Commission, amicus curiae in Railroad Commission of California v. Pacific Gas and Electric Co.*, No. 804 U.S. Supreme Court, October Term 1936, p. 30 ff. (302 U.S. 388 (1938)); separate concurring opinion of Mr. Justice Brandeis in *St. Joseph Stockyards Co. v. United States*, 298 U.S. 38, 73 (1936), and see the strictures on rate case delay by Mr. Justice Black, dissenting in *McCort et al. v. Indianapolis Water Co.*, 302 U.S. 419, 423 (1938).

¹³⁷ A good deal of the objection to the use of reproduction cost on the grounds here considered would be obviated if reproduction cost were determined by the use of index numbers rather than appraisals. It seems probable that the use of index numbers *properly constructed* would be held constitutional despite the rejection of a particular index method in *West et al. v. Chesapeake & Potomac Telephone Co. of Baltimore*, 295 U.S. 662 (1935). The difficulty is, however, that the proper construction of utility reproduction cost index numbers is, under current practice, moving so completely in the direction of re-pricing the particular property under exactly prevailing conditions as to approach the old type engineering appraisals in expense and delay.

nal installation of prudent investment records would occasion expense and controversy, but, once instituted, their maintenance and use would involve only a fraction of the cost and dispute which regularly attend the use of reproduction cost appraisals, and the time required for a rate determination could be stated more pertinently in terms of days rather than months.

A word should be said at this point with reference to the hybrid "fair value" ("trance") method which, in practice, is accepted openly and used far more frequently than both reproduction cost and prudent investment. The "fair value" method consists of an examination by the commission of evidence relating to reproduction cost and prudent investment, together with evidence of intangible values and observed condition of the property, the application of judgment whose processes defy analysis or description, and the selection of a final value figure which bears no derivative relation to any figures in evidence and no ascertainable relation to any functional purpose of rate making. The determination is typically accompanied by explicit denials that a formula was employed or that the result is a compromise, together with a statement that the commission is quite incapable of retracing and setting forth the processes by which the value figure was reached.¹⁸⁸ "Fair value" so determined is the embodiment of reproduction cost with most of its infirmities; yet, since reproduction cost is here alloyed with other factors without aim or reason, it conveys none of its redeeming pur-

¹⁸⁸ "Value must be determined by the exercise of reasonable judgment, having for its basis due consideration of all the relevant facts adduced in evidence. . . .

"Each element of value must be given proper consideration and, in order to do so, the consideration must be just, adequate and complete, viewed in the light of all the facts, conditions, and circumstances in evidence.

"The thing sought is the fair value of the utility property used and useful in the public service, and this cannot be found by applying a fair value to each operating unit and then by addition, obtain the total value thereof, but it requires that a comprehensive view of all the elements of property, both tangible and intangible, to be taken and considered, 'not as a separate thing, but, as an inseparable part of one complete harmonious entity, and exercising a reasonable judgment as to the value of that entity,' having in mind the cost of reproduction new, the cost of reproduction less depreciation, depreciation, actual or historical cost of all the property in place, the actual or historical cost of all the property used and useful in public service at the date of the inquiry, service capacity, service being rendered, and all the other elements of value." *Re Boise Water Co.*, P.U.R. 1926 D, 321, 357-58 (Idaho Public Utilities Commission, 1926), a typical case.

posiveness to the net result. The peculiar contribution of the "fair value" method to rate regulation is indecision and confusion.

Against this background, the story of the fate of "fair value" at the hands of the Supreme Court may be resumed. Following *Smyth v. Ames*, and until the entry of the United States into the World War, the contending schools of valuation theory presented their views with vigor in individual cases, but the general public was not greatly aroused, and proceedings on the scale common today were unknown. The general price level was stable, and sharp differences between prudent investment and reproduction cost valuations of particular properties had yet to develop. The Supreme Court's decisions at this time suggest a naive unawareness of the situation into which it had precipitated itself; it spoke with sureness, but it gave no certain answers and it offered no positive guide to regulatory authorities. The decisions made it clear that extravagant claims founded on fictitious "investments" need not be validated, and it appeared, as well, that, since "value" was to be considered as of the time of the rate proceedings, the utility was probably entitled to base its claims on at least some portion of any increase in "value" that might have accrued above earlier investment.¹³⁹

The keynote of the period, as, indeed, of all subsequent periods, was struck in the statement of Mr. Justice Hughes in the Minnesota Rate cases that fair value "is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."¹⁴⁰ This pronouncement, made in 1913, could have been offered with equal accuracy in 1898 or in 1938, as a statement of the Court's valuation position. The Court's Minnesota case ruling seems to epitomize indecision, but in the light of later years, its apparent uncertainty must be viewed, not as a temporary attitude pending the gaining of greater understanding, but as a calculated, studied uncertainty reflecting the conviction that

¹³⁹ However, the Court refused to extend its benediction to an application of reproduction cost carried to its logical conclusion, its common sense standing as a barrier to acceptance of reproduction "values" enhanced by land value "multipliers" in *Minnesota Rate Cases*, 230 U.S. 352 (1913); and "pavement over mains" in *Des Moines Gas Co. v. Des Moines*, 238 U.S. 153 (1915). Both of these claims, however, are easily within the "logic" of reproduction cost. But see Clark, *Social Control of Business*, pp. 306-12.

¹⁴⁰ 230 U.S. 352, 434 (1913).

“fair value” for rate making must be made to be the unpredictable product of incalculable considerations. The Court’s uncertainty in the determination of “fair value” had begun to assume a positive quality.¹⁴¹

The war-time and post-war disturbance of the level of prices, which reached their peak in 1920 and then, after a precipitous drop and readjustment, continued on a high plateau until 1929, afforded the occasion for the most spectacular episodes of the perennial battle between the formal valuation theories. The opening gun was fired in the Galveston street railway case when the Supreme Court approved a rate order based on a valuation with prices taken at a point between pre-war levels and a modified estimate of post-war prices, the decision constituting a victory for a weakened reproduction cost as against reproduction cost at full “spot” prices.¹⁴² The movement was under way, however, and in the Southwestern Bell case the Court refused to sustain rates based on a 1919 valuation made by the Missouri Public Service Commission, when it was established that “. . . the Commission undertook to value the property without according any weight to the greatly enhanced costs of material, labor, supplies, etc., over those prevailing in 1913, 1914 and 1916.”¹⁴³ Mr. Justice Brandeis saved the day, strategically, for the cause of prudent investment, by concurring, separately, with the majority’s judgment of reversal, on the ground that the Commission’s order prevented “. . . the utility from earning a fair return on the amount prudently invested in it.”¹⁴⁴ None the less an accurate appreciation

¹⁴¹ The leading valuation cases during this period were *San Diego Land and Town Co. v. National City*, 174 U.S. 739 (1899); *San Diego Land and Town Co. v. Jasper*, 189 U.S. 439 (1903); *Stanislaus County v. San Joaquin and King’s River Canal and Irrigation Co.*, 192 U.S. 201 (1904); *Knoxville v. Knoxville Water Co.*, 212 U.S. 1 (1909); *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Cedar Rapids Gas Light Co. v. Cedar Rapids*, 223 U.S. 655 (1912); *Minnesota Rate Cases*, 230 U.S. 352 (1913); *Missouri Rate Cases*, 230 U.S. 474 (1913); and *Des Moines Gas Co. v. Des Moines*, 238 U.S. 153 (1915).

¹⁴² *Galveston Electric Co. v. Galveston*, 258 U.S. 388 (1922). Earlier cases in the period of rising prices, in which the issues here under discussion did not appear, were *Denver v. Denver Union Water Co.*, 246 U.S. 178 (1918); *Lincoln Gas and Electric Light Co. v. Lincoln*, 250 U.S. 256 (1919); and *Newton v. Consolidated Gas Co.*, 258 U.S. 165 (1922).

¹⁴³ *Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276, 287 (1923).

¹⁴⁴ The same, p. 289. The point to note is, of course, that if a valuation is invalid under both the reproduction cost and prudent investment standards, a pro-

of the valuation spirit pervading the Court at this time (1923) can be had only by attending carefully to the words of Mr. Justice McReynolds, which were in the best reproduction cost tradition.¹⁴⁵

The reproduction cost method reached its highest point on the scale of judicial acceptance in the McCardle case in 1926, which came very close to identifying "fair value" with spot reproduction cost. A valuation found by the Indiana Public Service Commission employing the reproduction cost method, but applying average prices for the ten years ending in 1921, was enjoined by a lower federal court; and Mr. Justice Butler, speaking for six members of the Supreme Court,¹⁴⁶ affirmed the lower court and gave verbal support to the principle of reproduction cost at prices instantly prevailing. While the facts did not permit a clear holding that any valuation lower than a spot reproduction cost figure was confiscatory, the opinion suggests that the Court was on the verge of establishing a positive rule of valuation, and that prudent investment was in the discard.

However the achievement of the McCardle case be construed or appraised, the fact remains that it has never since been repeated. The recession began soon afterward, and in no subsequent case has the Court moved to lift the valuation problem from the morass of litigious confusion in which it has floundered since 1898. Even the relatively high level of prices that prevailed during the twenties, and the consequent demand by utilities for rate increases, were not sufficient to rid the Court of its hybrid-judgment complex. By

nouncement by a majority of the Court that the valuation is unconstitutional because it is lower than that dictated by reproduction cost possesses the force only of a dictum—the facts do not permit it to acquire the status of a binding decision. Justice Holmes joined Justice Brandeis in this opinion.

¹⁴⁵ Two decisions, flatly contradictory on their facts, although harmonious on the surface, which the Court handed down on the same day, at this time, suggest that most of the members of the Court were hopelessly confused, or indifferent. See *Georgia Railway and Power Co. v. Railroad Commission of Georgia*, 262 U.S. 625 (1923); and *Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923).

¹⁴⁶ *McCardle et al. v. Indianapolis Water Co.*, 272 U.S. 400 (1926). Mr. Justice Holmes concurred only in the decision; Mr. Justice Brandeis interpreted the case as supporting spot reproduction cost in contravention of the rule of *Smyth v. Ames*, and wrote a vigorous dissenting opinion in which he was joined by Mr. Justice Stone.

1929, Mr. Justice McReynolds was saying again, for the majority, "No doubt there are some, perhaps many, railroads the ultimate value of which should be placed far below the sum necessary for reproduction"—and this in a case holding that the "law of the land" required that value be determined upon a "consideration of present costs along with all other pertinent facts,"¹⁴⁷ but, as usual, offering no clue as to the weight—or as to the considerations bearing on the weight—to be accorded to the "pertinent facts."

From this position the Court has since shown no tendency to depart, but it has managed to add new incongruities to the existing confusion. Valuation moved into its newest phase under the direction of Chief Justice Hughes, speaking for six members of the Court in *Los Angeles Gas and Electric Corporation v. Railroad Commission of California*,¹⁴⁸ in 1933; and the decision was heralded as announcing the long-awaited self-imposed limitation on the reviewing function of the Court, which would unshackle the processes of administrative valuation.¹⁴⁹ The California Commission had reduced gas rates on the basis of two valuations—an "historical cost" and a typical "fair value," on which it was estimated the new rates would produce 7.7 per cent, and 7 per cent respectively. On appeal, the Supreme Court sustained the Commission's order.

The majority opinion recited the customary phrases, and indicated a willingness to attach special weight to historical cost because much of the property had been developed in recent years. But, it was in dealing with the Corporation's claimed allowance for "going value" that the Court displayed its apparent leniency toward commission rulings. The Court discussed the Corporation's claim at length, but concluded that the "fair value" of \$65,500,000 included a substantial margin over the "historical cost" which, itself, was largely taken at price levels higher than those immediately obtaining, and also included property no longer needed to serve

¹⁴⁷ *St. Louis and O'Fallon Railway Co. v. United States*, 279 U.S. 461, 487 (1929).

¹⁴⁸ 289 U.S. 287 (1933). Mr. Justice Sutherland joined in a dissenting opinion written by Mr. Justice Butler. Mr. Justice Van Devanter did not participate.

¹⁴⁹ See Bauer and Gold, *Public Utility Valuation*, pp. 106 and 454; and I. R. Barnes, "Federal Courts and State Regulation of Utility Rates," *Yale Law Journal*, Vol. 43 (1934), p. 417.

the public. This excess amount, the Court said, could "appropriately be assigned to elements of value which may not have been fully covered. . . . The fact that this margin in the rate base was not described as going value is unimportant." The item immediately in issue was slight but it served to elicit a pronouncement ostensibly of great significance, namely, that constitutionality is concerned not with the method, but solely with the result of valuation. "The legislative discretion implied in the rate making power," said Chief Justice Hughes,

necessarily extends to the entire legislative process, embracing the method used in reaching the legislative determination as well as that determination itself. We are not concerned with either, so long as constitutional limitations are not transgressed. When the legislative method is disclosed, it may have a definite bearing upon the validity of the result reached, but the judicial function does not go beyond the decision of the constitutional question. That question is whether the rates as fixed are confiscatory.¹⁵⁰

Henceforth, it appeared, commissions might employ any valuation method that came to hand; as long as they achieved constitutional results, the theory or method or technique of reaching the result was of no concern to the Court.

But there remained a substantial barrier to the acceptance of the Los Angeles decision as a charter of administrative freedom: "fair value" is not, in itself, a determinate concept; it has no meaning or measure apart from the theory or method which it expresses and which alone gives it size and substance. It is of little point that the Court is willing to permit a regulatory commission to ascertain "fair value" by any method it chooses, as long as the "fair value" so determined must, in any event, be as large as that "fair value" which the Court by *its* method (as yet undetermined and unannounced), finds to be the constitutional minimum.¹⁵¹ It is difficult to escape the conclusion that the Court has further muddled an

¹⁵⁰ 289 U.S. 287, 304-5, 317 (1933).

¹⁵¹ Specifically, what real freedom or discretion did the California Commission actually exercise when, on grounds of principle, it adopted the historical cost method and rejected going concern value; and was sustained by the Court only because the result was as large as it would have been if the Commission had adopted some other method (nature not disclosed) and had made a sufficiently large allowance (amount not named) for going concern value?

already confused situation by giving the impression that method is of no constitutional significance, when, in fact, the Court is forced by the very nature of the issue to employ method as the test of constitutionality.

Indeed, only two years later, over a pointed dissent by Mr. Justice Stone, the Court implicitly abrogated the Los Angeles rule, and invalidated telephone rates set by the Maryland Commission on a valuation derived by an "inapt and improper method," although there was no showing of substantive confiscation.¹⁵² This action of the Court, in turn, led a lower federal court to declare a California Commission valuation to be confiscatory, on the sole ground that proper evidence of reproduction cost had not been considered; whereupon the Supreme Court, in line with the Los Angeles case and despite the Baltimore decision, ruled that "the mere correctness of the method and reasoning" has no bearing on constitutionality, and remanded the case on the ground that the issue "whether the rates as fixed by the Commission's order are confiscatory" had not been determined by the court below.¹⁵³

Thus, forty years after the decision in *Smyth v. Ames*, a regulatory commission seeking to fix utility rates on an equitable, economic, and expedient basis, cannot be sure in advance of a long-drawn-out expensive appeal to the highest judicial tribunal, whether or not it is within the bounds of constitutionality. It knows that the Court denies any interest in the method employed in arriving at "fair value." But it is also aware that the result produced by its method must be at least as high as the "value" which the Court

¹⁵² *West et al. v. Chesapeake and Potomac Telephone Co. of Baltimore*, 295 U.S. 662 (1935). The case is significant for the future of the reproduction cost rule. The Court struck down the Commission's substitution of index numbers for an appraisal in calculating reproduction cost, and, while not condemning the index approach *per se*, placed such limitations around its use as to dissipate its principal advantages. Incidentally Mr. Justice Roberts went out of his way to identify rate value with eminent domain value, a curious confusion at this late date.

In his dissenting opinion in this case, Mr. Justice Stone took occasion to remark that "in assuming the task of determining judicially the present fair replacement value of the vast properties of public utilities, courts have been projected into the most speculative undertaking imposed upon them in the entire history of English jurisprudence" (p. 689).

¹⁵³ *Railroad Commission of California v. Pacific Gas and Electric Co.*, 302 U.S. 388, 394, 401 (1938). On remand, the lower court sustained the Commission's valuation and rate order. 6 *U.S. Law Week* 139 (1938).

will set up for test purposes by a method still undetermined and unannounced, and which will contain mutually inconsistent and irreconcilable elements joined together without pattern in completely indeterminate and unpredictable proportions. The commission knows, from actual cases, that if a financially successful utility appeals from its order, claiming, on the basis of a logical application of the "fair value" rule, that it is constitutionally entitled to charge more than, as a commercial concern, it has ever been willing to charge, the Court may, in sheer disgust, sustain the commission.¹⁵⁴ But while this knowledge may induce utility attorneys to be more restrained in preparing their cases for trial, it can scarcely be translated into a positive principle for the guidance of commissions.

It cannot be too strongly emphasized that the Court's "fair value" rule reflects no purpose, and finds no justification in either economics or equity—and certainly none in expediency. It seems probable, as one critic has pointed out, that in embracing revelation as its technique of rate value determination the Court, despite its professions, has become ensnared in a circular reasoning, eminent domain philosophy.¹⁵⁵ In any event, to use Mr. Justice Frankfurter's phrase, "the force of reason, confirmed by events, has gradually been rendering . . . [the *Smyth v. Ames*] formula moribund by revealing it to be useless as a guide for adjudication."¹⁵⁶

¹⁵⁴ *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151 (1934). And see *Dayton Power & Light Co. v. Public Utilities Commission of Ohio*, 292 U.S. 290 (1934).

¹⁵⁵ R. L. Hale, "The 'Fair Value' Merry-Go-Round, 1898 to 1938: A Forty-Year Journey from Rates-Based-on-Value to Value-Based-on-Rates," *Illinois Law Review*, Vol. 33 (1939), p. 517, quoting Mr. Justice Butler's statement in *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470, 479 (1938), that rate value "is measured, or at least significantly indicated, by the profitableness of present and prospective service . . . at rates that are just and reasonable as between the owner of and those served by the property."

¹⁵⁶ Concurring separately in *Driscoll et al. v. Edison Light and Power Co.*, 307 U.S. 104, 122 (1939). Leading cases since 1933, not cited above, are: *Clark's Ferry Bridge Co. v. Public Service Commission of Pennsylvania*, 291 U.S. 227 (1934); *Columbus Gas and Fuel Co. v. Public Utilities Commission of Ohio*, 292 U.S. 398 (1934); *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1)*, 294 U.S. 63 (1935); *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 2)*, 294 U.S. 79 (1935); *Ohio Bell Telephone Co. v. Public Utilities Commission of Ohio*, 301 U.S. 292 (1937); and *United Gas Public Service Co. v. Texas, et al.*, 303 U.S. 123 (1938).

Turning from court decisions to administrative practice, we find that the difficulty of determining whether commissions have really incorporated in their rulings on valuation the propositions supported in their opinions makes questionable any precise statement of their position. The situation is not made clearer by the erratic inconsistencies that have characterized their policies. In general, it may be said that the years since *Smyth v. Ames* have seen many and devious shifts in commission practice, and that the only constant feature has been the common recital of the "fair value" ritual irrespective of the procedures actually employed. At the outset, the issues were not clear; cost records were incomplete and unreliable, and experience had not yet disclosed the excesses to be invited by the reproduction cost method. The sharp rise in the price level brought on by the World War induced a sudden and substantial interest in rate regulation, and afforded a good case for basing rates on reproduction cost. During the World War and the decade that followed, commissions made their most extensive use of the reproduction cost method. There were many protests against its use, however, even in cases in which it was actually employed, and much of its apparent acceptance was a matter of form rather than substance.¹⁵⁷ While a large number of cases (including all of

¹⁵⁷ See Bernstein, *Public Utility Rate Making*, Chaps. 5, 6, and 7, for a discussion of various expedients—the use of average unit prices, corrective indexes, and split inventories—adopted by commissions to avoid the full effect, while retaining the appearance, of an acceptance of the reproduction cost doctrine.

In his concurring opinion in *Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*, 262 U.S. 276 (1923), at 301, footnote 14, Mr. Justice Brandeis gives the following information bearing on the predominant element "considered" by commissions in rate cases reported in *Public Utility Reports* for 1920, 1921, 1922, and 1923 (to March 1):

Reproduction cost at unit prices prevailing at date of valuation	5 cases.
Reproduction cost at unit prices prevailing at some date, or the averages of some period, prior to the date of valuation	28 cases.
Reproduction cost at unit prices prevailing at some date not specifically stated	12 cases.
Reproduction cost of an inventory of a prior date at prices prevailing at that date or prior thereto, plus subsequent additions at actual cost (so-called split inventory)	22 cases.
Reproduction cost on basis of future predicted prices	3 cases.
A prior valuation by the commission plus actual cost of subsequent additions	102 cases.
Actual original cost (both initial cost and additions)	85 cases.
Original cost arbitrarily appreciated	6 cases.

the cases of certain commissions) were decided flatly on a reproduction cost basis, the more usual method was to accord consideration to a modified reproduction cost figure as one among an assortment of irreconcilable elements to be transmuted into "fair value" by the alchemy of mystic judgment.

Despite the favor in which reproduction cost was held by commissions under pressure from the Supreme Court, the split inventory method found increasing support in the twenties, and smoothed the way for prudent investment. Several commissions based rates upon prudent investment in isolated cases during the reproduction cost era, and the Massachusetts Commission, although it has never proceeded formally on an investment basis, has achieved considerable attention by reason of its operation in what might be termed an investment "atmosphere" throughout its entire rate-making history.¹⁶⁸ The California Commission has worked steadily toward the progressive abandonment of reproduction cost for the past two decades; and Wisconsin and New York regularly use "book value" and "original cost" as the starting point in rate negotiations as well as the measure of fair value in many formal cases.

The depression years have softened slightly the opposition of utilities to the use of prudent investment and there is at the present time a clearly perceptible swing of regulatory sentiment in its favor throughout the country.¹⁶⁹ Great impetus has been given to the prudent investment movement by recent state legislation, acts of Congress, and rulings of several of the newer federal administrative commissions. Paced by the Wisconsin and New York Commis-

Historical cost of prudent investment	27 cases.
Book cost or investment	28 cases.
Bond and stock capitalization	12 cases.
Determination and classification of method impossible	36 cases.

¹⁶⁸ See Barnes, *Public Utility Control in Massachusetts*. Careful control of security issues has made it possible for the Massachusetts Commission to develop from the outset an accounting, as distinct from a speculative appraisal, approach to rate regulation.

See, also, N.A.R.U.C., *Proceedings of Forty-ninth Annual Convention (1937)*, p. 174.

¹⁶⁹ It should not be overlooked that at the time of the *Smyth v. Ames* decision in 1898, following a long period of declining prices, reproduction cost was supported by representatives of the public, and the use of original cost was advocated by utility spokesmen.

sions,¹⁶⁰ the Federal Communications Commission, on June 19, 1935 (to be effective January 1, 1936), and the Federal Power Commission, on June 16, 1936 (to be effective January 1, 1937), promulgated uniform systems of accounts for the utilities subject to their authority, designed to establish on books of record the original cost (estimated, if not known) of utility property to the company first devoting such property to the public service. While it is true that accounting provisions requiring the ascertainment and recording of original cost figures do not necessarily mean that rate bases will henceforth be established by reference solely to original cost, the institution of such provisions must serve as the necessary foundation for any really substantial and effective use of prudent investment. Of greater immediate significance is the indication which these provisions give as to the direction of prevailing regulatory sentiment. There has been a high degree of cooperation between federal and state commissions in the development of original cost accounting, 27 states having promulgated accounting systems for electric utilities in line with the federal pattern. Several states are now in the process of building up continuous property records for the utilities under their jurisdiction. A New York statute, passed in 1934, provides for the basing of temporary rates on original cost, and similar legislation was passed in Pennsylvania in 1937.¹⁶¹ One may agree that commission attitude,

¹⁶⁰ *In re Revision of a Uniform Classification of Accounts for Class A Electric Utilities*, 1 Wis. P.S.C. 257, Nov. 24, 1931 (effective Jan. 1, 1932); and Public Service Commission of New York, *Uniform System of Accounts for Electric Corporations*, Nov. 23, 1933 (effective Jan. 1, 1934), 3 P.U.R. (N.S.) 320; and *New York Edison Co. v. Maltbie*, 244 App. Div. 685, 281 N.Y. Supp. 223 (1935), affirmed in 271 N.Y. 103 (1936). See also, Federal Communications Commission, *Uniform System of Accounts for Telephone Companies* (1935), Account 100.1, 2, 3, and 4, and Instructions 3 (S1) and 21 (B), pp. 5, 12, 27; Federal Power Commission, *Uniform System of Accounts Prescribed for Public Utilities and Licenses*, effective Jan. 1, 1937, Definition 29, Accounts 100.1, 3, 4, 5, and 107, and Instructions 2A-E, pp. 6, 18-19, 38-39; and *American Telephone and Telegraph Co. v. United States*, 299 U.S. 232 (1936). Accomplishments under the Federal Power Commission requirements are detailed in the Commission's 19th Annual Report, pp. 19-20; and announcement of similar regulations for the natural gas industry is noted therein, pp. 18-19. For the story of the part played by the states, see New York Public Service Commission, *Annual Report, 1938*, Appendix A.

¹⁶¹ Section 114 of the New York Public Service Law, Laws of New York, 1934, Chap. 287, held constitutional by the New York Court of Appeals in *Bronx Gas*

and particularly the expression of that attitude, is uncertain and confused, but it is clear that the trend is toward prudent investmentmen.¹⁶²

and Electric Co. v. Maltbie, et al., 271 N.Y. 364 (1936). Section 72 (Chap. 212) of the law requires the Commission, in fixing gas and electric rates, to give "due regard" to "a reasonable average return upon capital actually expended." Sections 309 and 310 of the Pennsylvania Public Utility Law (Act of May 1937, Laws of Pennsylvania, 1937; No. 286), sustained in *Beaver Valley Water Co. v. Driscoll* (U.S.D.C., W.Pa.), 7 *U.S. Law Week* 101 (1939), approving temporary rates calculated to return 6 per cent on original cost less accrued depreciation.

¹⁶² The valuation of a public utility property involves a host of problems subsidiary to the main issue discussed above. Questions of inventory, condition of the property, land values, overheads, working capital, going value, etc., together with questions ancillary to each of these, arise in practically every case and add to the cost, confusion, and delay. Brief mention may be made here of two troublesome items—depreciation and going value. Irrespective of the valuation method, it is understood that the property is being valued in its "present condition," and that rates have been calculated to cover annual depreciation as an operating expense, and thus to reimburse the utility for capital used up; and, hence, that a figure representing the existing depreciation—whether due to physical or functional causes—is properly to be deducted from "cost new" to arrive at a rate base. There has been a voluminous literature on the theory of depreciation deductions from reproduction cost and from investment. See, e.g., J. C. Bonbright, "Depreciation and Valuation for Rate Control," *Quarterly Journal of Economics*, Vol. 41 (1927), p. 185; and his later discussion in *Valuation of Property*, Vol. 2, pp. 1126 ff. Emphasis upon depreciation as an accounting rather than a value concept has helped to clear the atmosphere. While there is controversy about deductions for depreciation in the case of large, diversified utility properties, the main disputes in practice have centered around the method (sinking-fund or straight line) and basis (reproduction cost, "fair value," or actual cost) of the annual charge, and whether the accrued depreciation to be deducted in valuation proceedings is to be measured by engineering observation or by age-life calculations. Court and commission practice has favored deduction from the rate base for depreciation under normal conditions, except where the "sinking fund" method of calculating depreciation has been employed. Engineering inspections to determine the extent of depreciation are responsible for long delays in rate proceedings, and result in widely divergent judgment estimates of "actual per cent condition." Courts, however, have insisted that prime reliance be placed upon observation as distinct from records, and this, together with the common confusion of "depreciation" with "deferred maintenance," and "depreciation reserve" with "replacement fund," and the tendency to ignore the interdependence of depreciation deductible from the rate base and the annual charge for depreciation, constitute phases of the problem which cry most urgently for improved understanding and treatment. In recent years commissions have assumed more active control of current depreciation practices, in anticipation of future rate proceedings. Leading Supreme Court cases are *Knoxville v. Knoxville Water Co.*, 212 U.S. 1 (1909); *Pacific Gas and Electric Co. v. San Francisco*, 265 U.S. 403 (1924); *United Railways and Electric Co. v. West*, 280 U.S. 234 (1930); *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930); *Los Angeles Gas and Electric Corp. v. Railroad Commission of California*, 289 U.S. 266 (1933); and *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 157 (1934). Two first-rate presentations of principles, court and com-

So much for valuation. It is difficult to understand why, since the rate of return is fully co-ordinate with the rate base in the calculation of total return to be allowed to utility investors, it has received so little attention at the hands of regulatory commissions. Whereas "fair value" is customarily debated on the witness stand for weeks, the hearings on rate of return will rarely last beyond a day; and a commission opinion which devotes dozens of pages to valuation will typically dispose of rate of return in less than a page. Little evidence is developed for the guidance of the commission, and the customary allowance (ranging from $5\frac{1}{2}$ to 8 per cent) is "ordinarily a conventional rate, expressed in round numbers . . . usually . . . selected in what may justly be termed an 'arbitrary' manner."¹⁶³

mission policies, and recommendations, are Public Service Commission of Wisconsin, *Depreciation—A Review of Legal and Accounting Problems* (1933); and Perry Mason, *Principles of Public-Utility Depreciation* (1937). And see "Report of Committee on Depreciation" in N.A.R.U.C., *Proceedings of Fiftieth Annual Convention* (1938), p. 438 ff.; and *Depreciation Charges of Telephone and Steam Railroad Companies*, 177 I.C.C. 351 (1931).

One of the most interesting and annoying of the valuation items is "going value"—the alleged value (to be added to the physical appraisal) of an operating, earning, going, concern in excess of the value of the same physical property standing only ready to operate and earn. It has been demonstrated on many occasions that "going value" is a market (exchange) value concept and, as such, has no proper place in a rate base. Strong claims have been made for inclusion of going value as the "cost of establishing business," but it seems now to be recognized that the costs in question are properly to be treated as operating expenses or as appropriate for consideration in adjusting the risk element in determining the rate of return. After a long period of development, the Supreme Court has arrived at the point of insisting that going value be "considered" in every case, but ruling that it need not be added as a separate named amount unless its existence is proved—and rejecting as proof every method and calculation which has yet been offered. Business development expenditures, such as advertising and training of staff, are to be covered by operating expense allowances, however. See Bonbright, *The Valuation of Property*, Vol. 2, p. 1146 ff.; L. R. Nash, *The Economics of Public Utilities*, 2d ed. (1931), p. 162 ff.; and B. W. Lewis, "Going Value and Rate Valuation," *Michigan Law Review*, Vol. 26 (1928), p. 713. Leading cases are *Cedar Rapids Gas Light Co. v. Cedar Rapids*, 223 U.S. 655 (1912); *Des Moines Gas Co. v. Des Moines*, 283 U.S. 153 (1915); *Denver v. Denver Union Water Co.*, 246 U.S. 178 (1918); *Galveston Electric Co. v. Galveston*, 258 U.S. 388 (1922); *McCardle v. Indianapolis Water Co.*, 272 U.S. 400 (1926); *Los Angeles Gas and Electric Co. v. Railroad Commission of California*, above; *Columbus Gas and Fuel Co. v. Public Utilities Commission of Ohio*, 292 U.S. 398 (1934); *Denver Union Stockyard Co. v. United States*, 304 U.S. 470 (1938); and *Acker et al. v. United States et al.*, 298 U.S. 426 (1936).

¹⁶³ Federal Communications Commission, Telephone Rate and Research Department, *The Problem of the "Rate of Return" in Public Utility Regulation* (1938), p. 7.

Although many controversies have been cast up by the rate of return problem, in only a few of these have commissions been able to translate their conclusions identifiably into specific allowances. To what extent should enterprise risks find expression in the allowable rate of return, and in what manner: through capitalization and amortization of losses, or through the possibility of profits sufficient to induce acceptance of the possibility of losses? Is efficiency, for which management is primarily responsible, properly (and effectively) to be rewarded by allowing a higher return to stockholders? To what extent should the rate of return be influenced in individual cases by any peculiarities in the capital structure or financial history of the particular utility involved? Should a fixed return be contracted for with each group of each class of security holders in each utility?

A recent report summarizes the principles announced by the judiciary in setting the constitutional minima of non-confiscatory rates of return, as follows:¹⁶⁴

1. A proper rate of return (percentage) or return (compensation) is a flexible concept and not a static rule.
2. What return is proper necessitates the exercise of "enlightened judgment" in each case.
3. Current conditions are controlling, and general conditions affecting all business should be considered.
4. The return should be sufficient to assure confidence in the financial soundness of the utility, to maintain its credit and to attract the required capital.
5. The propriety of the allowed return depends largely upon the circumstances, locality and risk of the utility enterprise.
6. The return should be equal to that generally being made at the same time and in the general region on investments in other enterprises which have corresponding risks.
7. The historical cost of money to the utility, and the current cost of money should be considered.
8. A utility's corporate structure, financial history and past operations should be considered.
9. The return should accomplish, among other things, due recognition of efficiency or lack of efficiency in management.
10. The future prospects of the utility, its taxes and development,

¹⁶⁴ Federal Communications Commission, Telephone Rate and Research Department, *Factors Underlying the "Rate of Return" in Public Utility Regulation, as Disclosed in Court and Commission Decisions* (1938), pp. vi-vii.

the potential stimulation from reduced rates and the character of the service should be considered.¹⁶⁵

Compilations of rates of return allowed by commissions since 1915 show composite percentages rising from 7 to 8 per cent in the early twenties, and declining to 7 per cent by 1929, and to about 6 per cent by 1937.¹⁶⁶ Since returns were allowed on a great variety of bases—ranging from actual investment, through “fair value” to spot reproduction cost plus liberal intangibles—it is apparent that too much significance cannot be attached either to the absolute size of, or to the considerations ostensibly reflected in, these allowances.

Recent rate of return theory and practice in certain quarters have emphasized the use of objective, statistical cost-of-capital data, in an effort to determine a rate of return which will so protect the utility's credit that an adequate flow of capital into the business will be maintained. Data bearing on the financial history of the utility, the relationship of its capitalization to its investment, the historical costs of debt and preferred stock capital, the current market yields on outstanding securities, the cost of financing by different classes of securities, bond and stock yields and capital costs to other comparable companies, the effect of special risks on investor demands, and ratios of earnings to market price of common stock, are all thought to throw light on the problem.¹⁶⁷ It is still not universal, however, to substitute careful study and analysis for arbitrary “customary allowances”; to think of the total return, and hence to treat valuation and rate of return as an integrated problem, and their respective standards as mutually interrelated; and to stress the real financial needs of the utility instead of (or as the measure of) its formal legal rights.

¹⁶⁵ Leading cases on the rate of return are *Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923); *United Railways and Electric Co. v. West*, 280 U.S. 234 (1930); *Dayton Power and Light Co. v. Public Utilities Commission of Ohio*, 292 U.S. 227 (1934); and *Driscoll et al. v. Edison Light and Power Co.*, 307 U.S. 104 (1939).

¹⁶⁶ See Smith, *The Fair Rate of Return in Public Utility Regulation*; J. R. Rose, “The Rate of Utility Return,” *Public Utilities Fortnightly*, Vol. 23 (1939), p. 131; and B. J. Sickler, “The Federal Communications Commission's Rate-of-Return Studies,” *Journal of Land and Public Utility Economics*, Vol. 15 (1939), p. 137.

¹⁶⁷ See Sickler, cited above. And see the discussion, of potentially great significance, of rate of return by Mr. Justice Reed in the *Driscoll* case, cited above.

Public utility rates must be designed to produce earnings sufficiently great to cover reasonable operating expenses in addition to—in fact, before—fair return on fair value. Here again, effective regulation must be alert: excessive operating expenditures can easily undo, in high rates, any purposive achievements in the field of valuation and rate of return.¹⁰⁸ On the other hand, if private enterprise is to be permitted to enjoy in any sphere the freedom that presumably serves as the necessary condition of its success, the area of day-by-day operation would seem to call for the very minimum of restrictive supervision. The always difficult problem of balancing the demands of effective regulation against the requirements of private initiative is, in this area, particularly troublesome.

The regulation of operating expenses usually comes to a head in a rate case, both because commission powers relate to operating expenses principally through the power to fix rates, and because it is when future expenses are being estimated as an element in future rates that the utility has the strongest incentive not only to admit but to insist that its costs are high. Operation of the utility may, without design or connivance, be flatly inefficient. Certain expenses may be high because it is to the advantage of individuals in managerial positions to keep them high—either because they gain personally as direct or indirect recipients of the expenditures, or because it is good policy to hide potential surpluses in high costs, since conspicuous surpluses are bound to invite rate reductions. The problem has appeared most dramatically and on the largest scale in the case of affiliated company systems, where a utility's purchase at high prices of supplies or services from a related company—the utility's rates being calculated to cover such costs—have siphoned swollen earnings into the treasury of the common owner. Indeed, it was this condition more than any other that inspired the institution of holding company regulation, as well as more vigorous control of "arm's-length" expenditures.

¹⁰⁸ "For rate-making purposes, increases or decreases in operating expenses have about twenty times the effect of equivalent increases or decreases in the rate-base valuation, assuming a 5 per cent return basis." *In re State-Wide Investigation of Wisconsin Telephone Co.*, 12 Wis. P.S.C. 1, 20 (1936), in which the Commission found some \$300,000 of operating expenses to be excessive, only to have its finding reversed by the Wisconsin Supreme Court. *Wisconsin Telephone Co. v. Public Service Commission*, 287 N.W. 122 (1939).

Until late years direct mandatory control of expense items was confined to annual depreciation (a "book charge"), but the most advanced of recent legislation has placed in the hands of the regulatory commission, supervision of all major expenditure contracts, both of affiliated and of independent companies (with the power to block). Control over affiliated and non-affiliated wholesale supply companies (e.g., natural gas) has also become general. It is still true, however, that the most active regulation of expenditures takes place in rate proceedings.¹⁶⁹

Regulation of operating expense estimates in rate cases involves inquiries along two lines—the kind of expenditure, and its amount. "Is this the kind of expenditure for which the public should reimburse the utility?" is asked with reference to such items as advertising, rate case costs, donations, anti-public ownership campaigns, management services, and delay rentals. "Should the utility be reimbursed in the claimed amount?" may be raised with reference to any item, but is most frequently directed to depreciation, maintenance, and salaries, in addition to the items questioned in their entirety.

The courts have been reluctant to admit commission regulation within the province of "management," and in many cases lower courts have reversed commission disallowances of items claimed by utilities as necessary expenditures.¹⁷⁰ The controlling rule was stated by the Supreme Court in the *Southwestern Bell* case overruling the Missouri Commission's disallowance of license contract payments to a parent company:

It must never be forgotten that while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of

¹⁶⁹ Direct and indirect control of expense payments to affiliates will be considered in section C of this chapter.

¹⁷⁰ See *West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1)*, 294 U.S. 63 (1935), for discussion and reversal of Commission rulings on "un-accounted for gas," and expenses for rate litigation and new business, and distribution and commercial expenses. But see *Acker et al. v. United States, et al.*, 298 U.S. 426 (1936), upholding the right of the Secretary of Agriculture to ignore actual expenses, if unnecessary or unwise, in calculating the cost of securing and maintaining business, as an incident in setting a rate for stockyards market agencies. But for a recent decision harking back to the most narrowly restrictive conception of commission function and authority in this matter, see *Wisconsin Telephone Co. v. Public Service Commission*, 287 N.W. 122 (1939).

the property of public utility companies and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in . . . 295 Ill. 209, 234.

"The Commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers."¹⁷¹

It must be apparent, however, that there is no hard and fast line separating regulation from management, and that if regulation is to be effective as a protective agent—and even more clearly if it is to be assigned a more positive, promotive role—no phase of utility operation can be deemed inherently immune to its processes. As a matter of fact, following the Southwestern Bell ruling as well as before it, commissions which were active in rate regulation did not hesitate to question and revise allowances for operating costs. Indeed, the Supreme Court felt impelled to reverse itself within seven years on the very item which prompted its Southwestern Bell pronouncement, holding in 1930 that it is the duty of regulation to inquire into the cost to the supplying company of supplies and services sold to an affiliated utility.¹⁷² General phrases are useless in this area; the course of regulatory conduct must be charted in individual cases. The earnings which a utility has received may not be made the basis of retaliatory regulation,¹⁷³ but the disposition of earnings is within the ambit of regulatory power, in the interest of continuous, adequate service. Further, the utility may be prevented from involving itself in contract commitments that dissipate its resources, and it may not draw upon the public to underwrite inefficiency, expenditures unrelated to public service, or concealed profits.

¹⁷¹ 262 U.S. 276, 289 (1923).

¹⁷² *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133 (1930). And see *Western Distributing Co. v. Public Service Commission of Kansas*, 285 U.S. 119 (1932); and the Acker case, just cited.

¹⁷³ *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1926). But, while the public may not seize upon the fact of excessive earnings in the past to justify a reduction of future earnings below an otherwise fair return, there would appear to be no constitutional barrier, as yet, to the adoption of a continuing plan to adjust rates and earnings on a reasonable average level over a stipulated span of years.

The pattern of rates. While a utility's consumers as a group have a very real interest in the total amount they are expected to pay, in rates, for the total service furnished, each consumer is more immediately interested in his share of the burden—the structure or mutual relationship of individual rates. Utilities are required to file their rates, and, to protect the consumer against discrimination, are forbidden to depart from their published schedules. It is the task of regulation to see that the rates as approved contain no discriminatory features that the regulatory agency is unwilling to support.

The fact that open discrimination (whether "fair" or "unfair") between classes of users is inevitable becomes apparent as soon as the implications of the characteristics of the typical electric utility are realized: the presence of common costs in the provision by a monopoly of non-transferable services, and the existence at times, if maximum demands are to be met as required by law, of substantial unused capacity. Certain costs, such as utility investment on consumers' premises, meter reading, billing, testing, collecting, are directly assignable to individual users, but the fixed investment costs of generation and distribution, together with that considerable portion of operating cost which, within wide limits, remains practically constant irrespective of the amount of service produced, are common to all users as a group, and even the variable operating costs are likely to have only an illusory assignability to particular units of output. It is literally impossible to ascertain the cost of particular services on any other than an admittedly arbitrary basis. An analysis of the costs of serving an individual consumer would show an outlay for "readiness to serve" as well as for service actually furnished, but any attempt to determine exact individual or class responsibility for the expenditure is doomed to failure. Where this is the case, there can be no cost basis for rate differentials as between different uses or users of the service. None the less, differentials in rates are an accepted feature of electric rate schedules, and it must be conceded that such differentials are bound to develop on a "value of service" basis, whether the purpose is to maximize profits or to make use of otherwise unused facilities.

Possibly the most venerable of the cost theories that have been employed to rationalize rate differentials is built around an analysis of alleged responsibility for so-called peak demand. The utility must be possessed of sufficient capacity to meet the maximum demands of each of its customers. This does not mean of course that it must have sufficient capacity to meet the summation of these demands, because individual peak demands never completely coincide. It is argued that the individual demands which condition the utility's fixed and constant costs are those which fall at the time of the peak demand upon the system, and, hence, that users who call for service "off the peak" can be served economically for all concerned at rates which cover only direct costs.¹¹⁴ Lower rates to industrial customers than to residential and commercial customers have been supported on this ground. As a matter of fact, however, where separate "demand charges" are made by utilities, they are very rarely calculated with reference to the time of the demand; and it is frequently true that industrial users, who, because they can turn easily to alternative sources of supply, cannot be made to bear a proportionate share of system costs, are responsible for the heaviest "on peak" demand. It is also the case that loads built up to utilize off-peak capacity by rates which cover only "incremental" costs, may come, in time, to constitute a new peak. Moreover, peaks may come at different times on different portions of the system. Even the theoretical analysis on which "peak cost" rates are sought to be justified is untrustworthy; assignment of responsibility for peak costs will vary as attention is directed to the composition of the peak demand alone, or to the composition only of the excess of the peak demand over demands at other times; and as attention is centered solely on the immediate peak or on its chronological (incremental) development. It is fair to say that the

¹¹⁴ Other formulas for allocating common costs and thus providing a cost rationalization for rates include the "kilowatt-hour" theory (an allocation of fixed and constant charges in proportion to the energy consumption of the customer); the "individual maximum demand" theory (a calculation of the customer's demand charge by multiplying the total fixed charges by the ratio which his individual maximum demand bears to the summation of the individual maximum demands); and the "phantom customer" theory (a combination of the "kilowatt-hour" theory with either the "peak responsibility" or the "maximum demand" theory).

function of rate structure cost analysis is to lend the appearance of support to rate patterns which are really dictated by intensities and elasticities of demand, that is, "what the traffic will bear."

To the extent that market conditions suggest and regulatory policy permits, differential prices are offered in an attempt to tap new sectors or levels of demand, without disturbing existing rates and patronage. Inducement rates are offered to particular users, or for particular uses, but they are typically so constructed as to offer less than the maximum feasible inducement to increased consumption. Rates filed for different classes may be expected to vary between short-run variable or incremental costs as a bottom limit, and the "value of the (enough) service" or "what the (enough) traffic will bear" as a ceiling. To the extent that regulatory commissions concern themselves with the pattern of rates they will be found to be skeptical of rate differentials based solely on differences in kinds of use, although such differentials are common, but quite willing to accept differentials as between classes of users. It cannot be too strongly emphasized that these bases reflect differences only in consumer demand characteristics; only occasionally and by chance do they reflect differences in cost of service. The "balance" between classes will reflect the commission's "judgment," after consideration of direct costs, estimated relative responsibility for common costs, competitive forces, anticipated consumer response, volume of protests from politically articulate consumers, and custom.

Simple types of electric rate structures fail signally to reflect determinable costs and to encourage consumption of energy. Meter rates (straight line, step, and block),¹⁷⁵ because the index of charge

¹⁷⁵ "Straight" rates provide a uniform charge per unit; "step" rates apply a "straight" rate to the total number of units consumed, but the rate so applied varies with the quantity consumed (e.g., if less than 40 units are taken, the rate is 8 cents per unit, but if between 40 and 80 are taken, the applicable rate to the entire consumption is 6 cents per unit, etc. "Block" rates charge a named price for all the units taken in specified blocks (e.g., the first 30 units at 7 cents per unit, the next 30 units at 6 cents per unit, etc. The "block" rates can be adapted to promotional pricing. See L. R. Nash, *Public Utility Rate Structures* (1933), and G. P. Watkins, *Electrical Rates* (1921) for discussion of problems treated in this section. See also M. L. Cooke, *What Price Electricity for Our Homes* (1928); H. B. Gear, "Diversity Factor," in American Institute of Electrical Engineers, *Transactions*, Vol. 29 (1910), Part I, p. 375; John Bauer and Nathan Gold, *The Electric Power Industry* (1939), Chap. VI.

is that of energy taken, provide no approximation of the individual customer's responsibility for the more significant investment costs, and by reason of the fact that they load the energy rate with demand costs, tend to operate as a deterrent to extensive use of the service. More elaborate forms have been constructed in an effort to spread the fixed investment and constant operating costs (the "demand" and/or "customer" costs) and to add thereto the marginal costs of generation (the "energy" costs).¹⁷⁶

It may be suggested that, in so far as possible, electric rates should be so arranged as to cover the ascertainable costs in the case of each user, spread the burden of non-imputable costs equitably, and conduce to maximum use of facilities. It seems probable that these ends could be satisfactorily approached by a pattern of two-part rates, the second part of which would be constituted by an energy charge, uniform to all consumers, equal to short-run marginal cost of producing the service, and the first an initial or demand charge covering all other costs. The demand charge would be adjusted as between consumers (or classes of consumers) so as to cover as a minimum for each the ascertainable fixed and constant costs for which his (its) presence on the system is directly responsible, and in addition such proportion of the remaining burden of cost as seems just and expedient in light of equitable and market considerations. Such rates would cover total costs, and would be as fair as rates constructed on any other pattern. Further, the relatively high

I have drawn heavily, throughout this section, upon an unpublished manuscript by H. P. Welch.

¹⁷⁶ The "Hopkinson" rate embodies two separately billed charges, one based on the demand costs, however determined, allocable to the consumer, and the second based on his energy consumption; the "Wright" rate conceals a demand charge by naming a relatively high energy charge for a designated number of kilowatt hours per kilowatt of (maximum coincident) demand, beyond which lower rates apply. To illustrate:

Hopkinson form:

Demand charge\$2.50 per month per kilowatt of demand.

Energy rate015 per kilowatt-hour.

Wright form:

First 30 hour use of demand per month \$.10 per kwh.

Excess consumption per month03 per kwh.

The Doherty three-part (demand, customer, and energy charges) rate has proved to be too complicated for general use.

charge for availability of the service (or for very early brackets of consumption) would coincide with the relatively high value to the consumer of early uses, and the sharp drop in rates for all or most of the energy taken should greatly stimulate consumption.¹⁷⁷

Two schemes have been put into operation, calculated to preserve existing revenues while tapping levels of demand hitherto unserved. So-called "promotional" rates have been offered, affording lower rates to additional blocks of consumption, without disturbing prevailing rates for the domestic lighting demand, which is deemed to be inelastic. The widths of the lower rate blocks are made to correspond to load characteristics of various appliances, and rate reductions are calculated to induce their purchase and use. The only revenue lost is that which represents use at the new low rates by customers who had already installed appliances under the previous schedule. To meet this problem, several companies have introduced "objective" rates, offering individual differential treatment in the form of an attractively low rate for all electricity consumed above the customer's consumption in a designated base period, or, as a variation, offering new lower rates if consumption is increased sufficiently to equal or exceed, at these rates, the amount of a designated base bill. A very great merit of these plans, besides the immediate extension of service which they induce, is the stimulation they afford to investigations of residential demand characteristics, and, hence their possible use as a regulatory instrument in the hands of commissions which are convinced in particular cases that lower rates would stimulate use of the service and also return adequate earnings to the utility, but which cannot point to existing excess earnings—the present legal prerequisite to a mandatory rate reduction.¹⁷⁸

¹⁷⁷ See Hubert F. Havlik, *Service Charges in Gas and Electric Rates* (1938), for a discussion of the limitations surrounding employment of so-called service charges. The unpopularity and, hence, the political difficulty of service charges should be recognized. The principal argument against demand charges of the usual sort is that they do not reflect the "diversity factor" in demand; and, against service or customer charges, that they ignore individual differences in customer costs.

¹⁷⁸ The Hartford Electric Light Co., Pacific Gas and Electric Co., and the Commonwealth and Southern system have pioneered in the field of promotional pricing; and the Wisconsin Commission has undertaken an "objective" rate experiment involving most of the electric utilities in the state. See *In re "Low-Cost" Rate Plan for Electric Service*, 8 Wis. P.S.C. 195 (1935); 9 Wis. P.S.C. 25 (1935); 10

Although the manufactured and natural gas industries are characterized by a large proportion of fixed costs, the maximum demand on the system is of less influence in determining the size of plant than in the case of electricity. Production can be stabilized within limits by storage and packing, and in periods of acute demand adjustments can be made in line pressure and heat content. Rate theories and experiments which have developed in the electric field are only lately receiving attention in the gas industry. While it is claimed that a substantial percentage of the domestic consumers of gas do not produce revenues sufficient to cover readiness-to-serve costs, the industry continues to labor largely under straight-line or block rate forms for domestic users.¹⁷⁹ The industry made something of a drive for demand and service charges at the close of the World War, but otherwise until recently its promotional pricing activities have been neither inspired nor sustained. Of late, the possibilities of building an appliance and space heating load have quickened interest in experimental rate reductions, and newer rate forms—block meter rates with a minimum charge and two-part demand charge and commodity rates—are being instituted. In an effort to stabilize operating revenues many manufactured gas companies which have shifted to mixed and natural gas have changed their measurement of consumption from volumetric meter readings to heat units.

The problem of telephone rate structure is particularly baffling from the point of view of relating rates to costs, because of the constantly changing character of the service. Every new subscriber alters not only the "value of the service" to those already connected to the system, but also previous cost allocations based on the unit of service.¹⁸⁰ It is significant that the phrases "value of service" and

Wis. P.S.C. 36 (1935). The New York Commission has been reluctant to lend encouragement to "objective rates," principally on the ground that they are discriminatory. *Yonkers Electric Light & Power Co.* 1936 New York P.S.C.R. 599, 602. See also W. F. Kennedy, *The Objective Rate Plan for Reducing the Price of Residential Electricity* (1937); "Report of Committee on Public Utility Rates," N.A.R.U.C., *Proceedings of Forty-eighth Annual Convention* (1936), p. 317 ff.; and R. R. Herrmann, "Characteristics of the Commercial Lighting Load," *Journal of Land and Public Utility Economics*, Vol. 13 (1937), p. 38. And see B. O. Wheeler, "The Production and Distribution of Bonneville Power," *Journal of Land and Public Utility Economics*, Vol. 14 (1938), p. 359.

¹⁷⁹ See Nash, *Public Utility Rate Structures*, Chap. IV.

¹⁸⁰ But see B. J. Sickler, "A Theory of Telephone Rates," *Journal of Land and*

“what the traffic will bear” appear so frequently in the literature of telephone rates. Customer classifications and rate forms tend to reflect demand characteristics of subscribers, and are apt to be correspondingly complex.¹⁸¹ Existing toll structures have grown up largely outside the reach of positive regulation, and regulatory standards have yet to be developed. Experience has demonstrated the reality and significance of different levels of demand for telephone service capable of being tapped by differential rates. But experience and analysis have yet to provide a set of criteria more positive than that furnished by the varying demands of patrons differently placed in the business and social scene, or a governing principle more precise than that of extending facilities and promoting their fullest use (without “overloading”), and eliminating “undue” discrimination. Telegraph rates have a mileage basis and are classified as to length of message and hour of transmission. The structure has been influenced by historical factors of company and community rivalry. Distance differentials are approximated by zones; there are special rates; and claims of discrimination are raised not infrequently.¹⁸²

There is little to be said concerning the work of courts and commissions in conditioning or determining the pattern of rates. With

Public Utility Economics, Vol. 4 (1928), p. 175; and L. Lyndon, *Rate Making for Public Utilities* (1923).

¹⁸¹ Telephone service is classified first as “exchange” or “toll”; exchange service is subdivided into “business” and “residence”; these into “private” and “multiple-party” lines; and the applicable rate forms are either “flat” or “measured.” An elaborate set of classifications is used in the case of toll service, as well—distance, hour of use, time interval, probability of completion, etc.

¹⁸² “. . . rate making, whether for utilities or for competitive and private business, is never a mathematical application of a theoretical principle. In every business, there is always a large percentage of customers, who are served at less than cost, for the reason that it has been found impracticable to devise and apply a system of cost accounting and computation which would carry out the principle literally; and if it were done, it would result in such an elaborate and complicated schedule of rates that the public could not understand it and few could apply it. . . . It may be true that any system of rate making which ignores the cost of service as a standard invites attack, and attracts those who would supply the part of the service that produces a profit, leaving to others the service which is furnished at a loss. But practically, rate making is always a compromise between what would be charged if certain principles of cost allocation were adhered to and the practical necessity that a rate structure should be easily understood and simply applied.” Chairman Maltbie in *Rates, etc., Electricity in New York and Suburban Territory*, 1931 New York P.S.C. 425, 433-34.

a few conspicuous exceptions their activity has been slight and intermittent, and their influence only slightly greater. It is not unusual to find a commission which has proceeded positively to mold the structure of rates in a lone case; but one encounters volume after volume of commission reports, filled with elaborate discussions and calculations of "fair return" and "fair value" but completely devoid of any mention of rate schedules beyond the fact that the form and balance submitted by the utility have been followed in promulgating the rates as found. Of course, rate case reports are only one indication of a commission's influence. The very fact that the schedule of rates must pass official scrutiny is undoubtedly a factor tending to temper any inclination toward conspicuously unfair discrimination; and it is probably the case that consultation with the commission's rate engineering staff prior to final submission of the case to the commission frequently results in ironing out in advance difficulties that might otherwise have called for formal adjudication. The utility is not ordinarily indifferent to the structure of rates, by any means, but it is more concerned with their capacity to produce over-all revenue. The rate pattern affects individuals and groups, but it is the rate level that engages the active interest of the community as a whole in any rate proceeding. With the two parties in interest directing their attention elsewhere, it is not strange that the commission should let the rate structure go largely by default. Individuals may bring actions for discrimination; certain groups, such as commercial users, may press for special treatment; a newspaper may conduct a vigorous campaign against a "demand charge" in the interest of the small user, or offer opposition to extra charges for hand-set telephones. In such a case the commission may take a stand. Too, specially inspired commissions with larger staffs may undertake active inquiry into the general structure of utility rates. But for the most part commissions have stood aloof from the problem, and for careful discussion of rate structure theory and practice the student must turn principally to the general literature in the field, rather than to the official reports.¹⁴³ And, curiously enough, it is true, further,

¹⁴³ But see the selection of excellent commission reports on rate structure in Irston R. Barnes, *Cases on Public Utility Regulation* (1938), Chap. VII. For a much larger but less discriminating assortment of commission pronouncements, see Henry

that for judicial attitude on the problem, it is necessary to consider railroad rather than utility cases; and even here the harvest is scanty.¹⁸⁴ The problem will never lend itself to exact solution, but the better commissions will insist upon some showing of specific costs, some reasonable balancing of rate burdens, and an active drive toward capacity use.¹⁸⁵

The setting of rates. The determination of the amount the utility is to be allowed to earn from its patrons as a whole, and the adjustment of rate relationships between groups of consumers, still leaves for consideration the problem of naming the actual rate figures which will produce the sought-for results.

If the discussion thus far has carried the suggestion that rate making is a precise, semi-automatic process, it needs amplification to emphasize that any precision relates solely to immediate rate calculations, which are altogether likely to be mechanical and without benefit of imagination, and that in terms of ultimate purposes and results rate making is far from precise and certain.¹⁸⁶

C. Spurr, *Guiding Principles of Public Service Regulation*, Vol. 3 (1926), Chaps. LX ff.

¹⁸⁴ The leading case is *Northern Pacific Railway Co. v. North Dakota*, 236 U.S. 585 (1915) holding that in the absence of some standard which would justify the practice, a state may not compel a carrier to transport a commodity at a loss or without substantial compensation (cost being interpreted, apparently, as direct outlay plus "proportionate" overheads), even though the carrier is receiving an adequate return from its entire business. The decision is not strong, on its facts, and its philosophy runs quite counter to that in the abandonment cases. See *Fort Smith Light and Traction Co. v. Bourland*, 267 U.S. 330 (1925). And at most the decision relates to the power of the regulatory authority to dictate a particular pattern of rates; it does not bear on rate structures which the utility is willing to institute.

¹⁸⁵ The thorough-going independent rate structure programs of the Wisconsin and New York Commissions, although quite divergent, are in point. See particularly *In re Investigation Wisconsin Power & Light Co.*, 5 Wis. P.S.C. 1 (1933); *Milwaukee v. Milwaukee Electric Railway & Light Co.*, 5 Wis. P.S.C. 61 (1933); *In re Rates and Rate Structures of Various Corporations Supplying Electricity in the City of New York and Suburban Territory*, 1931 New York P.S.C. 425; and *Petition of New York Edison Co., et al.*, 1935 New York P.S.C. 571; and the *Biennial Report of the Wisconsin Public Service Commission, 1934-1936*, pp. 17-18, and the *1938 Report of the New York Public Service Commission*, Vol. 1, pp. 21-22. The Illinois Commerce Commission, too, has made an enviable record in recent years. And see, *Re Boston Consolidated Gas Co.*, 30 P.U.R. (N.S.) 260 (1939).

¹⁸⁶ The nearest approach to "automatic" regulation is afforded by "cost of service" and "sliding scale" franchises, where the named prices are agreed upon by the parties, and are then varied without further negotiation or order on the basis of

It is clear that the typical "fair value" determination, whatever its pretensions, can give only a loose over-all result at best, and it is to be feared that, upon occasion, the most elaborate valuation and rate of return deliberations really serve only to rationalize decisions actually reached on the basis of considerations not even formally discussed. On the other hand, actual service rates are usually derived by a simple, mechanical division of hoped-for gross income, however calculated, by figures of past consumption, without regard to the probable effect of the new rates upon consumption in the future. Occasionally a commission will distinguish itself by making a study of prospective demand, but, in the main, any allowance for demand elasticities takes the form of an arbitrary estimate; and even this concession to the dynamic realities of pricing is a rarity.¹⁸⁷ Demand elasticity is a significant consideration; it

movements of a named index of cost (for example, a "stabilization fund"); or by the utility as a condition of varying its dividend payments from a named standard—reducing the price of gas, say, five cents per m.c.f., as a condition to increasing its dividend rate, say, from 6 to 7 per cent. It is a mistake to suppose, however, that these devices have (or can) rid regulation of the task of valuation and the need of exercising continuous supervision of utility finance and operation. See Irvin Bussing, *Public Utility Regulation and the So-Called Sliding Scale* (1936); and Martin G. Glaeser, *Outlines of Public Utility Economics* (1927), Chap. 32.

Probably the best example of non-automatic rate regulation is the attainment (on a considerable scale during the early days of the depression) of rate alterations "by negotiation." When shifting economic conditions suggest the rapid readjustment of rates, the "law-suit—fair value" method, with whatever it affords in the way of impressive procedure and formulas, is apt to be abandoned by mutual consent; utility operators sit at the conference table with representatives of the commission, a compromise advance or reduction designed to give both the company and the public part of the results to which they are "entitled" is negotiated, and the commission frowns upon any move to institute a formal proceeding. Negotiation is a useful procedure for any commission harassed by pressures, and also for any commission actively interested in changing rates in quick response to changes in operating conditions. Negotiation will appear frequently as the only feasible course when the single alternative is a rate case of the usual forbidding proportions. It should be noted, however, that public acceptance of rate negotiations as a regular rate-making procedure involves implicit confidence in the purpose, ability, and judgment of the commission. In the case of an active commission, negotiations will be begun on the initiative of the commission (without waiting for consumer complaints), and the company's net earnings on book value will serve, typically, as the starting point. See the *Annual Report of the New York Public Service Commission*, 1934, Vol. 1, p. 15; and the same, 1937, p. 25; and *In re Complaints of Washington Heights Taxpayers Association*, 1932 New York P.S.C. 341, 354 ff.

¹⁸⁷ Many reasons have been suggested for commission failure to allow for demand elasticities in rate making, ranging from ignorance and lack of reliable

might well be the factor determining a rate reduction or denial of a rate increase despite inadequate earnings under existing rates, and it can never be a factor properly to be ignored in any attempt at purposive pricing. That private industry is not always successful in predicting demands, or that mistakes might be made, cannot justify the failure of commissions, in setting prices, to probe and to act with reference to the pertinent characteristics of consumer markets which the prices are designed to tap.

Another consequence of the tendency to compute rates on the basis of past consumption is that rate experimentation is thereby discouraged. Utility owners are entitled to adequate returns, but it cannot be a matter of indifference to utility users how the returns are derived. If, as may well be the case, wholly reasonable earnings can be produced by different levels of rates, consumers of utility services are entitled to be charged at the lowest of the compensatory levels and to the fuller consumption which such a level would permit. Commission pricing which accords no weight to these con-

data to fear of court reversal. It is probable that the courts would be critical of such allowances only if they were unsupported by reliable data. See *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (No. 2), 294 U.S. 79 (1935). But *Chicago and North Western Railway v. Dey*, 35 Fed. 866, 881 (1888) still casts its shadow: "The only fair judicial test is to apply the rates to the business that has been done in the past, and see whether, upon that basis such rates will be remunerative or compel the transaction of business at a loss." But, for the suggestion of a different approach, see an early case, *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 51 (1909). The typical legalistic approach is exemplified in the Ohio Commission's approval of rates to which it found the utility legally entitled, accompanied by an admonition to reduce rates voluntarily to stimulate consumption, on the ground that the rate increase might defeat its own purpose. *Appeal of Van Wert Gas Light Co.*, 1925 Ohio P.U.C.R. 8, 10. In informal discussion regulatory authorities are likely to defend their reliance upon data of past consumption by pointing out that many factors are bound to change in unpredictable directions and degrees (e.g., wages, prices of supplies, taxes, general business conditions, etc.), hence, it is wise to assume that these and demand elasticities will cancel each other, and rely on past consumption figures as the only factual evidence on demand in the record. They are apt to add that the real solution lies in frequent rate revisions on the basis of current experience—a proposal which one could gladly support without forsaking advocacy of estimates of demand elasticity. Despite the importance of the subject, there appear to be no factual studies of the degree of success attained by commissions in setting prices for service which in fact produce the amount of revenue to which the utility is held entitled. See W. J. Crowley and C. H. Baily, "The Relation of Electricity Consumption to Purchasing Power," *Journal of Land & Public Utility Economics*, Vol. 13 (1937), p. 350 and W. J. Crowley, "The Prospects for Continued Electric Rate Reductions," *Journal of Land & Public Utility Economics*, Vol. 15 (1939), p. 464.

siderations lends approval to similar lackadaisical conduct generally by the utility. Consumers and utilities alike could profit from a shift from the complacent "necessary revenue (based on cost) divided by past consumption" approach, to the approach familiar to every person engaged in pricing for competitive markets—the lowering of prices in the expectation that increased consumption, increased output, and lower unit costs will follow.

Finally, sole reliance upon mechanical calculations places a further obstacle in the path of harmonizing utility prices with the structure and movements of industrial prices generally, and renders out of the question any program of employing utility prices positively to induce a fuller employment of economic resources.¹⁸⁸ The fair return on fair value formula may be made to exercise a determinative limiting effect on rate levels over a period of time, even though immediate service prices are permitted, by the use of adjustment reserves, to move in accord with significant movements of other prices. Thus, for example, any long-run limits exercised, say, by "fair return on prudent investment" need not be made to draw immediate rates away from levels required by immediate market forces. But these possibilities are severely limited if service prices are to be related exclusively to a rigid formula, and are to be insulated completely from forces operating in dynamic markets.¹⁸⁹

¹⁸⁸ See p. 625, above. "It is clear that if public price control in a particular area is to be successful in promoting a higher general level of use of resources, standards must be formulated in terms of the relation of price changes inside the area to changes in spending, hoarding, incomes and employment of resources both outside and inside this area." D. H. Wallace, "Kinds of Public Control Suited to Replace or Supplement Antitrust Laws," read before the annual meeting of the American Economic Association, 1939. While it is undoubtedly true that existing knowledge of this whole problem is quite inadequate to warrant any considerable action by regulatory commissions in the public utility field at present, it is worth noting that utility rates which would express purposes and criteria of this kind could never be attempted under the current mechanical approach in utility pricing.

¹⁸⁹ See M. G. de Chazeau, *Quarterly Journal of Economics*, Vol. 51, p. 298 ff.; R. F. Bryan and B. W. Lewis, "The 'Earning Base' as a 'Rate Base'," *Quarterly Journal of Economics*, Vol. 52 (1938), p. 335; M. G. de Chazeau, "Reply," the same, p. 346; and D. E. Lillenthal, "Regulation of Public Utilities During the Depression," *Harvard Law Review*, Vol. 46 (1933), p. 745. For extraordinary use of general economic testimony in the establishment of rate standards (not particular rates) see *Re Wisconsin Telephone Co.*, 2 Wis. P.S.C. 106 (1932); and *Re Electric Rates, New York City and Suburban Territory*, 1933 New York P.S.C. 391.

C. Accounts, Finance, and Intercorporate Relations

Public regulation of utility accounts, finance, and intercorporate relations is undertaken largely because of the effect of these phases of operation on public utility rates and services; it takes its character from, and its effectiveness must be judged by, the degree to which it facilitates rate and service regulation. Intelligent regulation can proceed only on the basis of facts developed and organized through the medium of a carefully conceived system of accounts. The institution by commissions of uniform accounting systems is extensive and of long standing; and the development of formal accounting control by progressive commissions has kept pace with the appearance of new regulatory problems and new techniques of regulation. As recounted above, recent years have seen a new flare of interest, reflected in the promulgation by over half of the country's administrative agencies of complete and searching accounting systems calculated to make available, in usable form, every item of information pertinent to modern utility regulation.¹⁹⁰ It will be appreciated, however, that the final test will come not in usability, but in use. From the point of view of formal regulation, commission control of accounts, even before the recent advance, was on a comfortably satisfactory level; but actual administration of, and performance under, the requirements were mediocre over wide areas. Too often, accounting regulation meant nothing beyond unpoliced orders that utility books be kept according to prescribed forms, and the submitting of periodic reports whose complete destiny was to gather dust in commission basements. Effective accounting control comprehends the designing of complete and penetrating requirements; periodic audits by the commission; and unrelenting scrutiny and sensitive interpretation of the returns. The latest uniform systems leave little to be desired and in many jurisdictions enough has transpired since their inauguration to demonstrate that in these instances, at least, effective control of accounts is a reality. It may be repeated here that rate regulation in the future will be effective to the extent that it can be trans-

¹⁹⁰ See E. W. Morehouse, "Innovations in Public Utility Accounting Regulation," *Yale Law Journal*, Vol. 46 (1937), p. 955.

ferred from a speculative appraisal to an accounting basis. Practical, positive accounting control should conduce to that end.

Control of utility security issues and financial practices, like control of accounts, is of long standing; but there is great variety in the existing state laws and even more pronounced variation in the intensity of their administration. While the stated purposes of utility financial regulation may range from protection of the investor to the formal establishment of the utility's capitalization as its rate base,¹⁹¹ the more usual analysis finds the need for supervision in the bearing of security issues upon capital costs, and in the indirect effects of overcapitalization and excessive debt upon the quality, adequacy, and price of utility service. A utility corporation must be able to meet its financial obligations in order to maintain its credit standing. The relative stability of utility revenues constitutes a temptation to resort excessively to "trading on the equity," and the resulting presence of excessive debt is bound to produce an intensification of difficulties during times of financial stress. The obligation to pay bond interest is, of course, of different character and more imperative than the claim of stockholders to dividends. Public utility commissions, in fixing rates, may, however, be reluctant to disturb the expectations not only of bondholders, but of preferred and common stockholders as well. If, as a result of capitalization in excess of "fair value," these expectations cannot be fulfilled from earnings equal to a "fair return on fair value," the likely alternatives are impaired credit, neglected maintenance, or increased rates. The fact that the relationship between capital structure, rates, and service may be denied because "rates are based on 'fair value' and not on capitalization," and the further fact that documentary proof of the relationship is usually not available, are not convincing; the various phases of rate making are sufficiently loose to permit consideration to be given to the utility's "financial needs," without formal announcement.¹⁹²

¹⁹¹ Note the intimate connection established in Massachusetts between security issues and rate levels. See p. 701, above.

¹⁹² See J. C. Bonbright, *Railroad Capitalization* (1920).

The problem of capitalization is complicated by the lack of a universally acceptable standard or definition of "overcapitalization," since there are many authoritative opinions with reference to the proper "value" base for the issuance of

Typically, before securities may be issued by a public utility, authorization must be had from the state commission,¹⁹³ and, formally at least, matters of purpose of the issue, price and terms, relation to the existing capital structure, etc., must be examined and approved before receiving official sanction. In a large number of cases, applications to issue securities are uncontested and approvals are routine, and while the reported cases are great in number, proceedings are usually of a most summary sort, and opinions accompanying orders are conspicuously barren. Nor are commissions meticulous in checking compliance with their orders, particularly with those relating to the disposition of proceeds. A commission that spends five years on a rate case will typically act within a fortnight on a security issue affecting the same property.¹⁹⁴ On the other hand, the commission may exercise substantial in-

securities. Without submerging oneself in the controversy it may be noted simply that capitalization value in the case of public utilities cannot properly be divorced from considerations which bear, as well, on rate value. See *Central Illinois Electric and Gas Co.*, S.E.C. Holding Co. Release 1592. See also, on the general subject, R. E. Heilman, "Development by Commissions of the Principles of Public Utility Capitalization," *Journal of Political Economy*, Vol. 23 (1915), p. 888; Barnes, *Public Utility Control in Massachusetts*, Chap. II, and D. F. Pegrum, *Regulation of Public Utility Security Issues in California* (1936).

¹⁹³ Under the federal Securities Act of 1933, operating companies must register securities offered for sale in interstate commerce with the Federal Trade Commission. This authority was transferred to the Securities Exchange Commission by the Securities and Exchange Act of 1934. Section 7 of the Public Utility Holding Company Act provides for S.E.C. regulation of the securities of the operating subsidiaries of holding companies. Although the S.E.C. is directed to exempt from its processes securities approved by state commissions, the exemption may be accompanied by such terms and conditions as the S.E.C. deems appropriate to protect the public interest; hence, utility securities now have a federal, as well as a state, barrier to hurdle. See J. F. Meck and W. L. Cary, "Regulation of Corporate Finance and Management Under the Public Utility Holding Company Act of 1935," *Harvard Law Review*, Vol. 52 (1938), pp. 216, 218, 238. The gap in state regulation of utility securities was partly closed by the federal legislation of 1935 giving the Federal Power Commission control over security issues by utilities subject to its jurisdiction if the commission in the state of incorporation is without authority.

¹⁹⁴ See H. G. Burke, *The Public Service Commission of Maryland* (1932), pp. 109-14. And see E. T. Hellebrandt, "The Development of Commission Regulation of Public Utilities in Ohio," *Journal of Land and Public Utility Economics*, Vol. 10 (1934), pp. 78, 91: "The Ohio Public Utilities Commission . . . usually approves applications in a routine manner. Although security issues accounted for about one-third of the more than 7,200 formal cases considered by the Commission up to the end of 1930, it has rendered written opinions in only a few cases."

fluence prior to the formal application. The attitude of the commission on broad issues may be well known, and details may have been worked out in advance by extended conferences with commissioners and members of the staff. And it is true, too, that the reports of a few commissions contain a sprinkling of penetrating opinions on aspects of utility finance.

Commission difficulties are sometimes increased by the necessity of facing the problems of improper capitalization and excessive debt after the event; principles of finance must be applied with judgment and with special regard to local conditions in dealing with the rates, service, or securities of a utility burdened with a troublesome capital structure inherited from the speculative era before regulation began. Supervision of utility mergers presents commissions with an impressive set of opportunities and dangers. The occasion is seized sometimes to require rate reductions and specific improvements in service, even to the extent of refusing otherwise to approve particular property combinations. But there are always pitfalls, too—prepossessing claims and exhibits concealing “write-ups” and property no longer “used and useful,” bound to annoy the commission at the time of subsequent rate inquiries. Where the commission is empowered to oversee reorganizations it has an unusual opportunity (and responsibility) to insist upon the active interest of the consumer in utility finance. It is to be regretted that momentary expediency has frequently been accorded more weight than long-run considerations, in these proceedings.

Reference to different phases of the relation of public utility holding companies to the regulation of rates and service has appeared at several points in the preceding discussion; it remains to draw these threads together. The ascendancy of the holding company device in the control of financial and operating policies of “local” electric, gas, and communication utilities has been traced. In these days of its disfavor it is sometimes overlooked that the holding company might have achieved a very high degree of acceptance quite aside from the driving force generated by its speculative character. The holding company has much to contribute to utility service, and vigorous pruning of the rank growth of the twenties and careful direction of the sound portions remaining

should make it a solidly useful agency to that end. The merits of the holding company are deeply rooted in economic and technological realities. The technical advantages of joint operation of integrated properties may be realized more quickly through legal and financial facilities afforded by the holding company; superior management, well organized and directed expert staffs, and the economies of volume purchases can be more readily made available to small and otherwise isolated concerns; and direct and indirect assistance can be provided in the extremely important area of finance.¹⁹⁵ Many of these advantages have, in fact, been realized, but they have been accompanied extensively and prominently by excessive construction and management fees, overcharges on supplies and equipment, write-ups and inflation of operating company assets, drainage of operating revenues, deception of investors, and distorted schemes of integration.¹⁹⁶ Only the most sober and completely documented of the charges brought against holding company practices prior to 1933 need to be believed to convince the most skeptical that a heavy price was being exacted from the public for any benefits the holding company was capable of conferring.

Regulation, as constituted until 1935, was quite impotent to deal with the holding company—legally so until the decision in the Smith case (cited above) in 1929, and as a practical matter until

¹⁹⁵ See 70 Cong. 1 sess., *Utility Corporations*, S. doc. 92 (1935), Part 72-A, p. 832 ff. But, for the opinion that the holding company is less effective as a financial instrument, see M. H. Waterman, *Public Utility Financing 1930-35* (1936).

¹⁹⁶ There is no need here to develop the details now known so well to the general public by reason of the exhaustive investigation of the Federal Trade Commission reported in 70 Cong. 1 sess., *Utility Corporations*. See also Federal Communications Commission, *Proposed Report Telephone Investigation*; and J. C. Bonbright and G. C. Means, *The Holding Company* (1932), Chap. 6. The state into which holding companies had fallen by the close of 1937—nearly half of the industries' preferred stocks in arrears as to dividends—is outlined graphically by W. O. Douglas, then chairman of the Securities and Exchange Commission, in "A Program for Business-Government Cooperation Under the Holding Company Act," *The Annalist*, Vol. 51 (1938), p. 747. When it is borne in mind that by the process of pyramiding huge superstructures on the foundation of utility operating companies, through the mechanism of successive layers of thin equities in voting stocks, so that a tiny investment could place far-reaching powers over investors and consumers in the hands of a small group of promoters interested in financial manipulation rather than utility service, the implications for society run far beyond the public utility industries alone. See Chap. IV of Vol. 1 for further discussion.

federal reinforcements arrived in 1935. Until the Smith decision, commissions were without authority to disallow as operating expenses the prices and fees charged by holding companies and affiliates to associated utilities, unless there was a showing of fraud or abuse of managerial discretion; following the decision the burden of sustaining the fees was placed upon the companies, but understaffed commissions whose jurisdiction extended only to state lines were quite unable, in practice, to do more than tilt at the problem. Further, as was developed earlier, commissions confronted with "write-ups" and depleted treasuries must accept these as conditions to be worked out; mismanagement can be halted or modified by an order, but losses which have accrued from mismanagement cannot easily be recouped. And commissions had no power positively to check the mismanagement.¹⁹⁷

The states began their affirmative attack immediately following the Smith decision, and by 1936 twenty-four states had enacted legislation designed to control phases of the holding company-operating company relationship. The laws reflected a variety of approaches: the requirement of approval by the state commission as a condition precedent to the validity of an intercorporate contract; the requirement that contracts be filed, with the commission empowered to disapprove; and the requirement that the burden of proof of reasonableness of contract terms be borne by the utility.¹⁹⁸ But, at best, the states were weak, and there were powerful forces making for federal action directed to the entire holding company problem, rather than merely to a correction of the abuses of contracts between affiliates. In 1935, the legislation detailed

¹⁹⁷ J. C. Bonbright, "Should the Utility Holding Company be Regulated?" and M. J. Insull, "Why the Regulation of Operating Companies Regulates Rates," in *Public Utilities Fortnightly*, Vol. 7 (1931), pp. 195-203, 204-10; D. E. Lilienthal, "The Regulation of Public Utility Holding Companies," *Columbia Law Review*, Vol. 29 (1929), p. 404; and "Recent Developments in the Law of Public Utility Holding Companies," the same, Vol. 31 (1931), p. 189; E. W. Morehouse, "Some Problems of State Control of Public Utility Holding Companies," *Journal of Land and Public Utility Economics*, Vol. 5 (1929), p. 5; and Note: "The Servicing Function of Public Utility Holding Companies," *Harvard Law Review*, Vol. 49 (1936), p. 957.

¹⁹⁸ See J. S. Ransmeier, "Regulation of Service Charges in Holding Company Systems," *Journal of Land and Public Utility Economics*, Vol. 14 (1938), pp. 32-39.

above (pages 653-55) was passed by Congress. The registration provisions of the Holding Company Act were upheld by the Supreme Court in the Electric Bond and Share case (cited above). Such activity as the Securities and Exchange Commission has directed toward finance suggests that a force likely to raise the level of financial practices throughout the entire public utility industry is at work. The problem of service fees is being handled by the Commission on the basis of cost to the supplying company, and uniform systems of accounts for mutual and subsidiary companies have been promulgated, together with the requirement of annual reports. And the program of realigning, reorganizing, and recapitalizing holding company systems, proceeding slowly and carefully, is actively under way both independently and in bankruptcy proceedings.¹⁸⁹ The difficulties are great. Many pertinent considerations relating to holding company structure, finance, and operation are mutually in conflict, and the Commission's authority to break existing systems is much greater than its positive authority to require the building of new systems along lines which it deems more economic. None the less, it appears safe to predict that the worst abuses of early holding company development will be eliminated, and that the utility holding company of the future will be made more fully to achieve its potentialities as a socially effective organizational device. It may be noted that the great wave of opposition present at the time of the enactment of the Holding Company Act has largely subsided in succeeding months.

In many respects, the federal holding company law is the most significant regulatory development since the Wisconsin legislation of 1907. If it may be accepted as indicating the direction of continuing active sentiment, it points to utility regulation motivated by positive purposes, proceeding on a factual, businesslike basis, and supported and engineered by forces equal, in authority and power, to the task. The degree of success attained in its administration may come to constitute a concrete measure of the possibilities inherent in the whole institution of commission regulation.

¹⁸⁹ Securities and Exchange Commission, *Fifth Annual Report, 1939*, pp. 69-72; W. O. Douglas, "Scatteration v. Integration of Public Utility Systems," *Public Utilities Fortnightly*, Vol. 22 (1938), p. 255; and S.E.C. *Holding Company Release No. 1946*.

IV. PUBLIC OWNERSHIP AND OPERATION

Before drawing together the threads of the discussion and attempting a summary statement of the present status and immediate prospects of commission regulation, it remains to consider briefly another system of control which, on a much smaller scale, has been running parallel to regulated private ownership—public ownership and operation of public utilities. Attention will be directed solely to electric utilities, since the public ownership movement in the case of the gas and communications industries has never, in this country, been either extensive or vigorous, and at the moment seems virtually moribund.²⁰⁰

Municipal ownership. Municipal ownership of electric plants and distribution systems dates from the beginning of the industry, and by the close of 1903 there were 912 municipally owned generating plants in the United States, with a capacity of 210,821 horsepower. At the close of 1930 only 19 more generating plants were in existence, but the horsepower capacity had increased more than tenfold. During the period 1904-30, 1,894 municipal generating plants were established, 1,230 municipally owned generating plants changed to private ownership, and 645 municipal plants shifted from generating all or part to purchasing all of the energy distributed. Small plants were particularly affected. In the three-year period ending in 1927, 604 more plants were lost to municipal ownership than were added. From 1924 to 1929 the merger and consolidation of isolated properties was carried on most intensively, and large interconnected transmission systems were developed by private electric companies. From 1928 to the close of 1930 there

²⁰⁰ From a peak of 138 municipally owned gas plants in 1914, there has been a steady decline to approximately 50 plants at the present time, 42 of which are located in cities with populations ranging from 5,000 to 30,000. In 1937, 31 municipalities of over 10,000 population operated gas manufacturing plants, and only six of these owned and operated distribution systems. Philadelphia owns a gas plant operated by private management under a lease. See G. L. Wilson, J. M. Herring, and R. B. Eutsler, *Public Utility Regulation* (1938), p. 524; and *The Municipal Year Book* (1938), pp. 246-47.

Note, however, that allotments totaling \$2,358,442 have been made by the Public Works Administration, since 1933, toward meeting total costs of \$3,566,078 of some 33 non-federal gas generating, transmission, and distribution projects. See P.W.A., *Allotments for Non-Federal Electric Power Projects* (March 1, 1939), p. 58.

was a net loss of 160 municipal generating plants. This tendency continued during 1931 and 1932, but at a greatly lessened rate.

The aggregate capacity of municipal plants increased from 210,821 h.p. in 1903 to 2,586,959 h.p. in 1930, but the aggregate and annual rate of increase was less than in privately owned central stations. During the same period there was a steady increase in the number of municipal plants of more than 500 h.p. capacity. The significance of size of individual plants in this connection is indicated by the fact that 13 plants established on the Pacific Coast during 1922-30 contributed 466,330 h.p. to the capacity, while 478 plants located between the Mississippi River and the Rocky Mountains were responsible for a gain of only 392,987 h.p. during this same period.

The explanation of the changes in number of municipal plants during the first three decades of the century is probably to be found principally in technological changes within the electric power industry coupled with the development of financial and management techniques which were more readily available to private owners than to public officials. Technical improvements in generation of power made economical the production of energy in large central stations, and such concentration of production was made feasible by the development of interconnected transmission lines. While private managers and promoters took advantage of favorable financial conditions and general public receptiveness to corporate operations on a large scale, to develop this opportunity, frequently paying very high purchase prices in order to absorb particular public plants, those in charge of municipal plants continued to labor under severe legal and economic handicaps. Most municipal plants were located in towns having a population of less than 5,000. In a great many of these towns, public ownership had been instituted because private capital could find more remunerative opportunities elsewhere, and the municipality could look only to its own resources to provide a greatly desired service. There was little pressure for expansion of capacity and the public plants, established early, continued to operate with obsolete facilities until the new transmission lines of private companies penetrated the territory, save in instances where Diesel engines proved to be feasible. Statutory and

constitutional restrictions on the amount of municipal indebtedness and the procedure by which it might be incurred made it difficult and frequently impossible to enter upon programs of improvement and expansion which would have made it possible to compete with privately owned plants. Laws preventing municipal enterprises from serving beyond the municipal boundaries were frequent, and in many instances occupation of the surrounding territory by the transmission network of private companies precluded the expansion of markets for municipal concerns or the interconnection of neighboring municipal systems.²⁰¹

The trend of municipal ownership has undergone a sharp reversal since 1932. From 854 generating plants with a kilowatt-hour capacity of 1,827,614 in 1932, the number of municipally owned plants increased to 1,008 in 1938, and capacity increased over 40 per cent to 2,631,098 k.w.h. Over the same period, private electric utilities decreased in number from 3,109 to 2,788, while capacity increased only 3.8 per cent, to 33,246,341 k.w.h. (in 1938). Production of electric energy by municipal plants increased by approximately 49 per cent during the period as contrasted with a production increase of 38 per cent for privately owned utilities.²⁰²

²⁰¹ It is interesting to note that the movement from east to west in the shift from public to private ownership, 1904-30, corresponds roughly with the regional extensions of large-scale private transmission systems. See P. J. Raver, *Recent Technological Developments and the Municipally Owned Power Plants* (1932), p. 37; and P. J. Raver, "Municipal Ownership in the Last Five Years," *Journal of Land and Public Utility Economics*, Vol. 9 (1933), pp. 125, 127. Much of the controversy over the relative merits of public and private operation would have more point if directed to small- versus large-scale operation, as the real issue.

Information and data on municipal ownership to 1930, together with some of the interpretation, have been drawn from the publications cited above, together with P. J. Raver, "Is Municipal Ownership at the Crossroads," *Journal of Land and Public Utility Economics*, Vol. 10 (1934), p. 61; and H. B. Dorau, *The Changing Character and Extent of Municipal Ownership in the Electric Light and Power Industry* (1929).

²⁰² The data in this paragraph were furnished by the Federal Power Commission, and as the reader will have noted, are not strictly comparable with those employed in the earlier parts of the section. They are sufficiently comparable, however, to show trends. Note that the municipal capacity and output figures do not include data on other publicly owned electric projects (federal, co-operative, state, and power districts); the private industry figures do not include the production of energy by mining and manufacturing plants, nor by railways and railroads. In 1938 there was a total of 1,115 public plants, with a total capacity of 4,245,754 k.w.h., whereas in 1932 the corresponding figures were 918, and 2,353,614.

The data thus far relate to generating plants; Bureau of Census figures (again,

Not the least powerful force making for the increase in municipal ownership since 1932 has been the program of loans and grants made by the federal Public Works Administration in aid of public electric power projects. Some 339 non-federal projects were given assistance in the total amount of \$204,766,665, to be added to the amount of \$44,233,446 raised by the applicants. The allotments took the form of loans (\$107,514,540) and outright grants (\$97,252,125). Of the 277 municipalities to which aid was given, and for which population figures are available, 27 had populations of less than 1,000, 139 were between 1,000 and 4,999, 56 between 5,000 and 9,999, 42 between 10,000 and 49,999, and 13 were over 50,000.²⁰⁸

As a further factor in the advance of municipal ownership, it should be noted that some of the statutory barriers to the entry of municipalities into the electric power field and to their successful conduct of electric power operations have been removed by recent state legislation. Laws authorizing municipalities to own and operate public utility enterprises, to issue revenue bonds (bonds to be paid solely from utility revenues, and not included in computing municipal indebtedness in relation to municipal debt limits), to extend municipal utility services beyond municipal boundaries, and to incur indebtedness to, and to contract with federal agencies for loans

not comparable with any of the above) show that in 1937, 1,860 municipal establishments (885 generating, and 975 distributing only) sold 5,674,398,803 k.w.h. to 2,656,958 ultimate consumers, for a revenue of \$149,544,540; while 1,340 private utility establishments (818 generating and 522 distributing only) sold 93,524,013,857 k.w.h. to 24,432,724 ultimate consumers, for a revenue of \$2,006,933,408. *Census of Electrical Industries: 1937, Electric Light and Power Industry*, pp. 44, 58-59.

²⁰⁸ Details to be found in P.W.A., *Allotments for Non-Federal Electric Power Projects* (March 1, 1939).

The total kilowatt-hour capacity installed in the case of the 339 projects was 833,797; the total population affected (1930 census) was 9,828,889; 118 projects were new, 212 were additions to existing systems, and 9 were transmission lines; and, as of March 1, 1939, completed projects numbered 131, projects under construction 196, and projects suspended by litigation 12. P.W.A. operations in the public power field obtained constitutional clearance in *Alabama Power Co. v. Ickes, et al.*, 302 U.S. 464 (1938).

Of the non-municipal public power projects to which the P.W.A. has given assistance, one of the most interesting is the so-called "Nebraska Grid." For an account and analysis of this state-wide enterprise, see W. F. Kennedy, "The Nebraska Public Power Districts," *Journal of Land and Public Utility Economics*, Vol. 15 (1939), pp. 29-48.

and assistance, have, in several states, tended to mitigate the legal difficulties which have beset municipal ownership in the past.²⁰⁴

Finally, in the matter of factors favoring the growth of municipal ownership, mention should be made of the influence exerted by the power program of the federal government since 1932, a program which has sought municipal customers and has made cheap power available at wholesale for municipal and other public distribution systems, and which has contributed an "atmosphere" conducive to the institution of public undertakings. The Tennessee Valley Authority, a corporation set up by the federal government in 1933 to undertake a program of flood control, improvement of navigation, and the generation, transmission, and marketing of electric power in the Tennessee Valley,²⁰⁵ was directed by Congress to conduct its operations "primarily . . . for the benefit of the people of the section as a whole and particularly the domestic and rural customers," to give preference to public agencies and co-operative organizations in its sales of power, and was authorized to co-operate with and extend credit to local agencies to acquire distribution facilities. As of August 16, 1939, the T.V.A. had contracts for the sale of electric power, for distribution, to 67 municipalities, 2 counties, and 28 co-operatives.²⁰⁶ Similarly, the Bonneville Power Administration—established in 1937 to market at wholesale the available electric energy generated at Bonneville Dam constructed on the Columbia River under the direction of the United States Secretary of War—

²⁰⁴ See O. C. Hormell, "State Legislation on Public Utilities in 1934-1935," *American Political Science Review*, Vol. 30 (1936), pp. 522, 531-33.

There is no occasion here to review the general constitutional and statutory situation surrounding municipal ownership of electric utilities. Although the general right of a state and its subdivisions to engage in a utility enterprise is clear under the federal constitution (see D. M. Keezer and S. May, *The Public Control of Business* (1930), Chap. VIII, and *Standard Oil Co. v. City of Lincoln*, 275 U.S. 504 (1927)), and the general right of municipalities under state constitutions and statutes is usually present, it remains true that tortuous procedural requirements are encountered at every stage of the development of a municipal ownership enterprise from inception throughout mature operation. It has been common for municipal projects to be forced to fight their way through costly, hampering litigation, and many, of course, fall by the wayside. See 74 Cong. 2 sess., "Restraining Orders and Injunctions Instituted Against Public Electric Projects," S. doc. 182.

²⁰⁵ 48 Stat. L. 58; 49 Stat. L. 1075. The Tennessee Valley Authority power program is discussed more fully at the close of this section (pp. 736-43).

²⁰⁶ *Annual Report of the Tennessee Valley Authority, 1938-39*, pp. 65-67.

was required by Congress, in disposing of electric energy to "give preference and priority to public bodies and co-operatives."²⁰⁷ By the close of 1939, two municipal systems were being served with Bonneville power, and negotiations with other municipalities were actively under way.²⁰⁸

The "basic merits" of private ownership versus public ownership have been debated endlessly, emotionally, and, apart from particular factual situations, quite fruitlessly, for many years. On the side of public ownership there are arrayed the arguments that regulation is costly and ineffective; that public operation is "logical" in that it eliminates the cost and inefficiency of duplicating operators with regulators; that costs of public operation are lower than costs of private operation, since interest rates on public bonds are lower than "fair return," administrative and supervisory expenses are lower because of lower salaries and fewer positions, and since it is possible to co-ordinate public ownership functions with other governmental functions which will help to bear expenses; and that public officials are freer than private management to undertake experimental rate policies in the interest of widespread service.

Supporters of private ownership, on the other hand, point to a record of rate reductions and greatly extended use; contrast the vigor and flexibility of private operation with the inefficiency, stodginess, and political corruption which, they say, characterize public ownership; dwell upon the operating advantages of far-flung, interconnected, private systems over isolated, small-scale, public plants; and, to the claim of lower capital costs for public plants, answer that public funds must stand ready to supplement inadequate revenues from public operation, and that private plants contribute heavily, through taxes, to the support of general governmental functions. Examples of "good" and "bad" municipal plants are freely cited by both sides.

One would like to be able to weigh these arguments definitively, or to be able to turn to quantitative data which would settle the public-private ownership controversy beyond question for all times and places. Needless to say, however, such data are not available,

²⁰⁷ 50 Stat. L. 731, 733.

²⁰⁸ *Annual Report of the Bonneville Administrator, 1939*, pp. 2-3.

and, apart from its settlement as part of some broad program undertaken on general philosophic grounds for at least a major portion of the entire economic system, the problem seems destined to receive only piecemeal answers in particular areas in light largely of particular, local considerations. It may be anticipated that, for some time in the future, the institution or abandonment of public ownership projects will reflect local personalities and immediate situations more than finely spun analyses and broad, "basic principles."²⁰⁹

A final phase of the current public ownership controversy relates to the institution of state public utility commission regulation over municipal utility undertakings. In approximately 20 states, the state regulatory commission has jurisdiction in some degree over the rates charged by municipal utilities (in some cases only for service

²⁰⁹ Rate comparisons between public and private plants are interesting, but, because of differences in cost conditions, quality of service, and accounting practices, are deceptive unless properly qualified. The Federal Power Commission reported in March 1939 the results of a nationwide survey of "Rates, Taxes and Consumer Savings—Publicly and Privately Owned Electric Utilities—1935-1937." Commenting on its findings, the Commission said:

"Comparison of the rates, by classes of service according to community size groups, of the two types of ownership disclosed that the average typical bills charged in 1937 by privately owned utilities were, with but one exception, higher for all quantities of electricity in all communities of 2,500 or more population. The one exception was that bills of privately owned systems for 250 kilowatt-hours per month residential service in communities of 2,500 to 10,000, were reported as being a per cent lower than those of publicly owned utilities. For communities of less than 2,500 population the privately owned utilities were reported as having lower average bills for residential service.

"However, for other services, such as commercial light and commercial power, in communities of 2,500 or more population and industrial service in communities of 10,000 or more, the 1937 average typical bills of publicly owned systems in every case were lower than those of privately owned utilities. . . .

"Comparing taxes paid and tax equivalents furnished in support of government by privately and publicly owned electric utilities, respectively, the Commission reported, on the basis of totals for the United States, that publicly owned utilities paid 17.3 per cent and privately owned utilities paid 13.2 per cent of their gross revenues in the form of net cash contributions and taxes during 1936, the last year for which complete figures were available for this study. . . .

"In addition to taxes and net cash contributions publicly owned utilities were reported as rendering 'free services' during 1936 having a value, estimated on the basis of rates charged by privately owned utilities in the same State for such services, equal to 8.5 per cent of their gross revenues and 8.8 per cent of their base revenues. Privately owned utilities reported 'free service' amounting only to \$50,310 or 0.0024 per cent of gross revenues during the same year." *Annual Report of the Federal Power Commission, 1939, p. 13.*

outside the municipal limits). It may be taken for granted that, in the main, the effect of commission regulation of municipal utility accounts and records has been good, and certainly in particular instances involving, for example, duplicate services and discriminatory pricing, a strong case for commission control can be made. On the other hand, if public ownership is to be regarded as an alternative to commission-regulated private ownership, and as vying with it for public acceptance, there is strong reason for leaving municipal utilities free from the control of the very agencies with which, in part, they are competing. In addition, there is at least a slight incongruity in the piling of public regulators upon public operators.

The Tennessee Valley Authority. The most significant development in the history of public electric power in the United States has been the institution by the federal government, through the Tennessee Valley Authority, of "yardstick competition" with the private power industry in the Tennessee Valley. Headed by a three-member Board of Directors appointed by the President, dependent upon Congress for major appropriations to finance construction (although possessed of a limited power to issue bonds on the credit of the United States), and accountable for reports to the Comptroller-General and Congress, the T.V.A. corporation was designed to combine the initiative and flexibility of independent corporate enterprise with the public responsibility of a governmental agency. The Tennessee Valley Authority Act was the culmination of a long series of congressional investigations and enactments which found the federal government, in 1933, in possession of two partly equipped nitrate plants and the Wilson Dam and power house serving a single utility wholesale customer, at Muscle Shoals on the Tennessee River. The avowed purpose of the venture was the unified development of the Tennessee Valley—flood control, navigation, reforestation, use of marginal lands, production of fertilizer, agricultural and industrial development of the Valley, national defense—and, so far as consistent with navigation and flood control, the generation and sale of electric power "in order to avoid the waste of water power" and "to assist in liquidating the cost or aid in the maintenance of the projects of the Authority."²¹⁰ The Board was given broad powers to

²¹⁰ 49 Stat. L. 1076. "The basic economies inherent in such a development simply mean that the Nation can purchase invaluable services at bargain prices. The river

construct and acquire properties, including dams, power houses, and transmission lines, and was permitted to use the governmental power of eminent domain.

By the middle of 1939, the Tennessee Valley Authority was well advanced on its schedule. At the end of June, it had completed and placed in operation four great dams—Norris, Guntersville, Wheeler, and Pickwick Landing—in addition to the original Wilson Dam. Two additional dams were nearly completed, work on two others was progressing, and only a single additional project remained to be authorized and built, to round out the Authority's basic program of construction.²¹¹ By September the Authority had carried out the greater part of an extended campaign for the acquisition by purchase of private electric properties in the Tennessee Valley. Director Lilienthal had announced in 1934 that "to avoid duplication of facilities, to avoid territorial competition, to buy property at fair prices, are cardinal policies of the Tennessee Valley Authority." The first contract for the purchase of private power property was made in January 1934, and in the ensuing five and a half years, an additional 21 purchases brought the value (purchase price) of properties acquired by the T.V.A., by the T.V.A. in co-operation with municipalities or co-operatives, or by these latter agencies alone, to a total of \$110,343,501, and the number of customers affected,

becomes an integral part of the country's great inland waterway system consisting of 5,700 miles of continuous 9-foot channel. Further, the Tennessee, uncontrolled, contributes as much as 25 per cent to the crest of floods on the lower Ohio. Practically all of this flow can be retained for several days when the T.V.A. dams, including the great Kentucky Dam near Gilbertsville, are completed, reducing the flood crests at Cairo and on the lower Mississippi by from 2 to 3 feet. In all these operations electric power can be produced in such abundance that revenue from its sale will not only repay the entire construction and operation costs of the improvement chargeable to power but a great part of the whole river channel development as well. This is not theory. Revenues of more than \$5,500,000 from the sale of electricity in the fiscal year provided a net income of \$1,478,000 after payment of all power expenses, direct and allocated." *Annual Report of the T.V.A., 1938-39*, p. 2.

²¹¹ The same, p. 2. The total amount of public funds allocated or appropriated to the T.V.A. to June 30, 1939, was \$231,066,270 (in addition to a net cost to the federal government of \$128,940,965 for the Muscle Shoals projects to August 15, 1933, carried on the books of the T.V.A. at a materially lower figure). The same, p. 143, and 76 Cong. 1 sess., *Report of Joint Committee Investigating the T.V.A.*, S. doc. 56, pp. 102 ff. Fixed assets, depreciated, shown by the T.V.A. as of June 30, 1939, were \$237,425,946; and total assets, \$257,664,417. *Annual Report of the T.V.A., 1938-39*, p. 142.

to 270,660.²¹² As of August 16, 1939, the generating capacity of the Authority had been increased to 719,000 k.w.h., and its transmission lines to 3,800 miles.²¹³

It is possibly of greater significance than the physical accomplishments of the T.V.A. to date, that the year 1939 saw the Authority as the survivor of its greatest legal battle, of a period of internal dissension, and of a congressional investigation. In *Tennessee Electric Power Co., et al. v. Tennessee Valley Authority, et al.*,²¹⁴ it was held that private power companies, possessing no exclusive monopoly rights in the areas which they served, were not entitled to question the constitutionality of the act. The story of the personality and policy conflicts within the T.V.A. Board, and their effects upon the morale and operations of the entire T.V.A. organization was generally aired in the press of the country at the time of the dismissal by President Roosevelt of the Board's first chairman, Dr. A. E. Morgan, and during the hearings and at the time of the report of the Joint Congressional Investigating Committee. The committee, with three members dissenting, supported the Board with reference both to specific allegations of wrongdoing and generally on its policies and operations.²¹⁵

In conformity with requirements of the act, the rate policy of

²¹² The same, pp. 49-51. The greatest single purchase involved the Tennessee Electric Power Co., and culminated in the sale, August 1939, to the T.V.A. and 22 municipalities and 11 co-operative associations, of producing and distributing properties at a purchase price of \$78,600,000. The price was a compromise figure, reached after prolonged negotiations; and was announced by the T.V.A. as being somewhat in excess of the original cost of the properties less the T.V.A. estimate of depreciation. Other major acquisitions were made in 1938-39, and at present only minor negotiations are pending. The same, pp. 52-56.

²¹³ The same, pp. 61, 64.

²¹⁴ 306 U.S. 118 (1939). The Authority emerged winner in its only other case to reach the Supreme Court for a decision, *Ashwander et al. v. Tennessee Valley*, 297 U.S. 288 (1936). From 1933 to June 1938, the constitutionality of the Tennessee Valley Authority Act was questioned in a total of 57 actions, in 41 of which the Authority was named as a party. See *Report of Joint Committee Investigating the T.V.A.*, p. 62 ff.

²¹⁵ See 75 Cong. 3 sess., *Message from the President of the United States Transmitting Information Relative to the Removal of a Member of the Tennessee Valley Authority*, S. doc. 155; *Report of Joint Committee Investigating the T.V.A.*, Introduction, Chaps. 15 and 16, and appendices A and B; D. L. Marlett, "The T.V.A. Investigation," *Journal of Land and Public Utility Economics*, Vol. 15 (1939), p. 212; and D. L. Marlett, "The T.V.A. Investigation: Minority Views," *Journal of Land and Public Utility Economics*, Vol. 15 (1939), p. 360.

the T.V.A. is designed (1) to induce widespread use of electric energy by domestic consumers, and (2) to produce gross revenues in excess of the cost of production. The Authority sells power directly to large industrial users and privately owned utilities, and to municipalities and co-operative associations for resale; and in the contracts entered into with municipalities and co-operatives, provisions inserted by the Authority govern the rates at which the power may be resold to residential, commercial, and industrial consumers. It is in its approach to the problem of the rates to be charged to and by its municipal and co-operative customers that the T.V.A. has made its most important contribution to the theory and practice of rate making, and has drawn public attention to what is, probably, the most vulnerable feature of the prevailing system of commission control of private utilities.²¹⁶

Rates as originally set by the Authority were not based upon T.V.A. costs or experience—no operating costs had been incurred at that time, and no experience had been had. Rates were drafted on the basis of the experience of a large number of public plants in this country and in Canada, and after consultation with rate experts and regulatory officials. The typical regulatory technique (the ascertainment of costs, and their division by the number of units of energy sold at past prices) was cast aside, and in its place was substituted a calculation of rates designed to be fully remunerative, but derived from the consumption and income which it was anticipated would result from rates much below those previously in effect generally in the Valley, and from the low unit costs which, it was believed, increased production would make possible. The anticipations were based upon relevant experience outside the Tennessee Valley, and upon elaborate studies of the market for energy which the T.V.A. might serve. It has been pointed out earlier in this chapter that regulatory commissions are virtually powerless to require rate reductions unless existing utility income is in excess of costs; consumption and production must increase before costs will decline, and costs must be lowered before rate reductions designed

²¹⁶ The Authority's industrial contracts reflect typical considerations: bargaining power, general industrial conditions, the desirability of a substantial industrial load particularly during developmental years, and the fact that industries can use secondary and interruptible power not suited to domestic use.

to increase consumption may be ordered. The T.V.A., by contrast, has sought to set its rates at the lowest possible remunerative level, and to promote full use of its facilities by the adoption of a commercial pricing policy familiar to any large business which, unprotected by monopoly, has to seek its customers in a competitive market.²¹⁷

There is no reason, of course, why any public utility may not voluntarily adopt such a rate policy, and it is a matter of record that many of them do so price their services. The point is simply that regulation is not conducive to such a course of action, and is quite without power to require it save by some indirect device such as the "objective rate" scheme which will provide the utility with full revenue protection while it cautiously explores the lower levels of demand.

The provocative issue as to whether or not the Tennessee Valley Authority power program is fully paying its way can scarcely be settled here. In its most recent report the Authority announced that its power operations for 1939 provided a net income "of more than \$1,478,000 after all expenses, including direct power expenses (management, operation of powerhouses, substations, and transmission system, promotion, etc.) and allocated expenses incurred jointly in the operation of the multipurpose dams . . . and . . . after provision of approximately \$1,736,000 for depreciation calculated on a straight-line basis."²¹⁸ Too, the Joint Committee accepted as "reasonably conservative" the estimates of its engineering staff that revenues from the sale of power would not only pay all power costs, but would also cover the annual expenses of navigation and flood control and return the total investment in these programs in about 50 years. On the other hand, the Committee's dissenting

²¹⁷ See the statements by L. S. Lyon, quoted in *Report of Joint Committee Investigating the T.V.A.*, App. A, pp. 203-04.

The Authority's rate policy is treated exhaustively in the same, pp. 162 ff.; App. A, p. 197 ff.; App. B, p. 203 ff., p. 469 ff.; and Hearings, Part 12, p. 5189 ff. and Part 13, p. 5511 ff. There is more than a suggestion in the Authority's publications that electric energy should be made available by public plants at low price even to small-use, high-cost domestic consumers.

²¹⁸ *Annual Report of the T.V.A., 1938-39*, pp. 58-59, and p. 144. The figure \$1,478,000 represents net income before interest (\$1,442,880) plus the excess of interest due to the Authority from long-term obligations of municipalities and co-operatives over interest due by the Authority on bonds payable.

minority found that "the electric power operations as now planned and as planned for the future, and at the rates now prevailing, inevitably must result in a loss which must be made up by the Government."²¹⁹

Whatever the proper verdict may be on whether or not the Authority's power program is self-supporting, it is clear that T.V.A. rates have resulted in a phenomenal increase in the use of electric power throughout the Tennessee Valley. Giving full credit to improved economic conditions generally, as well as to the intensive appliance selling campaign conducted in the Valley, for the part they may have played in increasing the demand for electric energy, the evidence remains overwhelming that the Authority's low-rate policy has served to tap a large reservoir of demand previously potential, but unserved.

The average use of 1,179 kilowatt-hours for these [T.V.A. distributing] agencies was well above the residential average of about 850 kilowatt-hours for the Nation. The average cost, 2.14 cents per kilowatt-hour, was approximately half of the average of 4.21 cents per kilowatt-hour for similar service in the United States in the calendar year 1938. During the 1938 fiscal year, the TVA average cost was 1.99 cents.²²⁰

²¹⁹ *Report of Joint Committee Investigating the T.V.A.*, pp. 249, 252, 303, and App. B, p. 289.

The conflicting conclusions were due to differences in predicted markets and revenues, and divergent views on interest rates, depreciation, the perennial question of taxes, and the allocation to be made to power production of costs incurred jointly with other T.V.A. projects. The majority of the Committee accepted the Authority's allocation to power of 40 per cent of the joint facility costs, and 52 per cent of the total costs of the completed 3-dam system; a combination of amortization and depreciation to provide a total annual retirement at the rate of 1.775 per cent; and average taxes "almost identical with the average paid by the private companies." The reader will appreciate that any allocation of common costs, by whomever performed, is, in the nature of the case, an arbitrary process; any allocation is "correct" if it serves the purpose for which it is intended. The same, pp. 153-61, 249.

Referring to T.V.A. distributors, the Committee found that "the Authority's rate schedules have produced sufficient revenues to cover costs and fixed charges, and to return a substantial profit to small towns and cities. Their application to co-operatives is still somewhat uncertain." The Committee continued: "... the committee concludes that their success is due to the adoption of a dynamic policy by the Authority, as contemplated by the act, of mass production and mass sales under drastically reduced rates, which is opposed to the static high-rate policy of the private power industry." The same, pp. 253, 254.

²²⁰ *Annual Report of the T.V.A., 1938-39*, p. 77.

That the objective of fuller use of facilities is being realized is suggested by the statement:

If a matter apparently so objective as cost is capable of producing such violent disagreement between the supporters and the critics of the Tennessee Valley project, it is difficult to believe that the larger question "whether the electric rates of the Authority provide a legitimate, honest 'yardstick' of equitable rates of private industry," can ever be given a universally acceptable answer.²²¹ A governmental power project may be undertaken in an area already being generally served by private industry, in an effort to spread the use of electricity irrespective of costs or on the basis of estimated lower costs which are peculiar to government enterprises. Again, it may, by the threat of economic extinction (possibly "cushioned"), force private utilities in the area (and in other areas which might be entered) to carry out the very best performance, in terms of rates and service, of which they are economically capable, as judged by a

"... it now appears that the demands of the Tennessee Valley region will require new generating capacity in addition to that which has been supplied by the Authority plus that which is planned in the 10-dam system for the control of the Tennessee River.

"The past few years have seen the demand for power in the Valley States increase at a rate more than double that for the United States as a whole. During the 12 months ending June 30, 1939, there was generated in the United States 123,034,000,000 kilowatt-hours of electricity, an increase of 29 per cent over the 95,925,000,000 kilowatt-hours produced in the year 1929. In the seven Tennessee Valley States, power production has increased from 7,376,000,000 kilowatt-hours to 12,060,000,000, or more than 63 per cent." The same, p. 57.

²²¹ The Joint Committee directed its attention principally to the retail rates of the municipalities purchasing T.V.A. power—"if their operations are shown to be of a kind that may be substantially duplicated in other parts of the country, their rates may be considered a Nation-wide yardstick, or measure of results to be expected." The majority's conclusions, after dealing with claims that a federal subsidy to the Authority was passed along to local distributors in the form of low wholesale rates, that distributors were being subsidized by federal promotional services and advertising, and that the bookkeeping of the local systems failed to show costs that would be borne by a private system, were that "the accounts and cost charges of the distributors of the Authority's power . . . do provide a legitimate, honest yardstick . . . in the field of [private] retail distribution," and that "it is evident that the yardstick does not supply a simple and invariable rule but rather a body of experience indicating what may be expected in various types of communities when local conditions are properly taken into account." The majority found, further, that the internal accounts of the Authority were not related to and did not provide a yardstick of equitable rates for the private generating industry, because of the multiple use of the dams, but that "the Authority's wholesale rates conform to the competitive standard of private industry, and result in power-supply costs to its distributors substantially the same as these costs in efficient private business." *Report of the Joint Committee Investigating the T.V.A.*, pp. 190-91, 198. And see App. A, pp. 197-271; and App. B, p. 200 ff. The minority was "amazed" at the majority finding (p. 285).

standard erected by the government on any basis it deems suitable.²²² The Tennessee Valley Authority is certainly spreading the use of power directly through its own facilities, and, in the judgment of the writer, on a paying basis. But it is in its capacity as a coercive regulatory instrument that the Authority may be making an equally valuable contribution. The Joint Committee observed that "the Authority yardstick is perhaps the greatest factor in forcing the private industry to drop the static policies engendered by regulation, and to adopt the mass-production policies of competitive industry. No one will know how cheaply electricity can be sold, and how much electricity people will buy in any particular area or community until these policies are adopted."²²³

Events seem to be establishing the T.V.A. as an effective adjunct to commission regulation in uncovering the potentialities of attracting, and rendering service economically to, wider ranges of consumption; and in forcing private industry, by the threat of competition, to a fuller development of these possibilities.²²⁴

V. CONCLUSION

The task which has been set for public utility regulation is, by inducement or compulsion, to evoke and make continuously available for actual consumption the maximum amount and quality of utility service consistent with society's accepted pattern for the provision of goods and services generally from a limited stock of productive resources. Unfortunately no completely convincing appraisal of its performance is possible. There is no exact measure of the degree to which regulation has prevented extortion or unjust

²²² Continuing point-by-point competition by public and private plants for the same customers is not feasible generally, although it may obtain during a brief transition period, and it may appear to exist in certain areas where, in fact, a division of territory is tacitly accepted. It seems clear, too, that strict "yardstick comparisons" in any sense involving exact measurement is out of the question if any significant operating or marketing factors are at variance.

²²³ *Report of the Joint Committee Investigating the T.V.A.*, p. 198.

²²⁴ On the T.V.A. program generally see D. E. Lilienthal, "T.V.A. and the Widening of Economic Opportunity," address at Columbia University, Jan. 15, 1940; W. L. Willkie, "Political Power," *Atlantic Monthly*, Vol. 160 (1937), p. 210; A. E. Morgan, "Public Ownership of Power," *Atlantic Monthly*, Vol. 160 (1937), p. 339; E. S. Mason, "Power Aspects of the T.V.A. Program," *Quarterly Journal of Economics*, Vol. 50 (1936), p. 377; and a series of articles by M. G. Glaeser, *Public Utilities Fortnightly*, Vol. 13 (1934), pp. 319, 394, 456; Vol. 15 (1935), p. 9; Vol. 24 (1939), pp. 259, 606, and 733.

discrimination; and certainly no measure of the extent to which regulatory pricing has contributed to the proper allocation and full, continuous use of social resources within the utilities industries and throughout the economy.²²⁵ It will suffice here to review briefly the implications of some of the considerations presented in the main body of the chapter, and to point them toward the formation of a present judgment on the regulatory process.

The record of public utility regulation generally since 1907 is neither impressive, nor yet too disheartening. The excessive costs and delays of regulation, its rigidities, and its apparent lack of purpose beyond the settlement of individual controversies, cannot fairly be overlooked. On the other hand, the utilities industries have experienced an enormous physical growth, the increasingly complex problems of regulation have been met by the improvisation of elaborate regulatory machinery, and the period for adjustment has, after all, been short.

The developing processes of regulation hold promise to the extent that they effect an informed and positive adjustment of public utility controls to other phases of a price-guided economy, rather than primarily the protection of mystically defined property rights in case-by-case adversary litigation; to the extent that they indicate an increasing reliance upon records and business realities, rather than upon expert revelation; and in the degree to which the structure of regulation is so tightened and pointed that it becomes less attractive for utilities to seek earnings by exploiting the regulatory system, and, consequently, more attractive for them to concentrate their efforts on the selling of service. Encouraging tendencies are all plainly discernible today, but they are to be seen in clearest re-

²²⁵ Data are available to show the steady increase in the use of electric power and the general lowering of electric rates—broken down for types of uses, size of markets, etc. But these indicate merely what has happened under the exact circumstances that have in fact obtained. There is no universal, objective standard against which the achievements of this industry under regulation may be measured; no way of knowing what the industry might have accomplished if regulatory conditions had been different. Similarly, data are available showing the earnings of the industry, its "profitability," and the ease with which it has been able to market its securities; likewise, cost ratio data, throwing light on changes in the efficiency of its operations; but with reference to all of these it must still be said that they throw little light either on how much of what has been accomplished has been due to regulation, or what might have been accomplished under regulation of another kind.

lief against the great backdrop of indifference which still dominates the regulatory scene.

Though the standards by which the effectiveness of regulation is judged are not exact, and perfect performance is not to be expected in any case, it is quite possible to identify specific defects of regulation in relation to rather widely accepted general goals, and, with considerably less agreement, to name remedies. The remedies, it may be noted, whether in the realm of government regulation or of government ownership, look universally toward more, or more intensive, control rather than less. There will be no reinstatement of competitive individualism in the utilities field. None the less, the final test of regulation may come in terms of its ability somehow to break through its rigidities and to supply the drive toward the lowest level of remunerative prices and the fuller utilization of facilities which has come thus far to be associated in the public mind more with the processes of effective competition than with those of private monopoly, however controlled.

CHAPTER XXII

TRANSPORTATION

Throughout our national history governmental authority has continuously and extensively been concerned with the adequacy of the supply and with the proper functioning of transportation facilities. As in all modern countries this interest has been motivated by recognition of the basically conditioning influence which transport services exert upon the economic and social well-being of an industrialized state. The character and scope of the relations of government to transport services have also been molded by political necessity and expediency, and throughout, by the limitations which our constitutional form of government places upon public authority in this particular field of activity. Regardless of the devices used or the doctrines prevalent at any particular time, public policy has consistently reflected in one degree or another a conviction that some form of government participation is essential to guarantee the production of the type of transport facilities conceived at the moment as essential to the nation's welfare.

In line with this concept, governmental agencies have at different times either subsidized or directly produced and operated transport facilities such as highways, lighthouses, waterways, and airports. They have maintained judicial processes through which an individual may seek reparation from common carriers for the violation of common law standards of responsibility, which require common carriers to treat alike all who are situated alike and to render to all reasonably adequate service. Both state and federal governments have sought through enactment and enforcement of statutes to require specified carriers to perform according to standards deemed to be in the "public interest." And more recently, public authority has exercised a continuing managerial supervision over the essential operating phases of the principal transport industries in order to direct the forces of private enterprise into operating patterns and practices thought to be socially desirable.

The chief issues of transportation policy which are of particular

relevance to this section of the study have in the main emerged from lines of development embraced within this last mentioned category of public action. It appears desirable, however, to review briefly the early efforts of the national and state governments to supply major systems of "internal improvements" and to outline the chief characteristics of the "competitive era" during which principal responsibility for the construction and operation of transport facilities was delegated to private enterprise.

I. THE INTERNAL IMPROVEMENTS ERA

During the early part of the nineteenth century the energies and ingenuity of the nation were directed toward the difficult task of securing the political stability and economic development of a sparsely populated and extensive territory. The prime importance of inland communications to the accomplishment of this task was perceived at an early date by public men and by the community at large. Advocates of a strong national government assumed that governmental authority would take the initiative in supplying adequate lines of communication.¹ And throughout this early period it was universally conceded that political consolidation, the provision of adequate defense,² and the effective exploitation of

¹ To those who contended that a central government could not function effectively because of the great territorial extent of the country, Madison answered: ". . . the intercourse throughout the Union will be daily facilitated by new improvements. Roads will everywhere be shortened, and kept in better order; accommodations for travellers will be multiplied and meliorated; an interior navigation on our eastern side will be opened throughout, or nearly throughout, the whole extent of the thirteen States. The communication between the Western and Atlantic districts, and between the different parts of each, will be rendered more and more easy by those numerous canals with which the beneficence of nature has intersected our country, and which art finds it so little difficult to connect and complete." Alexander Hamilton, John Jay, and James Madison, *The Federalist*, No. 14 (National Home Library ed.), p. 83.

² The striking deficiencies of the young nation's transport plant were dramatized by the War of 1812. On this point see, for example, *American State Papers, Military Affairs*, Vols. 2 and 4. During the great constitutional debates on the power of the national government to prosecute internal improvements a report of a House committee on Monroe's message of 1817 maintained: "The embarrassment of the nation during the war, from the want of good roads and canals, both in relation to trade and the transportation of cannon and military stores, have been too recently and sensibly felt to be forgotten. Vested with the power of making war, the Constitution could never have intended the General Government should make it under such disadvantages." (15 Cong. 1 sess., *Annals of Congress*, Vol. 31 (1817), p. 457.)

the country's natural resources would be governed in large measure by the speed with which hitherto isolated communities were furnished with economical facilities for the transportation of goods and people, and for the communication of intelligence. Such facilities were essential to the encouragement of permanent settlement in areas which offered promise but no assurance of profitable commercial development. The task was one of vast proportions; and it was highly speculative in character.

While numerous works of local importance were undertaken by private enterprise, the supply of private capital was insufficient to finance the construction of a national system of transport facilities as rapidly as was desired. This consideration, together with the repeated accrual of embarrassingly large treasury surpluses from the protective tariff, were advanced in support of extensive federal participation in the work of internal improvement. The famous Gallatin Report of 1808, for example, proposed to launch the national government upon an extensive scheme of highway and waterway improvements designed to link the older and newer sections of the country into a cohesive economic-political unit.³

During the first quarter of the century, the national government undertook one extensive project, the Cumberland Road. But the issues of public need for internal improvements, and of the choice of an appropriate agency to meet that need, gradually became entangled in the tariff controversy,⁴ the rising tide of sectionism, and hence in the intricate constitutional debates of the period.⁵ These conflicts diverted the national government from efforts to establish a systematic program of internal improvements. By about 1830 it had abandoned "grand schemes" for the develop-

³ Gallatin, Secretary of the Treasury, presented to the Senate a comprehensive plan for the development of an integrated scheme of internal improvements to be undertaken by the central government. The plan called for a broad development which according to his characterization adhered to the "great geographical features of the country" and was "calculated to diffuse and increase the national wealth in a very general way, by opening an intercourse between the remotest extremes of the United States." *American State Papers*, Vol. 20 (Misc. Vol. 1), p. 740. See also B. H. Meyer, ed., *History of Transportation in the United States before 1860* (1917), pp. 135-36.

⁴ See Chap. XX.

⁵ See 15 Cong. 1 sess., *Annals of Congress*, Vol. 31 (1818), p. 1119; and Meyer, *History of Transportation*, p. 142.

ment of transport facilities. A project-by-project policy of improvement had been adopted in the field of river and harbor work; and the national government was rapidly withdrawing from highway construction.⁶ The tendency was to allow the states to assume major responsibility for the transportation function.⁷

Turnpike companies were granted charters empowering them to construct pikes and to exact charges for their use. In many instances the states aided financially in the private construction of major highways and in some cases embarked upon railroad-building ventures. It was in the field of canal improvement, however, that the states expended their major energies during the second quarter of the nineteenth century.

The spectacular success of the Erie Canal, completed in 1825, gave great impetus to artificial waterway developments already under way in the East and ushered in an era of highly speculative canal development in other areas of the country. In the furtherance of this program, state activity as a whole was not distinguished by the exercise of political restraint or business acumen. Facilities were extended into regions giving little promise of remunerative traffic; and the potential role of the railroads in the transportation system was but vaguely sensed. True, several states ventured into the field of railroad development, but such action generally reflected the widely held view that the function of the railroads was to serve as feeders to or connecting links between canals.⁸ Undoubtedly this misapprehension as to the true potentialities of rail transportation contributed in no small measure to the eventual financial failure of most canal projects.

By 1838 about half of the states had incurred debts for internal improvements, debts which in the aggregate constituted tremendous burdens upon their resources,⁹ and contributed substantially to the

⁶ For history of highway developments during the 19th century see Harold G. Moulton and Associates, *The American Transportation Problem* (1933), p. 527. Contemporary policy is discussed below, pp. 833-48.

⁷ The national government, however, continued to supply aids to navigation such as river and harbor improvements and lighthouses.

⁸ 59 Cong. 1 sess., *Regulation of Railway Rates*, S. doc. 244, Digest of Hearings, Senate Committee on Interstate Commerce (1905-06), p. 19.

⁹ Indebtedness for canals and railroads comprised more than half the total, and canal indebtedness constituted the largest single item. E. L. Bogart, *An Economic History of the United States* (1922), p. 206.

destruction of state credit. In the financial maelstrom of 1837, obligations were repudiated,¹⁰ and so violent was the reaction against further governmental ventures in the field that provisions were embodied in many state constitutions prohibiting the use of state credit for such purposes. The collapse of state credit brought to an abrupt end governmental efforts to build directly and to operate the country's major transport facilities.

II. THE COMPETITIVE ERA

About the middle of the nineteenth century governmental policy with respect to transportation enterprises entered a transitional period of fundamental importance. With the abandonment of the policy of extensive public construction and operation, efforts were made by government to stimulate private enterprise in the construction of a railroad plant.

A. Public Assistance in Construction of Railroad Plant by Private Enterprise

Public aids took two main forms. First, private enterprise was freed of all major restrictions. Eastern states, in line with British practice, had commonly included provisions in their railroad charters providing, among other things, for control of maximum rates, for annual reports to shareholders or legislatures, and for responsibility for the safety of persons and property. In line with the current policy of facilitating rail expansion, western states, however, commonly omitted all such restrictions from their charters,¹¹ virtually conferring unlimited power on rail managements to charge whatever rates they deemed expedient.¹²

A second, and probably more significant, means of spurring the

¹⁰ Davis R. Dewey, *Financial History of the United States* (1931), p. 243 ff.

¹¹ J. L. Ringwalt, *Development of Transportation Systems in the United States* (1888), p. 231; Moulton and Associates, *The American Transportation Problem*, p. 864.

¹² It should be noted, however, that public authority did not wholly relinquish its traditional interest in the functioning of transport services. Railroad companies have always been required to secure state charters which in general (even during the 1860's and 1870's when "western" states liberalized charter provisions) have subjected them to more restrictions than have usually been applicable to ordinary business undertakings. And railroads, along with stage coaches, canal boats, etc., have consistently been subjected to the common law standards of common carrier responsibility.

private development of railroad facilities was the grant of governmental aids. These took numerous forms. National and state governments not only made extensive grants of public land, but local governments in particular offered direct financial assistance.¹³ Railroad promoters were not slow in taking full advantage of these circumstances. They resorted to ingenious devices to attract private capital to their undertakings. The attitude of the investing public rapidly underwent a change favorable to spectacular promotional schemes. Moreover, the inflationary situation brought about by the Civil War produced an environment favorable to prosecution of speculative ventures.¹⁴ Consequently, railway promoters were able to tap every available source of capital, large and small, domestic and foreign. Sufficiently large aggregations of domestic capital were available to carry many ventures, at least until shares could be distributed to a wider public. And surprisingly, foreign investors apparently had forgotten their unprofitable financial experience with state-financed canal ventures and were again ready to speculate on the economic possibilities of a new era of westward expansion.

Promoters did not find it necessary, however, to confine their operations to ventures which could be financed directly from relatively large aggregations of capital. New methods of financing such ventures were rapidly gaining acceptance. Through wide stock and bond distribution, quite often accomplished indirectly by compensating construction companies with railroad securities which they

¹³ By 1880, which marks the end of the policy of granting public lands to promote the extension of railway properties, approximately 215 million acres of land had been granted railway corporations. Of this amount the corporations had secured clear title to about 155 million acres. Moreover in 1880 there was outstanding in the form of county, township, and city bonds which had been issued for the purpose of granting railway aid, a total of approximately 185 million dollars. (59 Cong. 1 sess., S. doc. 244 (1905-06), p. 20.) For analysis of the land grant policies see Frederick A. Cleveland and Fred Wilbur Powell, *Railroad Promotion and Capitalization* (1909), Chap. XV.

¹⁴ As Ringwalt observed, railroads ". . . were no longer regarded as struggling enterprises, which could scarcely hope for success unless they were carefully managed, and remarkably fortunate in their location and surroundings, but rather as bonanzas, which could scarcely fail to enrich all who were prominently connected with them, either in construction or operation. Roads that had previously been prosperous increased their dividends, and roads that had been on the verge of bankruptcy suddenly became profitable. . . ." Ringwalt, *Development of Transportation Systems*, pp. 181-82.

in turn sold to the public, every type of potential investor was reached.¹⁵ Individuals located along the proposed right of way were persuaded that by purchasing railway shares they stood to gain both by sharing in the transportation advantages which would accrue from completion of the line, and by participation in the earnings anticipated from the venture.¹⁶

All of these factors—absence of restrictions, direct governmental aid, and the facility with which private capital was attracted to ingenious promotional schemes—united to produce a period of unparalleled expansion.¹⁷ Between 1850 and 1880 railroad extension took two main forms.¹⁸ First, links were extended from the eastern centers into the western commercial frontier. These links were generally built or soon controlled by eastern lines which had been

¹⁵ “. . . Roads were no longer built with money furnished by their nominal owners, but chiefly with the proceeds of bonds, or in cases where large advances were made by wealthy projectors they expected to be speedily reimbursed by the sales of bonds and stocks which were freely issued to represent the value of the new railways. The system of creating construction companies which undertook the entire work of completing a line, receiving as its compensation chiefly new railway stocks and bonds, which it marketed, also became more and more extensively adopted. . . .” (The same, p. 222.)

¹⁶ By this practice the railroad promoters unwittingly fashioned the spearhead of the subsequent agrarian agitation for public control. For when dividends failed to materialize and the farmer not only found himself deprived of anticipated income to support his mortgaged property but was called upon to contribute increased taxes to support indebtedness incurred by state and county for the same purposes, his resentment against railroad corporations became personalized and vehement. See Cleveland and Powell, *Railroad Promotion and Capitalization*, especially Chap. XII.

¹⁷ Adams observed that “. . . capital flowed [1865-70] to the West in an apparently inexhaustible stream, and under its influence railroads were constructed as if by magic. The best and the most preposterous lines were equally built; competing line was run upon competing line between the great centres; while other lines were laid out from points where no one lived to points where no one wanted to go.” Charles Francis Adams, “The Granger Movement,” *North American Review*, Vol. 120 (1875), p. 397.

¹⁸ Although railway mileage did not reach its peak in this country until 1916 (254,037 miles), the essential physical outlines and operating form of the system were created during the period from 1850 to 1880 when the public policy of non-interference was extensively applied.

The great trunk-line systems had been completed or were nearing completion. The first transcontinental line was opened in 1869 and by 1890 there were in existence about 164,000 miles of railroad. For the significant details as to the expansion of the physical mileage of the railways during the period up to 1890, together with capitalization, etc., see the following: 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), pp. 7-14, and Pt. 2, p. 222; and 59 Cong. 1 sess., S. doc. 244 (1905-06), App. VIII.

established between 1830 and 1860. This was a natural development for these carriers could hope to maintain their relative competitive status in the eastern territory only by acquiring facilities which would give them access to traffic being created by the westward expansion. Second, important independent lines such as the Illinois Central, the Chicago and Northwestern, the Chicago, Burlington and Quincy, the Chicago, Milwaukee and St. Paul, the Chicago, Rock Island and Pacific, and the Chicago and Alton were pushed fanwise west and south from Chicago. The competitive advantage gained by these carriers in the building up of long distance traffic added great weight to the natural tendency for the consolidation of local lines into competitive long distance lines and the elimination of barriers between rail lines such as toll charges, different gauges, and other disparities in operating methods and equipment. Thus emphasis throughout the entire period of rapid mileage expansion was upon "through" lines as contrasted with merely local facilities.

B. Operating Practices and Policies under Free Competition

As the rail network expanded over the country, there developed in the industry a highly competitive situation. This situation gave rise to practices designed to diminish or eliminate competition, and eventually brought about a program of extensive state and federal control. The practices which provoked the strongest opposition were rate discrimination, and combined and concerted action to destroy competition.

Rate discrimination. So long as rail traffic remained substantially local in character, facilities were relatively fully utilized, and the practice of discrimination was not common. But as rail facilities expanded, there developed much excess capacity, and a struggle for traffic ensued in which rate discrimination became a prominent competitive weapon. Where competitors were successfully driven out, discrimination in rates often remained as a by-product of the monopolies created.

Two kinds of discrimination became common. The carriers often charged differential rates to similarly situated individuals for the performance of identical services. And they established differential

charges between places according to their location with respect to competitive rail service. These rate discriminations usually took the form of secret rebates or drawbacks, or of higher charges for a shorter haul than for a longer haul in the same direction and over the same line. Most frequently favorable rates went to the large shippers, for whose business the competition was strongest.

By 1885, discrimination between similarly situated individual shippers had been thoroughly incorporated into the rate structure. Voluminous testimony elicited from shippers and state railroad commissioners during hearings before the Cullom Committee, a Senate committee established in that year to investigate operating practices in this industry, furnished evidence not only that such discrimination was universally practiced but that many railroad officials considered it an indispensable feature of their pricing system.¹ In view of these findings the Cullom Committee concluded that the powers of government would have to be invoked “. . . to protect the people in their common-law rights and to insure them the equal enjoyment of the advantages of transportation.”²⁰

Differentials between so-called “local” and “through” rates became an integral part of railroad operating practice during the 1870 decade when rapid expansion of trunk-line railroads engendered fierce competition for long-haul traffic. At the so-called railroad centers the struggle for traffic volume was so intense that rates were often driven to levels which failed to return even operating costs to the carriers. By virtue of the physical nature of rail transportation these railroad centers constituted only a few of the total number of shipping points served by any given line. Numerous communities were served by only one railroad. Moreover, competition from road and water agencies was extremely limited. Road transportation had declined during this period to inconsequential proportions. Federal and state governments had progressively abandoned road building and during the latter half of the nineteenth century this function was performed indifferently by counties and townships. The highway did not appear again as an im-

¹⁹ 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 188.

²⁰ The same. For a detailed analysis of the practice of giving concessions to large shippers, see the same, p. 190.

portant factor in the transportation system, except for purely local traffic, until after the World War.²¹ Nor did inland waterways compete effectively with railways, as they were extremely limited both geographically and as to the quality and range of service offered.²² Under these circumstances there were many non-competitive points at which carriers were able to charge monopoly prices, being limited only by what the traffic would bear, or, perhaps more accurately, by what the traffic would not bear.²³

While both individual and local discrimination were widely condemned, it was generally recognized that charges differentiating between local and through traffic do not under all circumstances constitute "unjust discrimination."²⁴ It was pointed out that in determining the justification for discrimination between places, where the through rate is lower than the local rate, the important question is not whether the through rate is too low, but whether the difference between the through and local rates can be justified on other than purely arbitrary grounds. The Cullom Committee, for example, suggested that this problem could be dealt with effectively by prohibiting the practice of charging less for the longer than for the shorter haul, except where the carriers could make

²¹ Compare below, pp. 834-48.

²² While the Cullom Committee in 1885 stated that the influence of water routes ". . . is not confined within the limits of the territory immediately accessible to water communication, but extends and controls railroad rates at such remote and interior points as have competing lines reaching means of transport by water . . ." we must assume that they were referring to the *potential* rather than to any *actual* role of water transportation. For at a later point, it was observed that "the chief defects of the present [1885] water-routes of the country, as a whole, are that they are too long for successful competition with the railroads, and that they are too isolated and disconnected for successful co-operation." 49 Cong. 1 sess., S. rep. 46, Pt. I (1885-86), pp. 170, 174.

²³ To cite an extreme case, it was often cheaper for a shipper at an intermediate non-competitive point to pay the through rate between railroad centers plus an added charge for having the shipment unloaded short of its technical destination than it was to pay the local rate. (See, for example, the account given by Adams, "The Granger Movement," *North American Review*, Vol. 120, p. 401.)

²⁴ The Cullom Committee, for example, observed: "No question connected with the problem of railroad regulation has given the committee more perplexity than that relating to the utility and expediency of legislation prohibiting a carrier from charging more for a shorter than for a longer haul under any circumstances, not that we have any doubt as to the injustice of such a charge under most circumstances, but because it seems inexpedient to enforce such a regulation under all circumstances." (49 Cong. 1 sess., S. rep. 46, Pt. I (1885-86), p. 195.)

positive showing that valid economic bases existed for such rate differentials.²⁵

Widespread public dissatisfaction with railroad rate practices led quite naturally to a closer scrutiny of some of the less obvious, but nevertheless important, consequences and implications of the relatively unrestrained competitive operation of the railroad system. Shippers were becoming cognizant of the fact that such competition, by destroying itself, tended to make inoperative the natural regulative forces which had been depended on to produce adequate and reasonable service.²⁶

Combinations and concerted action. Railroad consolidation had proceeded by 1885 to a point where a relatively few large interests either dominated or owned most of the properties.²⁷ Where consolidation proved impossible or inexpedient, competing companies began casting about for means of putting some brake upon the competitive forces in the industry.²⁸ As early as 1870 the carriers

²⁵ Specifically the Committee recommended "that a greater charge for a shorter than a longer haul shall be declared presumptive evidence of an unjust discrimination, and that such charges shall be prohibited whenever they shall constitute an unjust discrimination." (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 197.)

²⁶ Charles Francis Adams, a careful student of railroad transportation and its operation during the period under review observed: ". . . it is obvious that an active competition between two or more agencies,—the number, however, being always very limited,—no one of which can withdraw from the field, must necessarily result in the complete mastery of the stronger and the ultimate absorption of the weaker. In other words, where combination or absorption is possible, continued and sustained competition is not possible; and the truth of this aphorism has been demonstrated through forty years of railroad history. The distinction between a competition where the field is open to the whole world and one where it is confined to a few monopolizing agencies is very obvious,—competition of the first description is an end, an ultimate condition; that of the second is a means to an end, a mere phase of evolution." (Adams, "The Granger Movement," *North American Review*, Vol. 120, p. 400.) Important technical improvements in rail operation made during this period merely enhanced the competitive disadvantage of the less progressive and the unfavorably situated roads. For example, innovations such as the substitution of steel for iron rails, making it possible to carry heavier and longer trains, only intensified the struggle of rail managements to secure large volume, long haul traffic. (On this point see Ringwalt, *Development of Transportation Systems*, p. 198.)

²⁷ It should be noted, however, that the Cullom Committee in the report on which the original Interstate Commerce Act of 1887 was based expressed the belief that railroad consolidation had run its course; that the existence of such factors as water competition, abundance of capital, vast geographic extent of the country lessened ". . . the dangers to be apprehended from future consolidations and combinations." (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 180.)

²⁸ 59 Cong. 1 sess., S. doc. 244 (1905-06), p. 36.

began to enter into "pooling" or "confederation" contracts to divide traffic or revenues. These agreements were designed to reduce or remove incentives for rate cutting. The carriers, however, met with indifferent success in the maintenance of pooling agreements.¹⁹

Bad manners. In addition to complaints against rate discrimination and combinations and concerted action, there was considerable dissatisfaction among shippers because of the failure of the railroads to provide what they regarded as a satisfactory quality of service. Even where there was active competition for patronage, management was widely charged with "bad manners" in its dealings with the purchasers of rail service.²⁰

The charges of arrogance and indifference were of especial importance in the development of governmental controls because they were leveled against freight agents, passenger agents, and station masters—the men who transacted the railroads' business with the shipping and traveling public. Relationships between the railroads and the public were thus poisoned at the point of operating contact. The resulting bitterness injected into the relations of governmental authority to railroad management a distinctly punitive philosophy which persisted for almost half a century. Its immediate effect was to center regulatory effort upon the control of abuses rather than upon the control or elimination of the fundamental causes of those abuses.

C. Agitation for Control of Monopoly Power

Broadly speaking, the so-called railroad problem of this period

¹⁹ Although, prior to 1887, pooling agreements covered substantially all classes of competitive traffic they served as only partial checks on rate competition. The carriers chiefly interested in the maintenance of such agreements had no legally or otherwise enforceable method of requiring all carriers in a given area to subscribe. (Ringwalt, *Development of Transportation Systems*, p. 272.)

²⁰ A practical student of railroad problems, experienced both as a railroad commissioner and a railroad president, stated: "Taken as a class, the manners of the employees of the Western railroad system are probably the worst and most offensive to be found in the civilized world. It is difficult to see why the official should regard the traveler or the person having dealings with the railroad as his natural enemy; but it is apparent that he does. . . . A ticket is sold, and the purchaser is at the same time made to feel that a favor has been conferred upon him—that he is on no account to ask any questions—and, indeed, had best speedily remove himself out of the way. The gruffness of the baggage-master is, as a rule, only excelled by his violence to the baggage." (Adams, "The Granger Movement," *North American Review*, Vol. 120 (1875), p. 402.)

was associated with the more extensive issues revolving around the general problem of monopolies.³¹ "Down with monopolies" was proving a popular rally cry for all factions that believed themselves victims of such alleged monopolists as railroad, insurance, warehouse, telegraph, and farm implement companies. Even middlemen of all classes who had business dealings with the farm population were included within the general category of monopolists. So broad were the allegations of monopoly power that only laborers and farmers escaped condemnation.³²

Although agitation against monopoly was inclusive in scope, railroad management was destined to feel the initial thrust of the drive to control it. This was natural enough, for many communities and individuals were beginning to realize that through the power to control the price, quantity, and quality of transportation service, trade channels, producing regions, and individual business prospects could be created or destroyed almost at will.

III. STATE SUPERVISION

In line with the evolution of governmental activity in other fields, the federal government did not undertake public control of railroads until various states had experimented actively for several decades with a variety of regulatory devices. Initially, the New England states had attempted to control their railroads through charter provisions patterned largely on British experience and legal concepts. It soon became apparent, however, that a more flexible method of continuous supervision was desirable. As early

³¹ In commenting on these features the Cullom Committee stated: ". . . The interest everywhere manifested in its investigation has convinced the committee that *no general question of governmental policy occupies at this time [1885] so prominent a place in the thoughts of the people as that of controlling the steady growth and extending influence of corporate power and of regulating its relations to the public*; and as no corporations are more conspicuously before the public eye, and as there are none whose operations so directly affect every citizen in the daily pursuit of his business or avocation as the corporations engaged in transportation, they naturally receive the most consideration in this connection." (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), pp. 2-3.)

³² Fundamentally disturbing economic and social forces were at work. The burden of debt incurred in the rapid westward expansion was pressing heavily on the earning power of many enterprises. The farmer found himself caught in one of those recurring periods of price decline in which the price of farm products dropped precipitately but the cost of implements and other farm supplies remained relatively stable. For further analysis, see Vol. 1, Chap. X, of this study.

as 1839 Rhode Island created a railroad commission vested with limited supervisory powers; and by 1869 all of the New England states except New Hampshire had established commissions empowered to exercise varying degrees of control over railroads.³³ In general the authority of these commissions was limited to the collection of operating data and the inspection of railway equipment and service. Even where, as in the case of Massachusetts, a state attempted more extensive control through commission supervision, reliance was placed upon “. . . investigation, the justice of its conclusions, and the force of public opinion for the enforcement of its recommendations. . . .”³⁴

During this period, roughly up to 1870, when the New England states were experimenting with various methods of regulation, the western states, especially the so-called Granger states,³⁵ were more anxious to encourage the development of railways than to regulate them. When eventually the demand for regulation became urgent in the West it was only natural that the affected interests should seek the solution of their difficulties through state rather than through federal action, and that the regulatory systems should be patterned after those in New England. The regulatory programs of many western states were, however, much more authoritarian than those developed in the East.³⁶ Most of them were designed to control rate discrimination through direct commission supervision of rate-making practices.

³³ For details see 59 Cong. 1 sess., S. doc. 244, Pt. I (1905-06), p. 21.

³⁴ 49 Cong. 1 sess., S. rep. 46, Pt. 1, p. 66.

³⁵ Illinois, Wisconsin, Iowa, Minnesota, and Nebraska.

³⁶ In the Granger states, for example, such pressure groups as the “Patrons of Husbandry” were instrumental in securing the adoption of fully implemented and punitive systems of regulation. The direct influence exerted by the Granger organizations upon the course of railroad legislation (especially federal) has no doubt been exaggerated owing to the spectacular nature of their pronouncements and performance.

For substantially differing treatments of the Granger movement and its influence on rail legislation, both state and federal, see: S. J. Buck, *The Granger Movement, 1870-1880* (1913), and Adams, “The Granger Movement,” *North American Review*, Vol. 120 (1875), p. 397 ff.

The Cullom Committee characterized the movement in the following terms: “Whatever may be said of the character of the legislation inspired by that agitation, [Granger] it certainly served a timely and useful purpose in its day, and substantial and beneficial results must be accredited to that popular uprising against the railroad corporations. . . .” (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 64.)

By 1885, all but ten states and six territories out of the thirty-eight states and eight territories had adopted some type of railroad regulation.³⁷ Twenty-five of these had adopted the commission form of regulation. The degree of success achieved in the practical administration of these state regulatory systems varied widely, depending upon the character of the law, the quality of administrative performance, and the attitude adopted by the regulated carriers. It is clear, however, that these experiments exerted important direct influences on the subsequent trend of the federal government's relations to rail carriers. For one thing, they made available to the legislators who formulated the first federal regulatory law a wide variety of practical experience in the techniques and problems of railroad regulation. This was particularly true with respect to the complex problems of rate making. Moreover, in disclosing some of the more important economic characteristics and social implications of railroad transportation, state experimentation facilitated the application to railways of the legal concept of "affection with a public interest." Through this process railroad corporations were forced to adapt many of their practices and attitudes to a revitalized concept of broad public responsibility.³⁸

But the potential effectiveness of state regulation was materially circumscribed by two related obstacles: the power of the railroad corporation, and the constitutional division of power between the federal and state governments. Concentration of political power in the hands of railroad corporations developed as a corollary of the growth and consolidation of railroads. By 1880, approximately

³⁷ For a complete history of the creation and operation of state railroad commissions which had been created up to 1885, see pp. 63-137 of 49 Cong. 1 sess., S. rep. 46, Pt. 1. See also Moulton and Associates, *The American Transportation Problem*, p. 863 ff.; A. T. Hadley, *Railroad Transportation* (1886), Chap. VII; and L. H. Haney, *A Congressional History of Railways in the United States, 1850-1887* (1910).

³⁸ ". . . when, in the notable 'granger cases,' the United States Supreme Court upheld those methods and left the railroads at the mercy of the State legislatures, the corporations assumed a radically different attitude towards the community and towards the law-making power. They have since been more ready to recognize their public obligations, greater respect for public opinion is manifested, and in consequence the recommendations of the State commissions, which were at first contemptuously ignored, have since, as a rule, been complied with." (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 64.)

one-fifth of the nation's corporate wealth was accounted for by railroad value.³⁹ Moreover, there was a pronounced trend toward concentration of effective control over these properties into the hands of a few corporations. It was only natural that those who enjoyed control over this vast economic power should resist the efforts which developed to dilute it through the transfer of some important elements of control from private to public agencies. In some states the legislative process was so responsive to the wishes of railroad management that admittedly defective controls over railways were enacted; and the attainment of obviously desirable uniformity in the regulatory methods of states forming natural trade areas was blocked. In other states, moreover, the resistive power of railway management was sufficient to hamper effective administration of substantively satisfactory laws. Commenting on the power of the corporation to influence legislative processes, a witness testifying before the Cullom Committee observed:

. . . You get an institution like the Standard Oil Company, with its \$50,000,000 of capital, or an institution like the Burlington and Quincy Railroad, or the Northwestern Railroad, running through several states, and you concentrate that power at any state capital, the temptations are almost irresistible to bow to the powers that be, even if not corruptly, for the purpose of gaining its favor, on the part of an ambitious young legislator who is a lawyer and who desires to be appointed as counsel for the company in a particular district, and thus to make himself a member of like instruments of commerce and of influence. They have, like every other great agency, means of corruption that are not merely pecuniary. . . .⁴⁰

Even if the states had been competent and willing to cope with the power of railroad corporations, constitutional limitations would have precluded them from exercising effective control over interstate traffic, which had come to dominate railroad operations. Leading roads, such as the Chesapeake and Ohio, Chicago, Burlington and Quincy, Chicago, Milwaukee and St. Paul, Illinois Central, Missouri Pacific, and Pennsylvania, reported in 1885 that the bulk of their operating revenues was derived from interstate transporta-

³⁹ According to estimates introduced before the Cullom Committee. (49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 49.)

⁴⁰ The same, p. 44.

tion.⁴¹ Under these conditions it was obvious that state regulation would prove ineffective unless both interstate and local operations could be controlled. Consequently, various states attempted to subject interstate operations to regulation on the theory that

. . . there is a kind of neutral ground, especially in that covered by the regulation of commerce, which may be occupied by the State, and its legislation be valid, so long as it interferes with no act of Congress, or treaty of the United States.⁴²

This interpretation, however, was eventually rejected by the United States Supreme Court in the *Wabash* case, decided in 1886. The net effect of the ruling was to place the preponderant portion of railroad transportation beyond the regulatory jurisdiction of state authority.⁴³

Thus, by 1886, after extensive governmental efforts to find a satisfactory means of transferring substantial elements of responsibility for the conduct of transport services from private to public agencies, the most important phases of rail transportation remained uncontrolled; and the state controls imposed upon the remainder produced results of widely varying quality. It was, however, through such a process of experimental groping for solutions that public attention and action were directed toward the national aspects of the regulatory problem.

⁴¹ For a detailed tabulation of data showing division of business of leading railroads (1885) as between intrastate and interstate operations, see 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 138.

⁴² *Henderson, et al v. Mayor of the City of New York, et al*, 92 U.S. 259, 272 (1875).

⁴³ The Court said in part: "It cannot be too strongly insisted upon that the right of continuous transportation from one end of the country to the other is essential in modern times to that freedom of commerce from the restraints which the State might choose to impose upon it, that the commerce clause was intended to secure. This clause, giving to Congress the power to regulate commerce among the States and with foreign nations, as this court has said before, was among the most important of the subjects which prompted the formation of the Constitution. . . . And it would be a very feeble and almost useless provision, but poorly adapted to secure the entire freedom of commerce among the States which was deemed essential to a more perfect union by the framers of the Constitution, if, at every stage of the transportation of goods and chattels through the country, the State within whose limits a part of this transportation must be done could impose regulations concerning the price, compensation, or taxation, or any other restrictive regulation interfering with and seriously embarrassing this commerce. . . ." (*Wabash, St. Louis and Pacific Railway Company v. Illinois*, 118 U.S. 557, 573 (1886).)

This decision was in line with previous rulings of the Supreme Court on the

IV. FEDERAL MANAGERIAL SUPERVISION: RAILROADS AND ANCILLARY AGENCIES

With the passage in 1887 of An Act to Regulate Commerce,²⁴ the federal government entered upon a program of transport regulation which during the course of fifty years has evolved from a partial and admittedly experimental system into a comprehensive program of managerial supervision.²⁵ While all governmental activities in this field have had a common objective, namely, a "safe, adequate, and economical transportation system," a variety of theories and implementing techniques have been adopted. The evolution of regulatory policy, for example, has been influenced by two basically divergent theories. Certain lines of regulatory action have been predicated on the assumption that the railroad industry is inherently monopolistic in character,²⁶ while other lines of action, pursued simultaneously, have been designed to maintain competition or have in effect tended to maintain it, not only among railroad operating units but between the railroads and other transportation agencies.

During the early portion of the period under review, public regulation took a predominantly restrictive form, being designed to aid the shipping and traveling public in securing legal redress against rail carriers for the exaction of "extortionate" or "discrimina-

subject. In declaring unconstitutional an act of the state of Louisiana which attempted to regulate the interstate transportation of passengers the Supreme Court said: "While it purports only to control the carrier when engaged within the State, it must necessarily influence his conduct to some extent in the management of his business throughout his entire voyage. His disposition of passengers taken up and put down within the state, or taken up within to be carried without, cannot but affect in a greater or less degree those taken up without and brought within, and sometimes those taken up and put down without. . . ."

"It was to meet just such a case that the commercial clause in the Constitution was adopted." (*Hall v. De Guir*, 95 U.S. 485, 489 (1877).) For analysis of other relevant leading cases see 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), pp. 28-39.

²⁴ Stat. L. 379; approved Feb. 4, 1887.

²⁵ In the course of the twenty years prior to 1887 numerous bills were introduced in Congress proposing every description of federal regulation. Only two of those which involved the power of Congress to impose direct regulation upon the business of rail transportation were enacted. See Haney, *Congressional History of Railways*, especially pp. 281, 313.

²⁶ For explicit statements concerning this assumption compare Windom Committee report, 43 Cong. 1 sess., S. rep. 307, Pt. 1, p. 242 (1874), and Cullom Committee report, 49 Cong. 1 sess., S. rep. 46, Pt. 1, pp. 40, 176.

tory" rates. In general, these early regulatory measures did two things. They imposed upon carriers a few broad statutory standards of performance and they set up public agencies to aid the individual in securing reparation for individual damages suffered because of carrier violation of these standards.⁴⁷ Within these limits it was believed that the operating policies of private enterprises could be depended upon to produce an adequate supply of economical and otherwise satisfactory transportation service. It was assumed that in respect to other phases of operation, interline competition would suffice to protect the public interest.

After about two decades of experimentation with these indirect methods of regulation, public action began to change character and to embrace additional areas and points of control. Beginning with the passage of the Hepburn Act in 1906 there has occurred what may be termed a two-dimensional⁴⁸ growth of governmental supervision over transport facilities.

In the area of railroad control, the form of public action has been changed from an essentially negative or punitive to a positive or managerial system of supervision. The sphere of governmental regulatory action has embraced one after another of the essential operating features of railroad transportation. The determination of pricing methods and policies, the establishment of co-operative routing arrangements with competing lines and carriers, the provision of an adequate supply of operating facilities, the adoption of safety devices and methods, the inauguration, extension, and abandonment of service, the consolidation of and acquisition of control over properties, and, to a limited extent, the choice of labor policies,⁴⁹ have all been brought within the orbit of governmental supervision. In short, the managerial supervision by governmental authority has in large measure replaced the initiative of private

⁴⁷ To this end the initial Act to Regulate Commerce created the Interstate Commerce Commission to serve as the agent of Congress. It has since functioned continuously in that general capacity, administering the increasingly complex regulatory system.

⁴⁸ It should be noted in passing that during this period governmental agencies have assumed an ever-expanding responsibility for the direct production, maintenance, and management of such transport facilities as highways, waterways, and airways. These activities will be considered here only to the extent that they have impinged directly upon the effectuation of regulatory objectives.

⁴⁹ This phase of the subject is dealt with in Vol. 1, Chaps. VIII and XIII.

management in the formulation and execution of business policies affecting the quantity, quality, and price of railroad transportation service. More recently various types and degrees of managerial supervision have been extended to other modes of transport competitive with the railroads.

The complex and comprehensive managerial supervision which the federal government now exercises over rail transport agencies derives its substantive form from the Interstate Commerce Act and from a series of supplementary enactments dealing mainly with safety of operation.⁵⁰

During the course of some fifty years, the administrative application of this body of regulatory law has produced a vast collection of Commission reports and decisions, and an extensive series of court cases.⁵¹ It is apparent that a detailed analysis of each of these major statutes in terms of its legislative setting, its administrative application, and its interpretation at the hands of the courts would carry the present study beyond its intended scope. We shall, therefore, limit our treatment to tracing, in broad outlines, the evolution

⁵⁰ Control is exercised chiefly through the Interstate Commerce Commission created by sec. 11 of the Act to Regulate Commerce, 24 Stat. L. 379 (Feb. 4, 1887), and composed originally of five members with overlapping terms of six years each. By various amendments the number of commissioners has been increased to eleven, with seven-year terms. The term "independent agency" frequently applied within recent years to the Interstate Commerce Commission (and to similar units) was not at the time of its creation, and is not at present, accurately descriptive of its status. It was created as an agent of Congress to perform functions deemed inappropriate for direct congressional determination; it reports directly to Congress (until 1889 it reported to Congress through the Secretary of the Interior); its orders are subject to judicial review; and its membership is appointed by the President with confirmation by the Senate.

The present Interstate Commerce Act which contains the main body of railroad regulatory law administered by the Commission has evolved from the provisions of six major acts: An Act to Regulate Commerce, 1887; The Hepburn Act, 1906; The Mann-Elkins Act, 1910; the Esch Car Service Act, 1917; the Transportation Act, 1920; and The Emergency Railroad Transportation Act, 1933. The Motor Carrier Act, 1935 (see p. 839) now constitutes Part II of the Interstate Commerce Act. Numerous minor supplementary enactments have dealt mostly with procedural matters.

Prior to 1920 this general body of law was referred to as An Act to Regulate Commerce; since the passage of the Transportation Act, 1920, it has been known as the Interstate Commerce Act.

⁵¹ The extent and character of the Commission's railroad regulatory work is outlined in its uniformly excellent Annual Reports to Congress. Its formal decisions, rendered since its creation in 1887, have been published in a series of 231 bound volumes cited as 1 ICC 000, and 47 volumes dealing with valuation re-

of positive and authoritative managerial supervision over the quantity, quality, and price of railroad service.

A. Competitive Relationships

Before 1920 the chief concern of the federal government was with the statutory enforcement of a thorough-going interline railroad competition and with the maintenance of effective competition between water and rail carriers. This particular phase of public policy was implemented by the 1887 Act to Regulate Commerce which prohibited all forms of railroad pooling; by the 1890 anti-trust legislation⁵² which prohibited any form of concerted carrier action tending unduly to restrain railroad competition; and by the 1912 Panama Canal Act⁵³ which in practical effect excluded rail carriers from the field of water transportation. Pursuit of this line of public action has produced some striking and unanticipated consequences.

Statutory enforcement of competition. It will be recalled that the regional outlines of the railroad system took form under a regime of relatively free competition. Concerning the merits of this general method of developing a transportation plant, it was quite generally maintained in the eighties that

a method of uniform regulation adopted at the outset might have prevented a needless waste of capital and might have obviated or mitigated existing evils, but it would assuredly have retarded the building up of the country in comparison with the progress attained under freedom from legislative restrictions. If a mistaken policy was adopted in the beginning it is questionable whether its resulting general advantages do not outweigh its injurious effects. Indeed, it may be said that in a certain sense

ports (as of Jan. 10, 1940). The legislative evolution of the body of law known as the Interstate Commerce Act together with supplementary enactments is traced and I.C.C. and court decisions applicable to particular sections of the law are indicated in *The Interstate Commerce Acts Annotated* prepared by the I.C.C. in accordance with statutory instruction, and originally published in five volumes (1930). An historical analysis of the Commission's work and organization has recently been released by it (1937) under the title of *Interstate Commerce Commission Activities, 1887-1937* (269 pages). The character of the Commission's performance has been dealt with in a study by I. L. Sharfman, *The Interstate Commerce Commission* (in five volumes) published by the Commonwealth Fund (1931 to 1937).

⁵² Sherman Anti-Trust Act, 1890, 26 Stat. L. 209.

⁵³ 37 Stat. L. 560, 566 (1912).

the evils complained of today are in the nature of a mortgage handed down for payment to the present generation as its share of the price paid for making habitable and building up our vast domain at a rate of progress never equaled in any other country.⁵⁴

In the congressional deliberation on the initial Act to Regulate Commerce some witnesses counseled the adoption of remedies designed to preclude the accumulation of another "mortgage" for payment by the next generation. They contended that since the operating abuses complained of had grown directly out of interline and market competition, intelligent public policy would strike at the source of the evil by providing for authoritative control over the future expansion of physical plant, and over interline competition. Specifically they urged federal incorporation of railroad companies; and warned that any effective system of national regulation eventually would have to rest on such a foundation.⁵⁵ These counsels, however, secured no statutory recognition. On the contrary the 1887 act left full control over construction and financing with the various states,⁵⁶ and regulation was concerned mainly with the prevention of rate discrimination (to be discussed below), and the prohibition of pooling.⁵⁷

⁵⁴ 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), pp. 5-6.

⁵⁵ See testimony of Simon Sterne in 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86),

P. 44.

⁵⁶ The Cullom Committee recognized the desirability of exercising governmental control over the building of new facilities but concluded that no such power resided in the national government. It maintained that such control would interfere with the rights of the states. 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 51.

⁵⁷ 34 Stat. L. 379, 380. The circumstances under which the rigid anti-pooling provisions were inserted in the 1887 act illustrate the vicious type of compromise which has characterized the development of transportation policy. In this, as in other areas of public action, compromises have been necessitated in order to break legislative deadlocks growing out of conflict between incompatible ideologies. But in this field they have led not to the adoption of one or the other of these ideologies but to the simultaneous application of policies drawn from both.

Senate sponsors of the 1887 act were inclined to favor the recommendations of the Cullom Committee that rail carriers be required to adhere uniformly to published classifications and tariffs. Since it was recognized that such a provision would in effect require the carriers to function collectively rather than competitively in constructing freight classifications and rate schedules, the Senate group opposed the rigid prohibition of pooling. House sponsors, however, favored a rigid system of prohibitions to be enforced exclusively by the courts. (For analysis of the Reagan bill, incorporating these features, see Haney, *Congressional History of Railways*, p. 293.) They proposed outright prohibition of pooling and confedera-

There resulted a general abandonment of outright pooling (that is, the pooling of freight and division of earnings) which had been practiced extensively since 1870. However, the carriers continued to arrange rate schedules by joint agreement.⁵⁸ As a matter of fact the carriers were obliged to resort to some such form of group action in order to satisfy the rate-filing requirements of the 1887 act. As we shall explain in more detail below⁵⁹ that act made it necessary for the carriers to publish and adhere to fixed classifications and schedules of rates, and prohibited changes in those classification and charges except on prescribed statutory notice. Prior to passage of the 1887 act, Congress had been advised that the enforcement of these rate requirements would necessitate joint carrier action. The Cullom Committee had pointed out (in 1885-86) that such a proposal "must mean that the railroads shall be operated under a system of fixed rates, established by themselves, but just as inflexible as if the rate upon each article of shipment, for given distances or between places named, should be prescribed by statute."⁶⁰

The Sherman Anti-Trust Act of 1890⁶¹ as interpreted by the courts imposed prohibitions on the carriers which conflicted with the rate-filing requirements of the 1887 act. In the *Trans-Missouri Association*⁶² and *Joint Traffic Association*⁶³ cases the Supreme Court

tion in any form and a rigid rule against charging more for the shorter than for the longer haul, discussed below. (*First Annual Report of the Interstate Commerce Commission, 1887*, p. 16.) In principle, thus, the House Committee advocated legislation designed to enforce thorough-going competition on the carriers. As a result of the compromises required to secure legislation, the initial act embraced both of these conflicting principles of regulation. (Haney, cited above, p. 299.)

⁵⁸ "Generally speaking, their functions, after this date, were to effect agreements as to the charges to be applied to the traffic within the jurisdiction of each, to collect statistics of its distribution among the rival routes, to publish the rate schedule fixed by agreement, and to furnish a means of detecting and correcting deviation from these published schedules." (59 Cong. 1 sess., S. doc. 244 (1905-06), p. 37.)

⁵⁹ See p. 790.

⁶⁰ 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 200. And after passage of that act the Interstate Commerce Commission stated that ". . . it is perfectly reasonable to expect that the carriers of the country will, in so far as it is found practicable to do so, make such joint and general arrangements among their number that the public, when availing themselves of their services, shall find an arrangement with one adequate for the purposes of any single transaction. . . ." (*Second Annual Report of the Interstate Commerce Commission, 1888*, p. 25.)

⁶¹ 26 Stat. L. 209.

⁶² *United States v. Trans-Missouri Freight Association*, 166 U.S. 290 (1897).

⁶³ *United States v. Joint Traffic Association*, 171 U.S. 505 (1898).

ruled that the anti-trust law made railroad rate agreements illegal regardless of the "reasonableness" or "justness" of the rates involved. The impact of these decisions upon the regulatory theory and requirements of the Act to Regulate Commerce is indicated by the Commission's report:

The antitrust act, so called, as interpreted by the courts, renders any agreement with reference to the making or maintaining of interstate rates a crime. But if carriers are to make public their rates and to charge all shippers the same rate, they must, as a practical matter, agree to some extent with respect to these rates.⁶⁴

While these conflicting statutory provisions have never been reconciled, the anti-trust prohibitions are not applied to contemporary railroad rate-making activities. Railroad rate schedules and classifications are commonly constructed for various territories by rate and classification committees staffed by representatives of the carriers operating within those territories.

Having been forced to abandon outright pooling and most other forms of concerted action,⁶⁵ the carriers turned to other devices to restrict competition.⁶⁶ Where control over traffic could not be secured by lease or stock ownership, they adopted the only other effective weapon available, namely, the physical penetration of competitors' traffic territory.

By the construction of feeder and connecting lines, most carriers attempted to tap the traffic territory of other competitive lines operating within its area. Between 1890 and 1916 the railway network expanded from 163,597 to about 254,037 miles.⁶⁷ In contrast to the developments which occurred prior to 1890, this period of railway expansion was essentially intensive, in the sense that it consisted largely in the construction of feeder lines, connecting lines, and spurs.

⁶⁴ 14th Annual Report of the Interstate Commerce Commission, 1900, p. 9.

⁶⁵ Attempts to effectuate combinations of competing lines by various devices were definitely arrested in 1907 by the Supreme Court decision—*Northern Securities Company v. United States*, 193 U.S. 197.

⁶⁶ The range within which the differential rate device could be used for this purpose had already been narrowed somewhat by governmental rate control. See below.

⁶⁷ See Interstate Commerce Commission, *Statistics of Railways in the United States*, 1891, p. 14; 1917, p. 12.

A wide variety of devices were used by individual carriers in the competitive struggle to attract traffic to their own lines, and out of this situation there developed the inevitable wastes of cross-hauling, circuitous routing, and unco-ordinated terminal operations. These operating practices emerged as a natural corollary of a public policy which placed chief dependence for production of satisfactory railroad service upon statutory enforcement of competition. By 1920 operating practices, managerial policies, property rights, and trade channels had become rigidified around the competitive pattern of operation. It was under these conditions that public authority attempted to deal directly and authoritatively with the consequences of excessive and duplicating railroad plant.

The Transportation Act of 1920 empowered the Interstate Commerce Commission to exercise positive and comprehensive control not only over the physical extent of the railroad plant but over the competitive relations of operating units.

Relaxation of enforcement of competition. The Transportation Act of 1920 modified in important respects the policy of maintaining thorough-going interline railroad competition which had been followed since about 1890. It substituted a system of supervised co-operative action among the carriers, permitting pooling, the acquisition of control, and the consolidation of independent lines into a "limited number of systems." Faith in the efficacy of competition was not abandoned, however, for the statutory standards imposed upon the Commission in dealing with pooling, acquisition of control, and consolidations were designed to maintain a degree of competition among railroad operating units. Moreover the effective exclusion of rail carriers from the field of water transportation adopted in 1912, was retained as an essential feature of national transportation policy.⁶⁸

Pooling. While the outright prohibition against pooling, operative since 1887, was removed by the 1920 act, the sphere within which agreements could legally be made between "different competing railroads" for the pooling of freight or the division of earnings, was limited by several statutory requirements. In the first place, the Commission was authorized to approve a pooling

⁶⁸ To date no modification has been made in that policy.

agreement only after finding that it was "in the interest of better service to the public or economy in operation" and that it would not "unduly restrain competition."⁹⁹ Moreover, any such plan, whether initiated by the carriers or by the Commission, could be made binding only "if assented to by all the carriers involved."

This conditional legalization of pooling was, of course, designed to provide an avenue by which the carriers could avoid destructive rate wars. It might have proved significant in the general scheme of regulatory policy if more direct means of achieving the same end had not been provided. But, as we shall see later, the Transportation Act gave the Commission power to fix both minimum and maximum rates, and, therefore, the direct power to remove one of the conditions which had previously motivated pooling agreements. Moreover, through the consolidation and acquisition provisions of the act, the carriers were afforded more direct and what were believed to be more effective devices for cushioning the impact of competitive forces.

Consolidation and acquisition of control. It is clear from the events and discussion leading up to the passage of the 1920 act, and from the terms of the act itself, that the consolidation and acquisition provisions were designed to bring about the eventual consolidation of the numerous existing railroad units into a limited number of operating systems. For some rather obscure reason, however, Congress differentiated between the legal standards applicable to the actual consolidation of carriers into a limited number of operating systems and those applicable to the acquisition of control of railroad properties. As we shall observe below, this distinction, as applied in practice, contributed to the defeat of the purpose of consolidation.

The Commission was instructed by Congress, in unambiguous terms, to prepare and adopt "as soon as practicable . . . a plan for the consolidation of the railway properties of the continental United States into a limited number of systems."¹⁰⁰ In the preparation of such a plan, however, it was required to preserve competition "as fully as possible" and, "wherever practicable," to maintain "the

⁹⁹ Interstate Commerce Act, sec. 5(1).

¹⁰⁰ The same, sec. 5(4).

existing routes and channels of trade and commerce." In addition, the Commission was instructed to arrange the various systems so that "the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties."⁷¹ Upon completion of the tentative plan the Commission was instructed to enable interested parties, through the medium of public hearings, to register their views relative to its merits. The law provided further that upon completion of these two processes the Commission ". . . shall adopt a plan for such consolidation and publish the same."⁷²

The initiation of consolidation proposals affecting specific lines was left entirely to the discretion of the carriers. But no consolidation could be legally consummated without prior approval of the Commission. The Commission was, however, given no authority either to require the carriers to submit proposals or to *order* the consolidation of properties in harmony with its own master plan. It was authorized to approve a proposed plan of the carriers only when the details harmonized with its master plan, and when the aggregate par value of the bonds and stock of the prospective single corporation was found to be not in excess of the aggregate valuation of the consolidated properties as determined by the Commission under the "valuation" provisions of the act (see page 812). If the Commission found that a given proposal satisfied these two basic requirements, and that the public interest would be promoted, it could enter an order permitting the consolidation to be effected "with such modifications and upon such terms and conditions" as it saw fit to prescribe. Final effectuation of the officially approved plan, however, was made dependent upon acceptance, by "all the carriers involved," of the conditions and modifications imposed by the Commission.

All pooling agreements, acquisitions of control, and consolida-

⁷¹ The same.

⁷² The same, sec. 5(5).

tions effected with Commission approval under the terms of the law as noted above were specifically relieved from the operation of the anti-trust laws and "of all other restraints or prohibitions by law, State or Federal, in so far as may be necessary to enable them [the carriers or any corporation organized to effect consolidations] to do anything authorized or required by any order . . ."⁷³ issued by the Commission with reference to such matters.

It would appear, therefore, that under the terms of the Transportation Act of 1920 Congress had cleared away all legal obstacles to the constructive solution, under the initiative of private management, of one of the most troublous phases of the railroad problem. The desideratum of national policy in this matter was, of course, the discovery and application of methods under which the railroads could be operated under private management as a transportation system designed primarily to meet both normal and emergency public requirements for continuous, safe, and economical service, rather than as a series of unintegrated business units, each struggling to achieve its own corporate advantage. In the pursuit of this objective Congress adopted a policy which depended for its successful execution quite as much upon the character of Commission performance as upon the initiative of private management.⁷⁴

To enter into a detailed discussion of the administrative evolution of consolidation and acquisition proceedings, or to attempt an evaluation of the causes for the failure of this phase of national policy to achieve any impressive results, would carry the present study beyond its stated scope.⁷⁵ It will suffice to call attention to some of the main problems of both basic policy and administrative

⁷³ The same, sec. 5(8).

⁷⁴ It is interesting to note that Great Britain, in dealing with a similar problem after the World War, adopted a strikingly different method. Upon termination of governmental control following the war the British government, in effect, abandoned the effort to preserve competition among its railroad systems. Under the terms of the Railways Act, 1921, the railroads were organized into four main regional systems with a minimum of inter-regional competition. The scheme of amalgamation was compulsory. For one discussion see C. E. R. Sherrington, *The Economics of Rail Transport in Great Britain* (1928), Vol. 1, Chap. XII.

⁷⁵ A thorough analysis and an evaluation of the Commission's treatment of the acquisition and consolidation features of the Transportation Act as amended by the Emergency Railroad Transportation Act, 1933, is given in Sharfman, *The Interstate Commerce Commission*, Pt. III, Vol. A (1935).

feasibility encountered by the Commission in its somewhat halting efforts to carry out the law.

After a period of preliminary study the Commission issued a tentative plan,⁷⁶ proposing the consolidation of the Class I roads of the country into 19 systems.⁷⁷ It offered no explanation for the assignment of particular roads to a given system, other than the observation: "We have sought to minimize dismemberment of existing lines or systems."⁷⁸ Public hearings on the consolidation plan covered a period of almost two years⁷⁹; and a voluminous record, comprising 11,713 pages in 54 volumes, was accumulated.⁸⁰ Subsequently, however, the Commission informed Congress that

. . . On February 4, 1925, we addressed a letter to the chairman of the Senate Committee on Interstate Commerce, in which the majority of the commission expressed doubt as to the wisdom of the provisions of the law which now require us to adopt a complete plan to which all future consolidations must conform. They further stated that they had been impelled to the belief that results as good, and perhaps better, are likely to be accomplished with less loss of time if the process of consolidation is permitted to develop, under the guidance of the commission, in a more normal way.⁸¹

Consistently with this view, basic amendment of the consolidation provision of the Interstate Commerce Act (sec. 5) was proposed.⁸²

⁷⁶ Professor W. Z. Ripley was retained by the Commission to prepare a report on railroad consolidation. The result of his study, which served as the basis for the Commission's tentative plan, is given in full in 63 ICC 465-660.

⁷⁷ *Consolidation of Railroads*, 63 ICC 455 (1921). The Ripley plan proposed 21 systems. The same, p. 640.

⁷⁸ The same, p. 455.

⁷⁹ Hearings were closed Dec. 4, 1923.

⁸⁰ *38th Annual Report of the Interstate Commerce Commission*, 1924, p. 13.

⁸¹ *39th Annual Report of the Interstate Commerce Commission*, 1925, p. 13.

⁸² In brief, the Commission proposed amendments which would (1) relieve the Commission from the duty of adopting a master consolidation plan; (2) give the Commission broad power to pass upon the validity of any consolidation proposed, restricted, however, by the necessity for making the following positive findings prior to approval: (a) that the consolidation will afford better service to the public or will result in operating economies, (b) that it will not "unduly restrain competition or be in any other material respect inconsistent with the public interest," and (c) that the aggregate capitalization of the consolidated company is proper (as defined by sec. 5(4) of the act as noted above); and (3) would make it unlawful for any carrier to acquire control of or consolidate with any other carrier "in any manner whatsoever" except with Commission authorization. Explanation and justification of these proposals are given in some detail in *39th Annual Report of the Interstate Commerce Commission*, 1925, pp. 13-14.

For the next four years the Commission delayed the promulgation of a final plan, taking the position that "the need for amendment in this and other respects has been developed in hearings before the appropriate committees of both Houses of Congress and so generally recognized that, pending action thereon, we have deferred adoption and publication of a complete plan."⁸³ This attitude was maintained until 1929, when the Commission observed that since Congress had not "amended section 5 as suggested" it (the Commission) had concluded that it was its "duty to proceed to comply, as far as possible, with the mandate of the law."⁸⁴ Thereupon, almost a decade after the adoption of a national policy designed to further physical consolidation of railroad properties, the Commission promulgated the framework which, under the terms of the law, was essential before voluntary consolidation could legally proceed.⁸⁵ In 1932 the Commission modified its plan in conformity with the wishes of leading carriers in the eastern territory⁸⁶ but the negotiations looking toward consolidation of eastern trunk lines were eventually abandoned. To date, no major consolidations have been effected under the Commission's plan.

A wide variety of explanations have been advanced for the Commission's delay in conforming with the mandate of the consolidation law, and for the meager results subsequently achieved. In the first place, the Commission considered the law unsound in important respects. But even had the Commission regarded it as sound, it is doubtful if any progress would have been made in overcoming two inherent difficulties. One arose out of the rapidly changing financial condition of the roads, making impossible an accurate forecast of earnings. Thus it has been observed that

a period of trial is often necessary, both to reveal elements of strength and of weakness. Substantial equilibrium seems unlikely to be attained for a considerable period of time. Yet in the meanwhile, tentative plans must be set up, in preparation for the application of the final test of

⁸³ 40th Annual Report of the Interstate Commerce Commission, 1926, p. 13.

⁸⁴ 43d Annual Report of the Interstate Commerce Commission, 1929, p. 87.

⁸⁵ Consolidation of Railroads, 159 ICC 522 (1929). This plan differed from that tentatively proposed in 1921 mainly in the recognition given in the former to the consolidations which had, in effect, been accomplished in the interim through authorized acquisitions of control.

⁸⁶ 185 ICC 403 (1932).

relative financial strength as soon as the available data makes this possible. Not infrequently it will be found that in these plans it has been necessary to put together what appears to be a disproportionate number of weak roads, or at all events, of roads which have yet to establish their claim to entire stability.⁸⁷

Another main difficulty was rooted in the tendency of strong roads to submit proposals to ally themselves with other strong roads, thereby forcing weak roads to seek whatever advantage could be secured by combining their interests with other weak lines. This often conflicted with the provision of the law requiring the maintenance of competitive equality. Moreover, under the terms of the law the Commission was required, in effect, to preserve "wherever practicable" the existing operating and traffic relationships.⁸⁸

Additional obstacles to the prompt promulgation of a final consolidation plan were created by the interrelated character of the Commission's consolidation and valuation functions. The progress of voluntary consolidation rested, as we have seen above, not only upon the formulation of a "master plan" but upon accurate knowledge of the values of the various physical properties involved in any given proposal. Valuation was begun in 1913, but as is noted below, it was not completed until 1933. Had the Commission proceeded to approve consolidation proposals prior to the determination of one of the main factors requisite to such approval, it would have been placed in an untenable position.

It should not be inferred from what has just been said that the manner in which the Commission handled its consolidation functions robbed the Transportation Act of all practical significance in so far as it was designed to obtain a closer-knit railroad system. For, during the ten-year period marked by inaction under the con-

⁸⁷ 63 ICC 455, 481 (1921), from Prof. W. Z. Ripley's report to the Commission.

⁸⁸ Professor Ripley observed: "Under such conditions the mandate of the statute . . . impels one of necessity toward consolidation of a number of equally substandard roads. Conformity with the other mandate of the statute by seeking to ally strong and weak properties to a like degree, thus threatens to overset the traffic relationships which have become customarily established by very force of circumstances. It is because of the clash between these at times discordant requirements, that the emergent result is so often a piebald compromise" (63 ICC 455, 482).

consolidation provisions, some carriers were achieving practical consolidation of properties under section 5(2) of the act, which permitted one carrier to acquire control of another through lease or by purchase of stock, subject to Commission approval. Moreover, numerous practical consolidations were effected through use of the holding company device which could not be reached by the Commission under its grant of authority. The Federal Coordinator of Transportation observed in 1934 that "the delay in attempting a plan prevented the consummation of consolidations in the technical sense but did not prevent the accomplishment of the same virtual results in other ways."⁸⁹

In passing upon applications under the acquisition section the Commission's discretion was limited by only two statutory standards. No proposed acquisition could be approved which contemplated the consolidation of the affected carriers into a "single system for ownership and operation." And the Commission was required to make a positive finding that the proposed acquisition of control would serve the "public interest." There was no specific mandate to preserve competition nor to maintain the existing channels of trade. But since both the acquisition and consolidation provisions of the law were designed to achieve the same objectives the Commission was obliged to test the validity of acquisition proposals by the same criteria of "public interest" that were provided for its guidance in passing on physical consolidations.

The Commission followed the principle of approving only those proposals for acquisition which appeared designed to produce an "adequate, economical, and efficient transportation system," in terms of national rather than local or sectional interests.⁹⁰ In the disposal of individual cases the Commission characteristically imposed con-

⁸⁹ 73 Cong. 2 sess., *Regulation of Railroads*, S. doc. 119 (1934), p. 22. For a discussion of the methods used by leading carriers to secure strategic control of eastern territory roads, without resort to Commission approval, see dissenting opinions of Commissioners Eastman and McManamy in *Consolidation of Railroads*, 185 ICC 403, 442 (1932).

⁹⁰ In effect this interpretation meant that local facilities could be abandoned even in violation of state law where it could be demonstrated that some general interest superior to local considerations was involved. Commission action based on this criterion was upheld by the Supreme Court in *Texas, et al v. United States, et al.*, 292 U.S. 522 (1934).

ditions designed to preserve competition; to maintain existing routes and trade channels; to give consideration to the situation of connecting and short-line roads; and to protect the interests of investors.⁹¹

The essential similarity between the criteria which the Commission applied in acquisition cases and those prescribed by law for dealing with consolidation proposals casts some doubt upon the wisdom and propriety of the Commission's sustained policy of allowing effective consolidation to proceed through acquisition of control, prior to the promulgation of a definite consolidation plan. It has been pointed out, however, that the adoption of any other procedure would have wholly defeated the declared legislative intent.

The impact of depression forces in 1930 accentuated the structural weaknesses of the railroad system and furnished the chief stimulus for the enactment in 1933 of legislation⁹² designed among other things to facilitate the elimination of the "wastes" resulting from the operation of duplicating facilities. Through this legislation an effort was made not only to eliminate some of the obvious defects of the consolidation devices provided in the 1920 act, but to deal along wholly different lines with the problem of competitive waste.

In effect, the amended act abandoned the difference between the statutory conditions under which acquisitions and consolidations could be prosecuted and approved; and it brought all devices for securing control of carriers, including the holding company mechanism, within the scope of Commission jurisdiction. The previous requirement that the capital obligations of the proposed company could not exceed the aggregate value of the merged units was abandoned. But the essential theory of the 1920 act was preserved. All proposed consolidations, mergers, or acquisitions were still required to be in harmony with the Commission's general consoli-

⁹¹ *Interstate Commerce Commission Activities, 1887-1937*, p. 196.

⁹² The Emergency Railroad Transportation Act, 1933, 48 Stat. L. 211 embraced both "permanent" and "emergency" policies. Title II of the act contained provisions amending the Interstate Commerce Act. The emergency provisions, which among other things created the office of Federal Coordinator of Transportation, were contained in Title I.

tion plan, and this plan was required to be framed in terms of the same general objectives. Moreover, the initiation and prosecution of specific proposals were left to the voluntary action of the carriers.

Other provisions of the 1933 legislation, however—those enacted as emergency measures—reflected a legislative conviction that “. . . the time had arrived for affirmative action to encourage and promote, and, if necessary, *compel* [italics supplied] action by the railroads so as to avoid unnecessary duplications of services and facilities, and to eliminate waste and preventable expenses of operation.”⁹³

Thus one of the declared purposes of the Emergency Railroad Transportation Act was:

. . . to encourage and promote or require action on the part of the carriers and of subsidiaries subject to the Interstate Commerce Act, as amended, which will avoid unnecessary duplication of services and facilities of whatsoever nature and permit the joint use of terminals and trackage incident thereto or requisite to such joint use; . . . to promote financial reorganization of the carriers, with due regard to legal rights, so as to reduce fixed charges to the extent required by the public interest and improve carrier credit; to provide for the immediate study of other means of improving conditions surrounding transportation in all its forms and the preparation of plans therefor.⁹⁴

As the operating situation actually developed, however, the efforts of the Federal Coordinator of Transportation⁹⁵ (the officer designated to effectuate the purposes of the act) in this direction yielded no immediate or tangible operating economies. The failure of this part of the program—the original goal of emergency action⁹⁶ was

⁹³ *Interstate Commerce Commission Activities, 1887-1937*, p. 253.

⁹⁴ 48 Stat. L. 211, sec. 4.

⁹⁵ By Executive Order No. 6196 issued July 6, 1933 Commissioner Joseph B. Eastman was appointed by the President to this office. He served in that capacity for three years from June 16, 1933 until June 17, 1936. The Coordinator was largely relieved from his duties as a member of the I.C.C. and was authorized to appoint a staff of assistants to carry on the work of the Coordinator's office. Under the original act the emergency measure was made effective for one year. By proclamation of May 2, 1934, the President extended the effective date of Title I from June 16, 1934 until June 16, 1935, 48 Stat. L. 1740. The effective period of Title I was further extended from June 16, 1935 to June 17, 1936 by a joint resolution of the Senate and House of Representatives, 49 Stat. L. 376.

⁹⁶ In reviewing the work of his office the Coordinator at one point stated: "In the discussion of the Act prior to its enactment attention had been particularly

attributed by the Coordinator to the anomalous situation brought about by the provision of the act which limited reductions in the number of employees.⁹⁷ In summarizing the effects of these labor provisions upon his work as it related to the reduction of wastes and the increase of operating efficiency the Coordinator stated: "The result was a general disposition on the part of the railroads to regard Sec. 7 (b) as a bar to any effective action and to lapse into inactivity, so far as the purposes of the Act were concerned."⁹⁸

Whether the failure of this portion of the Emergency Railroad Transportation Act to produce any measurable result was attributable to the recalcitrant attitude of the carriers, to the Coordinator's strict interpretation of the law, or to the rigid provisions of the law itself, need not be discussed here. The fact is that the Coordinator chose, or was forced, to concentrate his efforts on the investigational activities provided for in the act, rather than to utilize such devices

directed to forms of waste which involved unnecessary duplication or multiplication of operations, and to projects for the elimination of such waste, like the unification or joint use of terminal facilities or the pooling of trains or traffic. Upon consideration it seemed to the Coordinator that there were even more important forms of waste growing out of failure to adjust operations, equipment, service, and rates to the new conditions which had been created by the tremendous development of competing forms of transportation. . . ." 74 Cong. 2 sess., *Fourth Report of the Federal Coordinator of Transportation on Transportation Legislation*, H. doc. 394 (1936), p. 35.

⁹⁷ The provision referred to reads as follows: "Section 7 (b). The number of employees in the service of a carrier shall not be reduced by reason of any action taken pursuant to the authority of this title below the number as shown by the payrolls of employees in service during the month of May 1933, after deducting the number who have been removed from the payrolls after the effective date of this Act by reason of death, normal retirements, or resignation, but not more in any one year than 5 per centum of said number in service during May 1933; nor shall any employee in such service be deprived of employment such as he had during said month of May or be in a worse position with respect to his compensation for such employment, by reason of any action taken pursuant to the authority conferred by this title." 48 Stat. L. 211.

⁹⁸ 74 Cong. 2 sess., H. doc. 394, p. 35. This point was further elaborated by the Coordinator as follows: "The railroads at first attempted to avoid the restrictions of section 7(b) by the use of general 'waste committees' to function independently of the agencies set up by the Emergency Act, keeping all projects away from the Coordinating Committees and the Coordinator unless voluntary action by the carriers proved impossible. The Coordinator regarded this attempt as inconsistent with the policy declared in the Act, and took steps to insure that the 'regional coordinating committees shall assume the leadership and responsibility which the Act intended that they should assume, and take charge of the general committees.'" The same, p. 35.

as compulsory co-ordination or consolidation of physical facilities as a means of forcing railroad management to improve operating efficiency."⁹⁹

While, since 1920, some consolidation has been effected indirectly through acquisition proceedings, and minor integration of properties has been accomplished through consolidation of railroad corporations¹⁰⁰ it appears that the fundamental problem of railroad consolidation remains unsolved.¹⁰¹

In 1934 the Federal Coordinator of Transportation gave expression to an accumulating body of opinion which holds that a consolidation policy which stresses "the preservation of railroad competition as fully as possible and [gives] minor consideration to economies [is] not the wisest plan."¹⁰² More recently a special committee appointed by the President and composed of Interstate

⁹⁹ In his fourth legislative report issued Jan. 17, 1936 the Coordinator reported that he had issued no orders (with one minor exception) and stated his reasons for avoiding that procedure (the same, p. 40).

¹⁰⁰ The Commission reports that by the end of 1935 approved consolidation proceedings had resulted in "a closer knitting of properties including approximately 17,341 miles of railroad of subsidiaries or connecting railroads to properties of larger carriers." And by 1936, Commission approval had been granted in 445 acquisition cases involving 78,961 miles of road. *Interstate Commerce Commission Activities, 1887-1937*, pp. 200, 201.

¹⁰¹ For a discussion of the economic advantages offered by various consolidation proposals see: Moulton and Associates, *The American Transportation Problem*, Chap. XXXVI, and for analysis of such "grand consolidation" schemes as the Prince Plan see the Coordinator's first legislative report, 73 Cong. 2 sess., *Regulation of Railroads*, S. doc. 119 (1934), p. 106.

Sharfman concludes his analysis of the Commission's administration of the consolidation and combination provisions of the 1920 act with the following observation: "After a decade and a half of crowded experience, then, the problem of railroad cooperation and combination still awaits solution." (Sharfman, *The Interstate Commerce Commission*, Part III, Vol. A, p. 501.) And more recently the Commission said: "Although the plan [the Commission's master consolidation plan] can be and has been changed, in our discretion, it evidently has not been attractive enough to managements and controlling interests to impel much voluntary action, and hence it has never been carried to fruition, although there has been some measure of accomplishment." *52nd Annual Report of the Interstate Commerce Commission, 1938*, p. 15.

Compare, however, the following statement by the Federal Coordinator of Transportation: "By resort to long-term leases, often accompanied by complete stock ownership, properties were tied together about as tightly as if they had been technically consolidated, and lesser degrees of control were also effected. Much more was done in this way than is commonly supposed." 73 Cong. 2 sess., S. doc. 119, p. 22.

¹⁰² 73 Cong. 2 sess., S. doc. 119, p. 23.

Commerce Commissioners considered, as a part of a general report on the transportation problem, the question of railroad "consolidation" and "co-operation."¹⁰³ Discussing the need for the creation of a specialized agency to function as a promotional and planning unit, the committee observed: "Probably the greatest opportunity for early helpful action by the [proposed] Authority lies in the reduction of operating expenses by the elimination of the waste caused by the fact that our national railroad system is owned and operated by a large number of independent companies."¹⁰⁴

Thus some seventeen years after the legislative creation of machinery intended to utilize the initiative of both private management and public authority in securing the integration of the railroads into a unified national plant, the consolidation and pooling problem still stands as an important controversial question in national transportation policy.¹⁰⁵

B. Construction, Extension, and Abandonment

Prior to the passage of the Transportation Act of 1920, the federal government had made no attempt to exercise direct control over the construction and abandonment of railway lines. Under that act the Commission was given power to grant or deny railroad permission to construct new lines, to extend or abandon existing

¹⁰³ The special report prepared by Commissioners Splawn, Eastman, and Mahaffy was submitted to Congress Apr. 11, 1938, accompanied by a special presidential message. 75 Cong. 3 sess., *Immediate Relief For Railroads*, H. doc. 583.

¹⁰⁴ The same, p. 36. It repeated recommendations formerly advanced by the Federal Coordinator of Transportation that the general consolidation plan be abandoned and that the Commission be authorized to approve any unification proposal which it finds promotive of the public interest.

¹⁰⁵ This particular phase of the transportation problem has bulked large in all recent discussion of government relations to transportation. In 1933, for example the National Transportation Committee concluded that "parallel lines and systems are wasteful and unnecessary. Regional consolidations should be hastened and where necessary, enforced, looking eventually to a single National system with regional divisions and the elimination of all excess and obsolete lines and equipment." (Reproduced at p. xviii of Moulton and Associates, *The American Transportation Problem*.) For more recent expression of opinion see editorial comment in such transportation journals as *The Traffic World* for November 1937 to March 1938; press accounts in all leading newspapers relating to the President's conferences on transportation problems held at the White House, Mar. 15, 1938; and discussions of the several members of the Interstate Commerce Commission in the *Fifteen Percent Case, 1937-1938*, Ex Parte No. 123, decided Mar. 8, 1938, 226 I.C.C. 41.

lines, or to acquire additional or extended lines (sec. 18). In the administration of these controls the Commission was required only to find that "the present or future public convenience and necessity" required or would require the additional service or the proposed abandonment.¹⁰⁶

Legislative action in this matter came about three decades too late to serve any real purpose so far as control over expansion of facilities is concerned. The physical framework of the railroad system had already rigidified, and the statutory concern over its future expansion was largely academic, for functional obsolescence had already set in.¹⁰⁷ Highway transport was rapidly demonstrating a marked competitive efficiency, particularly in those areas which the most recent railroad expansion had been designed to serve—the area of short haul traffic. Pipe line transportation, water lines, and eventually, air transport, all added to the competitive pressure under which the railroad system was forced to function. The Commission's authority to regulate the physical extent of the railroad plant, therefore, became largely one of directing the orderly scrapping of obsolete lines.

Even the orderly abandonment of functionally obsolete rail lines was retarded by the resistance of local communities and labor groups to curtailment of operations.¹⁰⁸ Localities, including those which had transferred a large portion of their patronage to highway agencies, uniformly protested carrier proposals to abandon branch lines. They desired to retain not only tax revenues derived from the carriers, but the advantages of an alternative service. And labor groups were equally militant in defense of their interest in the continuance of railroad employment.

Thus few constructive results have been produced either by the

¹⁰⁶ Under certain circumstances the Commission was empowered to require a carrier to extend its facilities. This particular power is dismissed without further comment since it has been utilized in only one case. That order was overruled by the Supreme Court. See *Interstate Commerce Commission Activities, 1887-1937*, p. 193.

¹⁰⁷ Railroad mileage reached its peak of 254,037 miles in 1916; since that date, continuous abandonments have reduced the total to 240,104 miles (1936) of "first track." See I.C.C., *Statistics of Railways, 1917*, p. 12; 1937, p. S-5.

¹⁰⁸ For a brief discussion of the Commission's administrative treatment of abandonment proceedings see *Interstate Commerce Commission Activities, 1887-1937*, p. 194.

provisions of the 1920 act which were intended to regulate the physical extent of the railroad plant, or by those designed to secure an economic competitive adjustment among operating units through the supervision of acquisitions, consolidations, and mergers. The Commission's main productive efforts have been in the supervision of the quality and price of transportation service.

C. Quality of Service

So far as general standards of railroad service are concerned, the 1887 Act to Regulate Commerce went little beyond a restatement of the common law principles of common carrier responsibility to furnish reasonably adequate facilities. It did, however, require the carriers "according to their respective powers" to supply proper and equal facilities "for the interchange of traffic between their respective lines" (sec. 3). And it prohibited the use of any device calculated to impede the direct movement of traffic from point of origin to point of destination (sec. 7). This particular provision, however, was designed more to prevent escape from federal jurisdiction by artificially converting interstate movements into a series of intrastate movements than it was to control the quality of service. Subsequently, however, there has been undertaken a direct and extensive public supervision over the adequacy of supply and safety of operation of railroad facilities. Thus during the same period in which the competitive theory has been given wide application in the control of those phases of railroad management which determine the physical extent and operating patterns of the transportation system, there has been a marked tendency to substitute governmental judgment for that of private management in the making of decisions which determine the manner in which facilities shall be utilized and the standards of service which shall be offered to the public.

Adequacy of supply. Under the provisions of the Hepburn Act of 1906 and the Mann-Elkins Act of 1910 a positive statutory responsibility was imposed upon the carriers not only to establish through routes and rates but to provide adequate facilities to serve these routes. In short the obligation of individual common carriers was made applicable to the system as a whole, and specific appli-

cation of the principle was made by requiring the carriers (1) to furnish switching connections for lateral branch line railroads and for interstate shippers; and (2) to make reasonable rules for the exchange, interchange, and return of cars.¹⁰⁹ The Commission was not given power to allocate cars to specific regions or groups of shippers. While in the judgment of the Commission the need for such control had been clearly demonstrated by the widespread traffic congestion which had resulted from the car shortage of 1906,¹¹⁰ Congress took no action in the matter until 1917. In that year, under the stimulus of the war emergency, the Esch Car Service Act was passed.¹¹¹ It gave the Commission summary authority

. . . to suspend the operation of any or all rules, regulations, or practices then established with respect to car service for such time as may be determined by the commission, and also authority to make such just and reasonable directions with respect to car service during such time as in its opinion will best promote car service in the interest of the public and the commerce of the people.¹¹²

The scope of the Commission's powers over adequacy of supply was considerably increased by the Transportation Act of 1920. This expanded authority took two forms: statutory prescription of positive standards of the service obligations of carriers to the public; and delegation to the Commission of authority to issue orders affecting car supply, interchange of traffic, use of terminals, and safety of operation.

With reference to standards of service, the carriers were required to furnish "safe and adequate" car service¹¹³ and to establish and enforce "just and reasonable" rules with respect to that service (sec. 1 (11)). Coal transportation was singled out for special treatment. If the carriers were unable to furnish sufficient cars to

¹⁰⁹ *Interstate Commerce Acts Annotated*, Vol. 1, pp. 79 and 81.

¹¹⁰ ". . . the Commission can apparently make no order, even after complaint and hearing, which will afford substantial relief." *10th Annual Report of the Interstate Commerce Commission, 1906*, p. 17.

¹¹¹ 40 Stat. L. 101, approved May 29, 1917.

¹¹² The same.

¹¹³ "Car service" was defined by the 1917 act as including the ". . . movement, distribution, exchange, interchange, and return of cars. . . ." The 1920 act expanded the definition to include the use, control, supply, movement, etc., of "locomotives, cars, and other vehicles . . . including special types of equipment, and the supply of trains. . ." (Interstate Commerce Act, sec. 1 (10).)

move the volume of coal offered for shipment in a given producing area, they were required by law to prorate the available supply according to predetermined mine ratings (sec. 1 (12)). The requirement of the Interstate Commerce Act that the carriers offer reasonable facilities for the interchange of traffic was reaffirmed in the act of 1920. But important modifications were made with respect to the conditions under which the carriers could exercise exclusive operating control over their privately owned terminals and rolling stock.

Broad powers were vested in the Commission to make rules and regulations governing "car service," including the compensation to be paid by one carrier to another for the use of locomotives and other equipment. In addition it was given summary authority (1) to perform functions which in effect amounted to taking over the management of traffic during periods of emergency (sec. 1 (15)), and (2) equally summary authority to direct the "handling, routing, and movement" of traffic whenever it had reason to believe that the public was not being reasonably served (sec. 1 (16)). In these matters the Commission was empowered to proceed without complaint, upon its own motion, and without notice and hearing or any other formal procedure. Its discretionary authority over "car service" was, therefore, virtually unlimited.

Power to prescribe the joint use of terminal facilities¹¹⁴ during normal times was more restricted. Such joint use could be required by the Commission only if it found that the arrangement was "in the public interest" and that it would not "substantially impair" the ability of the carrier owning the terminal to conduct its own business (sec. 3 (4)). Even this restricted limitation upon the carriers' exclusive right to the use of their terminal properties represented a sharp break with prior public policy; for the act of 1887 had specifically provided that the law requiring the carriers to extend reasonable facilities for interchange of traffic between their lines should not be "construed as requiring any such common carrier to give the use of its tracks or terminal facilities to another carrier engaged in like business" (sec. 3).

¹¹⁴Including the main line track for a "reasonable" distance outside the terminal.

Safety of operations. Prior to 1920 railroad safety regulation had been legislatively developed as a body of supplementary law¹¹⁵ rather than as an integral part of the main railroad regulatory enactments. Generally speaking these safety statutes imposed a positive responsibility upon the carriers to install specified devices, such as automatic couplers, power brakes, or locomotive ash pans, and designated the Commission as the enforcement agency.¹¹⁶ The act of 1920 appreciably broadened the Commission's discretion and authority over safety by empowering it to order the installation not only of specified devices but of any "other safety devices which comply with specifications and requirements prescribed by the Commission. . . ." No further standards were prescribed for the guidance or restraint of the Commission in the exercise of this function.¹¹⁷

Thus through the assumption of public authority over the manner in which the operating facilities of the carriers are technically equipped and operated, the Commission has been given power to penetrate far into the field of private management. In final analysis it has the power to take almost any action with respect to service matters which it believes will serve the "public interest" by tending to produce a safer and more adequate transportation service, and its discretion in the prescription of service and safety controls has been surrounded by few meaningful standards.

Not all of the powers granted to the Commission in this area

¹¹⁵ The main safety legislation prior to 1920 is found in (1) the Safety Appliance Act, approved Mar. 2, 1893, 27 Stat. L. 531; as amended by the act of Apr. 1, 1896, 29 Stat. L. 85; by the act of Mar. 2, 1903, 32 Stat. L. 943; and supplemented by the act of Apr. 14, 1910, 36 Stat. L. 298; (2) the Federal Hours of Service Act of Mar. 4, 1907, 34 Stat. L. 1415 as amended by the act of May 4, 1915, 39 Stat. L. 61; (3) the Accident Reports Act of May 6, 1910, 36 Stat. L. 350; (4) the Ash Pan Act of May 30, 1908, 35 Stat. L. 476; (5) the Transportation of Explosives Act of May 30, 1908, 35 Stat. L. 554, as amended by the act of Mar. 4, 1909, 35 Stat. L. 1134, and by the act of Mar. 4, 1921, 41 Stat. L. 1444; and (6) the Boiler Inspection Act of Feb. 17, 1911, 36 Stat. L. 913.

¹¹⁶ For a brief discussion of the administration of safety legislation see *Interstate Commerce Commission Activities, 1887-1937*, pp. 117-39; and for a more exhaustive analysis see Sharfman, *The Interstate Commerce Commission*, Pt. 1, Chap. VI.

¹¹⁷ Section 26 of the Interstate Commerce Act empowered the Commission, after investigation, to require any carrier subject to the act to ". . . install automatic train-stop or train-control devices or other safety devices, . . . upon the whole or any part of its railroad, such order to be issued and published at least two years before the date specified for its fulfillment. . . ."

of control have been so widely and continuously applied in the day-to-day operation of the railroad system¹¹⁸ as those dealing with rate regulation and related financial matters to be discussed below. Nevertheless they constitute a reservoir of tremendous potential authority.

D. Railroad Rates: Judicial Remedial Control, 1887-1906

Rate controls inaugurated in 1887 were essentially negative in nature, and constituted what may be described as a system of judicial remedial control. They evidenced no intent on the part of the federal government to exercise a positive influence over the development and management of railroad transportation. In scope and intent the system constituted an experimental and oblique approach to the problem of rate regulation.

The initial act was limited to the regulation of common carriers engaged in the interstate transportation of persons and property exclusively by rail or jointly by rail and water.¹¹⁹ And, it was concerned almost exclusively with the control of what were conceived to be abusive rate practices. Moreover, the initial system was indirect in method in the sense that it attempted to achieve its declared objective, not through the process of direct governmental rate fixing, but through the statutory prescription of broad standards enforceable by the courts. Thus while the law created a continuously

¹¹⁸ The emergency powers have been exercised on several occasions, primarily in critical situations brought on by strikes of railroad employees. For example, in 1920, the Commission, upon petition of the carriers, issued a series of "service orders" requiring "(1) that all common carriers by railroad should forward traffic to destination by routes most available to expedite its movement and relieve congestion, without regard to routing by shippers or carriers, or to the ownership of cars, all car service rules, regulations, and practices being suspended and superseded insofar as conflicting with such directions; (2) that various western carriers should deliver 30,000 open-top cars to eastern connections; and (3) that eastern carriers should deliver 20,000 serviceable box cars to western connections." *Interstate Commerce Commission Activities, 1887-1937*, pp. 157, 158. And again in 1922 it issued another series of similar orders. Both of these series were designed primarily to accommodate emergency conditions growing out of strikes, called in the first instance by railroad workers and in the second instance by railroad workers and coal miners.

¹¹⁹ In the latter case only if the joint service was being furnished under arrangement for a continuous shipment or if both facilities were under a common control or management.

functioning regulatory agency in the form of the Interstate Commerce Commission, rate making, for all practical purposes, remained the prerogative of the carriers. The Commission was given no express authority to *fix* a rate which would have any continuous binding effect upon the carriers. And, although it was empowered to investigate and give publicity to railroad rates and practices, enforcement of the prescribed standards of rate performance rested, in final analysis, with the courts.

This initial approach to the problem of railroad rate control is significant chiefly because of the influence exerted upon subsequent assertion of public authority. It will, therefore, suffice to indicate briefly the character of the practical results obtained from the Commission's administration of the statutory rate standards and from the means of enforcement provided by the law.

Administration of standards. The Act to Regulate Commerce required that the charges of common carriers subject to its jurisdiction be "reasonable and just"; it made "unjust discriminations" unlawful, and specifically prohibited any form of "undue or unreasonable preference."¹⁰⁰ Unjust discrimination was defined as charging one person more or less than another when both are being furnished "a like and contemporaneous service in the transportation of a like kind of traffic under substantially similar circumstances and conditions" (sec. 2). One special form of discrimination was, however, specifically prohibited. Under the provisions of the so-called "long and short haul" clause of the act (sec. 4) it was declared unlawful to charge more in the aggregate for a shorter than for a longer haul, where the former was included within the latter, was over the same line and in the same direction, and where a like kind of property was being transported "under substantially similar circumstances and conditions." The Interstate Commerce Commission was, however, empowered in "special cases" to exempt carriers from the operation of the section. These clauses left largely undefined the standards to be used in determining the justness or reasonableness of a rate, throwing on the courts the major burden of this difficult task.

¹⁰⁰ 24 Stat. L. 379.

Specific obligations, as well as general standards of rate performance, were imposed on the carriers by the initial act. It required each to print, to keep open for convenient public inspection, and to file with the Commission, copies of rate schedules, freight classifications, and all accessorial charges and regulations affecting rates and routes. Each carrier was, in addition, required to file with the Commission copies of all joint tariffs providing for through rates and routes. The Commission was given full discretion in determining the extent to which these joint arrangements should be publicized. No filed rate could be increased except on ten days' notice. Rates could be decreased, however, without previous notice (sec. 6).

Within a decade, the Commission, in its attempt to give precise significance to the indefinite standards of rate performance prescribed by statute, ran afoul of judicial review. The first major judicial test of the Commission's authority came when it attempted to *prescribe* rates. Although the Commission was not given by the act express authority to fix a rate to control in the future, it interpreted the general language and intent of the law to mean that

. . . when it had found a particular rate or group of rates to be unreasonable it was its duty to find that some other rate or group of rates was reasonable or constituted the maximum rate or group of rates which could be regarded as reasonable, and that it had the power in these cases to order the substitution of the rate or group of rates thus approved for those which had been disapproved.¹²¹

The Supreme Court rejected this interpretation in the *Social Circle* cases, and said:

. . . We do not find any provision of the act that expressly, or by necessary implication, confers such a power.

It is argued on behalf of the Commission that the power to pass upon the reasonableness of existing rates implies a right to prescribe rates. This is not necessarily so. The reasonableness of the rate, in a given case, depends on the facts, and the function of the Commission is to consider these facts and give them their proper weight. . . .¹²²

¹²¹ 59 Cong. 1 sess., S. doc. 244 (1905-06), p. 53.

¹²² 162 U.S. 184, 196 (1896), *Cincinnati, New Orleans and Texas Pacific Railway Company v. Interstate Commerce Commission*.

The Commission interpreted this decision not as a denial of its power to prescribe rates but as a judicial definition of administrative procedure to be followed. In a subsequent case, however, the Supreme Court, referring to the Commission's contention that the rate-making power could be construed into the act, stated in unequivocal terms:

... The grant of such a power is never to be implied. The power itself is so vast and comprehensive, so largely affecting the rights of carrier and shipper, as well as indirectly all commercial transactions, the language by which the power is given had been so often used and was so familiar to the legislative mind and is capable of such definite and exact statement, that no just rule of construction would tolerate a grant of such power by mere implication.¹²³

Nor did the Commission fare any better at the hands of the courts in its effort to interpret the phrase "under substantially similar circumstances and conditions" as contained in the long and short haul clause of the act (sec. 4).¹²⁴ In administering this provision of the law the Commission had adopted the following principle:

... The carrier has a right to judge in the first instance whether it is justified in making the *greater charge for the shorter distance* under the Fourth Section in all cases where the circumstances and conditions arise *wholly upon its own line* or through competition for the same traffic with carriers not subject to regulation under the Act to regulate commerce. In other cases under the Fourth Section the circumstances and conditions are not presumptively dissimilar, and carriers must not charge less *for the longer distance*, except upon the order of the Commission.¹²⁵

According to the Commission, "This view of the law was generally accepted by carriers throughout the country and tariffs were made to conform to it, with the exception of certain parts of the southern territory."¹²⁶ On review, however, the Supreme Court refused to enforce a Commission order based on this interpretation of its

¹²³ 167 U.S. 479, 509 (1897), *Interstate Commerce Commission v. Cincinnati, New Orleans, and Texas Pacific Railway Co.* This litigation grew out of the Commission's decision in the Maximum Rate case, 4 ICC 592 (1894).

¹²⁴ For a full discussion of the long and short haul problem see *11th Annual Report of the Interstate Commerce Commission, 1897*, pp. 37-46.

¹²⁵ 5 ICC 324.

¹²⁶ *11th Annual Report of the Interstate Commerce Commission, 1897*, p. 41.

authority. In the Alabama Midland Railway or "Troy" case the Court held, in effect, that competition among carriers subject to the act creates "dissimilarity of circumstances" sufficient to justify charging more for the shorter than for the longer haul.¹²⁷ As a result of this ruling the Commission reported to Congress that "it is hardly correct to say that the Court has disapproved of these views [the Commission's as outlined above], for, so far as appears from a reading of the opinion, the court never took pains to inform itself what the position of the Commission had been," but that in any event since "competition is the only reason why a carrier would desire to charge less to the more distant point, and if competition justifies him in so doing, there is nothing left for the section to act upon."¹²⁸ It, therefore, concluded that no effective regulatory action could be taken under the fourth section of the act.

Thus ten years after its creation the Commission was forced by judicial interpretation to abandon any attempt to exert direct and continuing control over railroad rate relationships.¹²⁹ Moreover the means of enforcing those provisions which remained operative were proving inadequate.

Enforcement. While sponsors of the Act to Regulate Commerce believed that effective enforcement could be facilitated through the instrumentality of informed public opinion, they placed chief reliance upon court procedure to secure compliance from recalcitrant carriers. The act was, therefore, implemented with various devices calculated not only to keep the public informed as to the manner in which railroad corporations were being managed but to supply individuals with evidence to be used in court prosecution of their claims against the carriers for infraction of the prescribed

¹²⁷ *Interstate Commerce Commission v. Alabama Midland Railway Company*, 168 U.S. 144 (1897).

¹²⁸ *11th Annual Report of the Interstate Commerce Commission, 1897*, p. 42. Compare also p. 21.

¹²⁹ Absolute reasonableness was more or less an academic issue since ". . . even in the few cases in which charges have been declared excessive in themselves by the Commission (no such finding has ever been made by a Federal Court [1905]), the tests applied have invariably been comparative. Until the effort is avowedly to revise an entire schedule by altering all or nearly all of the rates which it contains, it is unlikely that any other standard will ever be applied." 59 Cong. 1 sess., S. doc. 244 (1905-06), pp. 25, 26.

standards. On these points the law provided among other things:

[1] That complaints against the railways should be investigated by the Commission, and that its findings of fact, conclusions, and recommendations should be made public.

[2] That the Commission should have authority to inquire into the management of the business of all carriers subject to the law and should keep itself informed as to the manner and method in which such business is conducted.

[3] That the Commission should collect statistics of railway operations.

[4] That the Commission should make annual reports of information considered of value in relation to the regulation of commerce, which should also include its recommendations, if any, for further legislation.¹⁸⁰

Another provision made it possible for "any person, firm, corporation, or association, or any mercantile, agricultural, or manufacturing society, or any body politic or municipal organization" to complain to the Commission not only of things "done" but of things "omitted to be done" by any common carrier in contravention of the provision of the act.¹⁸¹ Such complaints could not be dismissed merely because of the failure of the complainant to demonstrate that *direct* damage had been suffered. Moreover, the Commission was empowered to initiate inquiry on its own motion, thereby functioning as a complainant.

After investigation of complaints the Commission was required to make a written report of its findings, conclusions, and (if the conclusions so indicated) recommendations for reparation to the injured party. If the common carrier complained against complied with the Commission's order within the time specified, either by discontinuing the practice under investigation or by paying the reparation award recommended, the case was closed, and the carrier was relieved from further obligation so far as that particular complaint was concerned.¹⁸² But if the carrier ignored the Commission order the only procedure open to the complaining

¹⁸⁰ 59 Cong. 1 sess., S. doc. 244 (1905-06), p. 40.

¹⁸¹ 24 Stat. L. 379, 383.

¹⁸² It is important to note here that there was nothing in the initial law, except the possibility of another complaint, to deter the carrier from reinstating the practice of rate making found by the Commission to be injurious.

individual or to the Commission was to seek court enforcement of the order.

It was contemplated, however, that under this system an individual seeking relief in the courts from injurious practices of railroad corporations would find himself in a substantially stronger position than under the common law remedy. For one thing, standards of obligation as defined by the statute were somewhat more definite than those which had been developed through the common law process. But of greater importance, particularly to the small shipper, the findings of fact of the Commission constituted, under the Act to Regulate Commerce, *prima facie* evidence in judicial proceedings. Thus, if a carrier failed to make an award, or failed to "cease and desist" from a practice as ordered by the Commission, and the complainant instituted a *de novo* suit, it was incumbent upon the carrier to disprove the Commission's case against him. Previously the full burden to prove injury had rested exclusively on the complaining shipper.

Enforcement machinery proved defective in several important respects. First, great delay was encountered in securing court enforcement of the Commission's orders. This was due primarily to the fact that in reviewing Commission orders, the courts considered not only the lawfulness of the order, that is, the basic legal authority of the Commission to make the order, but the accuracy and completeness of the facts on which the order was based. Hence the Commission's findings, although legally designated as *prima facie* accurate, constituted only one part of the record on which the court based its decision. Neither party to the suit was confined to the testimony entered on the Commission record nor to the issues considered there. Under such procedure it was not uncommon for the defendant to make a perfunctory case before the Commission, withholding essential material for subsequent presentation to the courts.¹²³ During the long periods required for re-trial of the

¹²³ The Supreme Court condemned this practice stating: "We think this is a proper occasion to express disapproval of such a method of procedure on the part of the railroad companies as should lead them to withhold the larger part of their evidence from the commission, and first adduce it in the Circuit Court. . . ." The Court added, however, ". . . We do not mean, of course, that either party, in a trial in the court is to be restricted to the evidence that was before the Com-

Commission's case, there was nothing to deter the carrier from continuing the practices that had occasioned the original complaint.¹²⁶

A second defect in the enforcement method was related to the restrictions imposed upon the Commission's rate-fixing authority. This procedure had been conceived as a means of enabling groups such as state regulatory commissions, mercantile and agricultural organizations, to act co-operatively in securing rate adjustments, thereby guaranteeing a more even balance of legal power between the complainant and the railroad corporation. But when the Commission was precluded from establishing a rate which would control in the future, a complainant could hope to gain nothing from a suit at law except reparation for damages suffered from past payment of rates found to be unreasonable. Since the effective remedy was available only to the individual who had been overcharged on specific shipments in the past, and since there was nothing in the process of relief which would protect either the complaining individual or others similarly situated from unreasonable rate exactions in the future,¹²⁷ neither individuals nor associations were afforded satisfactory relief.¹²⁸ Under such circumstances the recurring burden of enforcement was thrown back almost wholly upon the individual shipper. Procedurally, at least, the act afforded little in the way of relief which had not previously been available to the public through the common law process. And, as before, because of the expense

mission, but that the purposes of the act call for a full inquiry by the Commission into all the circumstances and conditions pertinent to the questions involved." "Social Circle" case, 162 U.S. 184, 196.

¹²⁶ The Commission pointed out that ". . . the delay which is attendant upon an attempt to enforce the order of the Commission is unjust to the public. . . . If a carrier is allowed to exact an excessive freight rate, the public, or that part of the public which is injured, never can be compensated by any money payment for the injury. The average duration of the cases which have been actually prosecuted for the enforcement of the orders of this Commission has been about four years. . . ." *11th Annual Report of the Interstate Commerce Commission, 1897, p. 32.*

¹²⁷ No penalties were provided for the "taking of an excessive rate" *per se*. The shipper could recover only the difference between the rate charged and the one found to be reasonable.

¹²⁸ In connection with this problem the Commission observed that "since we are powerless to reduce the rate for the future, it is manifest that complaints will no longer be made by State railroad commissions, by business organizations, nor by the Interstate Commerce Commission upon its own motion." *11th Annual Report of the Interstate Commerce Commission, 1897, p. 20.*

involved, the court route of relief was open only theoretically to the great majority of individual shippers.

Thus ten years of administrative trial and error demonstrated that the Act to Regulate Commerce was not capable of producing the results anticipated by its legislative sponsors. A fundamental conflict in the interpretation of its purposes and jurisdiction developed between the judicial and administrative agencies; and enforcement methods proved defective. Moreover, as we have already indicated, the positive obligations imposed upon the carriers were incompatible with the prohibitions against collective action embraced in the anti-trust laws of 1890. (See page 768.)

During the next decade the Commission functioned actively in the one field left open—fact-gathering and publicizing the results of its administrative experience. Each annual report to Congress contained detailed accounts of its efforts to attain the objectives which in its judgment motivated Congress in passing the law. Many of these reports contained specific suggestions for substantive and procedural amendments designed to remove acknowledged imperfections in the law.¹³⁷ However, the act was not amended in any fundamental respect until 1906.¹³⁸

E. Railway Rates: Positive Administrative Regulation

The years 1906 to 1910 were a transition period of fundamental importance in the development of federal railway regulatory policy. The passage of the Hepburn Act¹³⁹ in 1906 and the Mann-Elkins Act¹⁴⁰ in 1910 marked the abandonment of the indirect system of controlling rates through court enforcement of statutory

¹³⁷ See especially *Annual Reports, 1895, 1897, 1898.*

¹³⁸ The amendments enacted during the interim period dealt chiefly with such procedural matters as taking of testimony and attendance of witnesses at hearings, all strengthening the Commission's administrative processes. The Elkins Act of 1903, for example, made penalties applicable alike to railroad corporations and their agents. The chief supplementary acts gave the Commission limited control over railroad safety matters. The first of these (1893) required the installation of automatic couplers, power brakes, etc., and the second (1903) dealt in more detail with the same subject.

For analysis of these enactments see *Interstate Commerce Acts Annotated*, Vol. 1, pp. 76-78; and *Interstate Commerce Commission Activities, 1887-1937*, pp. 36, 37.

¹³⁹ 34 Stat. L. 584, approved June 29, 1906.

¹⁴⁰ 36 Stat. L. 539, approved June 18, 1910.

standards, and the substitution of a positive system of Commission rate making.¹⁴¹ Although the positive theory of regulation was as yet only partially implemented, being limited largely to the establishment of maximum railroad and related rates,¹⁴² it was during this period that the foundation was laid for the subsequent assertion of corollary authority over other phases of rate making.

Prescription and suspension of rates. Under the Hepburn Act the Commission was, for the first time, expressly vested with the power to "determine and prescribe by order a [railroad] rate, regulation, or practice for the future."¹⁴³ It is significant to note that this first step in the evolution of governmental rate making which has gradually transferred all essential features of transportation pricing from private to public agencies was apparently based upon a congressional misconception of—or perhaps a preference to side-step—the real issues involved.

During its deliberations upon the various forms of rate control proposed for inclusion in the original act, Congress had been presented with a well-defined question of public policy, namely, whether, as a matter of permanent policy, primary responsibility for the determination of railroad rate levels and relationships should be transferred from private to governmental agencies.¹⁴⁴

¹⁴¹ These acts also included numerous ancillary provisions designed to increase the general administrative effectiveness of the Commission. Membership of the Commission was increased from five to seven presumably on the somewhat dubious theory that more commissioners were required to cope with its expanding jurisdiction and volume of work. Specific provision was made for the appointment of agents and examiners to collect data, inspect carrier accounts, and to act as agents of the Commission in hearing cases and analyzing records. Difficulties formerly encountered in securing informative reports from the carriers were removed by the Hepburn Act. The Commission was definitely authorized to obtain periodical and special reports from the carriers and to prescribe the form of accounts and records.

¹⁴² The Hepburn Act brought within the jurisdiction of the Commission express companies, sleeping car companies, and pipe-line companies transporting oil. It also clarified and amplified the definition of "railroad" and "transportation."

¹⁴³ *Interstate Commerce Acts Annotated*, Vol. 1, p. 79.

¹⁴⁴ Congressional rejection of the proposal for Commission rate fixing reflected the doubt expressed by the Cullom Committee as to "whether a commission or any similar body of men could successfully perform a work of such magnitude, involving, as it would, infinite labor and investigation, exact knowledge as to thousands of details, and the adjustment of a vast variety of conflicting interests." 49 Cong. 1 sess., S. rep. 46, Pt. 1 (1885-86), p. 194.

Precisely the same basic issue arose again in 1906 when the Senate committee which was responsible for reporting on the Hepburn proposals was advised by its experts:

It is not possible to entertain a consistent opinion relative to remedial legislation, such as is now pressed upon the attention of Congress, without assuming a definite point of view with regard to the extent to which reliance may be placed upon commercial conditions and commercial forces in the regulation and control of railway operations, as well as upon the wisdom and precision with which remedies involving the exercise of political power can be applied.¹⁴⁵

And the Committee in turn advised Congress:

The testimony submitted to the committee [on the question: "Is a government commission capable of making railway rates?"] gives scant information as to the comparative merits of those fundamental principles of transportation essential for a reasonable opinion upon the point at issue.¹⁴⁶

The dilemma in which the legislators found themselves apparently was resolved by adopting the counsel of those who contended that the power to *revise* rates, as distinguished from the power to *make* rates in the first instance, constituted fundamentally different grants of power over private enterprise.¹⁴⁷ On this premise it was maintained that since the proposal under consideration contemplated only the revision, on complaint, of specific rates there was no necessity to scrutinize either the economic wisdom or the administrative feasibility of delegating full rate-making authority to the regulatory commission. Various witnesses, however, pointed out that

... the view that a power to revise and change rates is essentially different from a power to establish rates in the first instance is fundamentally erroneous for this reason: All the railroad rates of this country are inter-

¹⁴⁵ 59 Cong. 1 sess., S. doc. 244, p. 16. This document gives a digest of hearings held before Senate Committee on Interstate Commerce on the bill which evolved into the Hepburn Act, together with important supplementary data, both historical and contemporaneous, bearing on the railroad problem. The material assembled by experts retained pursuant to a Senate resolution comprises together with the Cullom Report (49 Cong. 1 sess., S. rep. 46 (1885-86)) an impressive analysis of the economics of railroad transportation and of the complex legal, economic, and social problems inherent in governmental regulation.

¹⁴⁶ 59 Cong. 1 sess., S. doc. 244, p. 125.

¹⁴⁷ The same, p. 124.

woven and connected together as interdependent parts of one enormous system, so that a change of any important rate at any important point shakes the whole fabric from one extremity of the country to the other, and it may reasonably be assumed that the changes which the Commission would be called upon to make under this proposed power would naturally affect important business rather than that which is unimportant.¹⁴⁸

It seems clear that at this crucial juncture in the evolution of regulatory policy, legislative action was taken either without full recognition of the real extent of the powers of positive rate making which were being granted, or without full appreciation of the probable consequences of such action.

Under the provisions of the Hepburn Act the government did not assume full control over the rate-making function. The control, while direct in method and theoretically binding on future actions of the carriers, was still essentially corrective rather than affirmative in nature. As before, the initial determination of freight classifications and of the rates applicable to these different classes of freight remained with railroad management. The Interstate Commerce Commission was given no power to fix minimum rates. Nor could it suspend, pending investigation of their reasonableness, new rate schedules filed by the carriers. It could act only upon complaint that a rate in force was unreasonable. Consequently, the carriers were enabled, by maneuvering other rates at will, to compensate for specific adjustments required by the Commission, and to move traffic under those rates until complaint was lodged with the Commission, investigation was made, and another order issued. In the meantime, however, rate relationships were altered, thereby undermining the Commission's previous rate determinations. This resulted from the fact that in determining the reasonableness of any given rate complained of, the Commission, because it possessed no criteria by which absolute reasonableness could be determined, was forced to consider the rate in terms of relative reasonableness; that is, by comparing it with the other charges contained in an entire schedule. The continuing validity of the Commission's prescribed rate, therefore, rested upon relationships which the carriers had

¹⁴⁸ The same, p. 124.

power to alter at will.¹⁴⁹ Under these circumstances, the next step in positive Commission rate regulation was obvious and necessary.¹⁵⁰ The factors which were of necessity utilized by the regulatory agency in the determination of relative reasonableness had to be removed from the exclusive control of private management and placed within the purview of public authority.¹⁵¹ This was accomplished through the provisions of the Mann-Elkin Act of 1910¹⁵² which, among other important features, empowered the Commission to suspend and investigate proposed changes in rate schedules.¹⁵³

In this way the Commission's authority over proposed rates was for all practical purposes made co-extensive with that exercised, since passage of the Hepburn Act, over rates already in effect.

The long and short haul problem. Another gap in the Commission's power over rates was closed by the provisions of the Mann-Elkins Act which redefined the long and short haul clause of the initial act. As already noted, the Commission had been made powerless, by judicial interpretation of its authority under the fourth section, to control what it considered one of the most pernicious forms of rate discrimination. After the Supreme Court decision in the "Troy" case in 1897 (page 792) the Commission had repeatedly called attention to the need for positive control over the general type of rate discrimination involved in charging more for the shorter than for the longer haul. It stated, for example, that "unless the country is satisfied to undergo a recurrence to the practices which existed before the passage of this section, it must,

¹⁴⁹ Limited only by the statutory requirement for notice of changes in rate schedules as provided in the act of 1887 and amended by the Hepburn Act. The latter provided that no rate could be changed without 30 days' notice except as authorized by the Commission.

¹⁵⁰ It should be noted that throughout this expository treatment of the evolution of regulation we are not attempting to evaluate particular governmental policies or lines of action in terms of social or economic validity. Thus the term "necessary" as used here has reference to devices or grants of authority which were required in order to implement or give internal consistency to previously adopted lines of governmental action.

¹⁵¹ In its first annual report after passage of the Hepburn Act, 1907, p. 9, the Commission called attention to the need for authority to suspend proposed rates pending investigation of their reasonableness.

¹⁵² 36 Stat. L. 539, approved June 18, 1910.

¹⁵³ The initial suspension period was set at 120 days, with a maximum of ten months. If the Commission issued no final order within this period the proposed rates became effective.

in some form or other, be reenacted."¹⁸⁴ This recommendation was carried out in the provisions of the Mann-Elkins Act which in effect made it illegal for the carriers, except with specific authorization of the Commission, to charge a higher rate for a shorter haul than for a longer haul where the shorter was included in the longer.

Enforcement. As the Commission's direct rate-making power expanded it became necessary to develop enforcement methods adapted to these new types of control. Administrative experience had thoroughly demonstrated that neither the force of public opinion nor recourse to the courts by aggrieved private parties could be depended upon to secure enforcement either of general statutory standards of performance or of the Commission's specific orders. A more direct enforcement method was provided by the Hepburn Act, which prescribed severe penalties for failure to comply with Commission orders. This act also amended the enforcement procedure so as to give a high degree of finality to orders issued by the Commission. Neither the individual complainant nor the Commission was required, as before, to seek an affirmative court order to obtain enforcement of a Commission decision.¹⁸⁵ The carriers, however, were still in position to seek temporary injunctions, restraining enforcement of the Commission's orders pending final court review of the issues.¹⁸⁶

¹⁸⁴ *11th Annual Report of the Interstate Commerce Commission, 1897, p. 46.*

¹⁸⁵ Except in the case of reparation awards.

¹⁸⁶ In an effort to minimize the delays and frictions involved in these judicial contests the Mann-Elkins Act of 1910 created the Commerce Court. This specialized judicial tribunal was granted exclusive original jurisdiction over review of Commission orders. Its decisions were made directly appealable to the Supreme Court. The creation of the Commerce Court represented an effort to adapt traditional judicial procedures to the specialized, technical, and voluminous issues arising out of the administrative phases of the regulatory process. In actual practice it failed to speed up procedure and, according to some observers, it created friction by persistent impingement upon the Commission's jurisdiction. (*Interstate Commerce Commission Activities, 1887-1937, p. 39.* See also, Sharfman, *The Interstate Commerce Commission, Pt. I, pp. 63-70.*) After only three years' trial, the court was abolished and its jurisdiction and specialized procedures were transferred to the district courts. (By the Urgent Deficiencies Act, 1913 (38 Stat. L. 208, 219).)

Since 1913, the procedural relationship of the courts to the work of the Interstate Commerce Commission has not been modified in any important way, for it appears that the recently promulgated Federal Rules of Civil Procedure have not appreciably altered this relationship. (See E. M. Reidy, "Effect of New Federal Equity Rules upon Review of Interstate Commerce Commission," *I.C.C. Practitioners' Journal, Vol. 5, No. 10 (1938), p. 481.*)

In final analysis, however, the Commission tended progressively to become the final arbiter in the exercise of the extensive discretionary powers with which it was equipped by the Hepburn and Mann-Elkins Acts. The legislative standards under which it functioned were stated in the highly generalized terms of "reasonableness," "justness," and "adequacy." Consequently they imposed no measurable limits upon the exercise of authority. In interpreting and applying these standards the Commission was, of course, subject to the ultimate disciplines of legislative correction and judicial review. We have seen, however, that the former comes haltingly, and usually only after overwhelming evidence of unsatisfactory operation has been accumulated. Moreover, judicial restraint in this field has progressively tended to operate within narrower limits. At first the Commission's actions were extensively reviewed as to findings of fact, economic interpretation, and general lawfulness. But as the scope of its positive authority was expanded, its orders were given a greater degree of finality. The courts tended to scrutinize only the legal authority of the Commission to make an order on the subject involved, to determine whether or not any constitutional or legal rights of the affected parties had been abridged (legal notice, full hearing, confiscation of property, etc.), and within these limits to accept the Commission's fact findings and economic interpretations as final.¹⁵⁷

Thus by 1910 the federal government was launched upon a fairly comprehensive and positive program of railroad regulation, intended to be used to prevent the occurrence of abuses rather than to secure reparation for injuries already inflicted. Chief responsibility for the enforcement of statutory standards of performance upon the carriers was delegated to a continuously functioning agency of Congress. This method made it unnecessary to rely upon the force of public opinion, or upon the initiative and power of individuals to secure judicial redress for private injuries.

¹⁵⁷ In such matters as rate fixing the Commission was, of course, controlled by judicial interpretation of due process, such as the vague doctrine that the carriers are entitled to a "fair return" on a "fair value" of their properties, first enunciated by the Supreme Court in *Smyth v. Ames*, 169 U.S. 466 (1898); restated in many subsequent cases and elaborated somewhat in *St. Louis and O'Fallon Railway Co., et al. v. United States, et al.*, 279 U.S. 461 (1929).

Although it was thus positive rather than remedial in method, the regulatory system was still designed primarily to protect the shipping public against discriminatory railroad rates. As we have seen it was concerned only incidentally with the quality and the quantity of service offered to the public by rail and ancillary carriers, and no positive concern for the interests of the carriers themselves had found explicit statutory recognition.

Weaknesses in operating and regulatory system. Between 1910 and 1920 situations developed which tended to broaden the scope of regulatory concern and to shift attention to the national aspects of the problem. These situations related to operating policies and methods and to the credit position of the carriers.

Although interline competition had pushed the general level of rates, as reflected in revenue per ton-mile, to a low level as early as 1900, the steady increase in traffic volume, accompanied by improvements in operating methods and technological betterments, enabled the carriers, for a number of years, to obtain adequate revenues. But by 1916 the immediate opportunities for achieving substantial operating economies through such means as heavier car loadings, increased length of trains, and speed-up of line haul had been largely exhausted. At the same time the carriers were faced with an upward trend in labor and materials costs and in taxes.

The major operating economies which might have been achieved by physical consolidations and co-operative action were largely blocked by the anti-pooling provisions of the Act to Regulate Commerce and by the anti-trust legislation of 1890 and 1914; and those lines of unified action which did remain open were not effectively utilized. For it appears that, even under normal (peace time) conditions, the carriers had been unable to unify their operations sufficiently to prevent seasonal congestion of traffic.¹⁵⁸ While the Mann-Elkins Act required the carriers to make reasonable rules

¹⁵⁸ As early as 1907 the Commission, after investigating the car service problem, concluded: "If the Interstate Commerce Commission is to be vested with power to make rules under which railroads shall be required upon penalty to furnish cars to shippers [it possessed the power and had exercised it], this Commission should also be empowered to make rules under which free interchange of cars shall be effected or to require railroads engaging in interstate commerce to make such rules for their own protection and provide for their enforcement. (12 I.C.C. 561, 577.)

for exchange of cars, the Commission found in 1916 that "when- ever business generally is good and times are prosperous there is widespread difficulty and complaint due to inability to secure satisfactory transportation service from the railroads."¹⁵⁰

Moreover, since 1910, the aggregate flow of revenue upon which the carriers depended for existence had, in effect, been controlled at its source by public authority. The net result of this regulation had been to maintain constant pressure against the attempts of the carriers to increase revenue through general rate advances. In the major cases through which the carriers, between 1910 and 1917, sought to advance the general level of rates,¹⁵⁰ the Commissioner either refused to grant any increase or allowed only partial and selective rate adjustments. Thus, while some measure of revenue relief was secured, the petitions were neither considered nor decided primarily in terms of the carrier's need for additional revenue. The Commission had no express statutory authority to use this consideration as a primary standard in determining the reasonableness of any schedule of rates brought into question. Under court decisions, the carriers, of course, could not be legally deprived of a "fair return" on a fair value of their properties.¹⁵¹ But neither the carriers, the Commission, nor the courts had any reliable means of ascertaining the value to be considered in rate making, for no authoritative valuation of the carriers' properties was available.¹⁵¹ Under these circumstances, it is difficult to see how the Commission's rate determinations could have been based upon any criteria other than "relative reasonableness."

Furthermore, the disclosure of cases in which railroad funds

¹⁵⁰ 30th Annual Report of the Interstate Commerce Commission, 1916, p. 67. See pp. 67-74 of the same for a full discussion of car shortages.

¹⁵⁰ See: *In re Investigation of Advances in Rates by Carriers in Official Classification Territory*, 20 I.C.C. 243 (1911); *In re Investigation of Advances in Rate by Carriers in Western Trunk Line, Trans-Missouri and Illinois Freight Committee Territories*, 20 I.C.C. 307 (1911); *The Five Per Cent Case*, 31 I.C.C. 351 (1914), 32 I.C.C. 325 (1914); *1915 Western Rate Advance Case*, 35 I.C.C. 4971 and *The Fifteen Per Cent Case*, 45 I.C.C. 303 (1917).

¹⁵¹ *Smyth v. Ames*, 169 U.S. 466 (1898).

¹⁵² The Commission had, since 1903, periodically urged upon Congress the "urgent need of a physical valuation of the interstate railways of this country." 23d Annual Report of the Interstate Commerce Commission, 1909, p. 6. The Valuation Act was not, however, passed until 1913; and the actual work of the physical valuation required almost twenty years (see p. 815).

were being diverted to purposes not calculated to improve transportation service, or were being dissipated through general financial mismanagement, tended to make the investing public cautious in the acceptance of railroad offerings. For example, in the financial investigation of the New Haven Railroad, undertaken by the Commission at the request of the Senate, the existence of "glaring . . . maladministration" was revealed. The Commission found that interlocking directorates gave financial control of this and other roads to corporations whose financial interests were given priority over the efficient management of these enterprises as transportation businesses.¹⁶³

While madadministration was unquestionably contributing substantially to the devitalization of the carriers, it can hardly be said that they possessed the power to take decisive corrective action. As was noted above they were not permitted by law to engage in any action or practice which would tend materially to reduce inter-company competition, and it was becoming increasingly evident that the application of this principle militated at every point against the operation of the numerous carriers as a unified, smoothly functioning system.

The unusual transportation requirements imposed by the World War thus fell upon a regulatory and operating system which had already exhibited a tendency to clog under normal load. At the outset, efforts were made by the Railroads' War Board,¹⁶⁴ the Interstate Commerce Commission, and the Council of National Defense to weld the numerous independent competing units into a unified operating system capable of handling war-time transportation demands. But it rapidly became evident to the authorities responsible

¹⁶³ See: *In re Financial Transactions of the New York, New Haven, and Hartford Railroad Company*, 31 I.C.C. 32 (1914). Other major disclosures of financial mismanagement of railroad corporations were made at about this time by the Interstate Commerce Commission. Some of the more important were: *The New England Investigation*, 27 I.C.C. 560 (1913); *In re Financial Relations . . . Louisville Nashville Railroad . . . and other Carriers*, 33 I.C.C. 168 (1915). For a complete listing of the special financial investigations undertaken by the Commission during this period see Annual Reports of the Commission from 1914 to 1918.

¹⁶⁴ An organization created under the terms of a resolution adopted by the chief executive officers of the railways at a meeting held in Washington, D.C., Apr. 11, 1917.

for the successful conduct of war operations that legal restraints¹⁶⁴ and the nature of private corporate interests rendered private management incapable of achieving the necessary degree of operating unity through voluntary collective action.¹⁶⁵

Increasing traffic congestion, augmented by extremely severe weather conditions experienced during the latter part of 1917 and by increasing labor unrest, added impetus to the already strong sentiment in favor of unified federal operation of the carriers. On December 26, 1917 President Wilson, by proclamation,¹⁶⁷ took possession of the railroads, of all systems of coastwise and inland transportation controlled by the railroads, and of sleeping and parlor car companies.¹⁶⁸ They were retained and operated under federal control for the succeeding 26 months.¹⁶⁹

With the passing of the actual war emergency, the federal government shifted its attention to the formulation of a permanent transportation policy. Congress was presented with a flood of plans including proposals to extend substantially the period of federal

¹⁶⁴ The actions of the Railroads' War Board were backed by no legal sanctions: on the contrary, every one of its moves to produce effective unification of railroad operation, either through physical unification of properties or pooling arrangements, ran directly counter to anti-trust prohibitions. While the emotional temper of the time would no doubt have countenanced substantial violations of these prohibitions, on the ground that the immediate public interest would be served thereby Congress made no attempt to remove these legal obstacles to voluntary carrier action. And the Attorney General (according to Hines) refused to guarantee the carriers immunity from the legal responsibility which they would knowingly have incurred by binding themselves to the pooling or other arrangements practically necessary to secure unified operation of their properties. On this point see Walker D. Hines, *War History of American Railroads* (1928), p. 14.

¹⁶⁵ Looking back upon the period Hines observed: "An inescapable fact was that the railroad companies, despite the best intentions, could not unify themselves in practice into the single 'continental railway system' in the manner contemplated by the resolution adopted by their executives on Apr. 11, 1917. It was against human nature to expect any such complete unification. If a railroad company voluntarily surrendered traffic which it thought it could carry, the resulting loss of revenue was a loss to the company's stockholders, which was not authorized by them and not indemnified against by the Government." The same, p. 16.

¹⁶⁶ Under authority of "An act making appropriations for the support of the Army for the fiscal year ending June 30, 1917, and other purposes" approved Aug. 29, 1916. 39 Stat. L. 619.

¹⁶⁷ The President's proclamation is reproduced in Hines, *War History of American Railroads*, p. 245. Express companies were not taken over until Nov. 16, 1918.

¹⁶⁸ See provisions of "The Federal Control Act," 40 Stat. L. 451, approved Mar. 21, 1918 and passed to implement the President's proclamation taking possession of the carriers.

control;¹⁷⁰ permanently to retain the railroads under a socialized form of control;¹⁷¹ and to return the carriers to private ownership under government regulation. In committing itself to the latter course the Interstate Commerce Commission stated:

Much can be said on either side as to the relative advantages and disadvantages which accrue from or necessarily attend either Government ownership and operation or private ownership and operation. It seems obvious that no plan of private ownership should be considered unless it be under a broadened, extended, and amplified governmental regulation. Considering and weighing as best we can all of the arguments for and against the different plans, we are led to the conviction that with the adoption of appropriate provisions and safeguards for regulation under private ownership it would not be wise or best at this time to assume Government ownership or operation of the railways of the country.¹⁷²

In the end legislative action was dominated by those who advocated the return of the carriers to private operation under a comprehensive, positive, and authoritative system of government supervision. The Transportation Act of 1920 represented a congressional effort to construct such a system.

F. Railway Rates: Authoritative Managerial Supervision

Under the provisions of the Transportation Act of 1920¹⁷³ public authority assumed comprehensive managerial supervision not only over railroad rate policy but over the other essential functions involved in the operation of any enterprise—the determination of the quality and the quantity of service to be produced.¹⁷⁴ However, the

¹⁷⁰ The Director General of Railroads (William G. McAdoo) proposed a five-year extension of federal control. See testimony before 65 Cong. 3 sess., Senate Committee on Interstate Commerce, Hearings on *Extension of Term of Government Control of Railroads*, Vol. 1 (1919), pp. 4-124.

¹⁷¹ The "Plumb Plan" as presented by Glenn E. Plumb speaking for "executives of the organized body of railway employees." The same, pp. 985-1027.

¹⁷² *33d Annual Report of the Interstate Commerce Commission, 1919*, p. 3. It should be noted, however, that Commissioners Woolley and Eastman dissented from this view. Both favored continuance of some form of government operation. See pp. 7 and 54-60, respectively, of the same for statements of their views.

¹⁷³ 41 Stat. L. 456, approved Feb. 28, 1920. Since the passage of this act, the general body of law administered by the Interstate Commerce Commission is officially cited as The Interstate Commerce Act rather than An Act to Regulate Commerce as prior to 1920. See *Interstate Commerce Acts Annotated*, Vol. 1, p. 85.

¹⁷⁴ It will be recalled from previous sections that through the substantive provisions of the 1920 act, the federal government undertook for the first time to

rate policy enunciated in the 1920 act and the administrative devices provided for the effectuation of that policy constituted the core of affirmative regulation. Together they brought about the abandonment of the essentially restrictive and particularistic approach which had characterized regulatory action from 1887 until 1906, and they attempted to furnish effective implementation for a comprehensive system of managerial supervision. The railroad systems of the country were to be dealt with by public authority as enterprises whose continuous and economical functioning was essential to the national welfare; and as such they were to be allowed to collect from the public sufficient revenue in the aggregate to enable them not only to operate and maintain the existing plant in an efficient manner but to anticipate and provide for future transportation needs. The new approach looked to the revenue needs of the carriers as a whole, or in definite rate groups, rather than to the operating situation of individual roads. In short, the final goal sought under the reoriented policy of public supervision was stable, adequate, and continuous railroad transportation service.¹⁷⁸

exercise direct control over additions to and abandonment of railroad lines. It defined in positive terms the manner in which the consolidation, merger, and acquisition of control of railroad units could be effected by management, with a view to securing unified operation. As a corollary to this jurisdiction it assumed, for the first time, authority over the issuance and disposal of proceeds of railroad security issues. And the authority already possessed by the Commission over railroad service was greatly amplified by delegating to it affirmative control of car supply or distribution, joint use of terminals, and safety of operation.

Other means of control were either retained or expanded. In some cases, however, administrative jurisdiction was not vested in the Interstate Commerce Commission. Thus control over labor relations was administratively divorced from the main body of railroad regulation by the creation of the Railroad Labor Board. No statutory provision was made for administrative co-ordination between that agency and the Commission.

¹⁷⁸The United States Supreme Court characterized the broad purposes of this act as follows: ". . . the Transportation Act adds a new and important object to previous interstate commerce legislation, which was designed primarily to prevent unreasonable or discriminatory rates against persons and localities. The new act seeks affirmatively to build up a system of railways prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the railway an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose, it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission, which is to supervise their issue of securities, their car supply and distribution, their joint use of terminals, their construction of new lines, their abandonment of old lines, and by a proper division of joint rates, and by fixing adequate rates for interstate

As one means of achieving that goal, the 1920 act added the power to prescribe minimum rates to the Commission's already comprehensive rate-making authority, and prescribed a new rule of rate making intended to assure the carriers a fair return on a fair value of their properties. Delegation of this power to the Commission completed the process of bringing all essential phases of rate making within the orbit of public authority, thereby accomplishing the transfer from private to public agencies of the ultimate power to determine the price to be paid for railroad transportation service.¹⁷⁶ Thus at the present time the Interstate Commerce Commission exercises a direct and compelling authority over the rates charged by railroad transport and ancillary agencies.¹⁷⁷ These agen-

commerce, and in case of discrimination, for intrastate commerce, to secure a fair return upon the properties of the carriers engaged.

"It was insisted in the two cases referred to [*Railroad Commission of Wisconsin, et al. v. Chicago, Burlington and Quincy Railroad Company*, 257 U.S. 563; and *New England Divisions Case*, 261 U.S. 184] and it is insisted here, that the power to regulate interstate commerce is limited to the fixing of reasonable rates and the prevention of those which are discriminatory, and that when these objects are attained, the power of regulation is exhausted. This is too narrow a view of the commerce clause. To regulate in the sense intended is to foster, protect and control the commerce with appropriate regard to the welfare of those who are immediately concerned, as well as the public at large, and to promote its growth and insure its safety." (*Dayton-Goose Creek Railway Company v. United States, Interstate Commerce Commission, et al.*, 263 U.S. 456, 478.)

¹⁷⁶ All of the rate regulatory authority accumulated by the Commission through the three major enactments—An Act to Regulate Commerce, 1887; the Hepburn Amendment, 1906; and the Mann-Elkins Act, 1910—was retained in the 1920 act.

It will be recalled that prior to 1920 the Commission had no direct authority to fix minimum rates and, therefore, could not directly determine precise rates to control in the future. Except to the extent that the carriers might have been deterred from initiating a particular rate reduction, fearing that the Commission would order the reduction of another charge in order to preserve proper rate relationships on competitive traffic, they were free to fix their minimum charges without interference from public authority. However, rates reduced to meet water competition could not be raised except upon a showing that factors other than a disappearance of water competition justified such increase.

Moreover the carriers were well aware that even where no question of direct discrimination was involved the Commission might be deterred from granting requests for rate increases based on the need for added revenue, if it had reason to believe that a substantial quantity of traffic was moving at unduly low rates.

¹⁷⁷ As was noted above, the comprehensive system of price control which now constitutes the core of authoritative managerial supervision has evolved through three more or less distinct stages: (1) judicial remedial control, (2) transition from judicial remedial to positive administrative regulation, and (3) positive and authoritative managerial supervision.

cies must file schedules of their rates with the Commission and keep them open for public inspection; charging other than a filed rate constitutes an illegal act on the part of the carrier. Filed rates may not be changed except upon notice prescribed by statute; they may be suspended by the Commission pending investigation of their legality; they may be set aside or changed either upon complaint of interested parties or upon the Commission's own initiative on the grounds of relative unreasonableness. And, finally, for all practical purposes, their general level may be determined according to the Commission's economic judgment concerning the rate policies which will produce the optimum carrier revenue measured in terms of the public interest in preserving a transportation system in workable order.

The specific nature of the rate-making power possessed by the Commission after 1920 is illustrated by reference to the annotated rate section of the Transportation Act which provided:

. . . whenever, after full hearing . . . the commission shall be of opinion that any individual or joint rate, fare, or charge whatsoever demanded, charged, or collected . . . or that any individual or joint classification, regulation, or practice whatsoever of . . . carriers subject to the provisions of this chapter is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of this chapter, the commission is authorized and empowered to determine and prescribe what will be the just and reasonable individual or joint rate, fare, or charge, or rates, fares, or charges, to be thereafter observed in such case, or the maximum or minimum, or maximum and minimum, to be charged (or, in the case of a through route where one of the carriers is a water line, the maximum rates, fares, and charges applicable thereto), and what individual or joint classification, regulation, or practice is or will be just, fair, and reasonable, to be thereafter followed. . . .¹⁷⁸

Prior to 1920, the Commission had been given no definite statutory rule of rate making. It was governed only by the Supreme Court doctrine that the carriers were entitled to a fair return on a fair valuation of the properties "devoted to public use." Neither the Commission nor the courts possessed any means of determining the validity of valuation figures adduced by the carriers in support

¹⁷⁸ Interstate Commerce Act, sec. 15(1).

of rate proposals. No formula had been promulgated to govern the assignment of weighting factors to the various essential elements of "fair value." No statutory method had been devised for reconciling the inherent conflicts involved in the co-terminous operation of high cost and low cost units. The 1920 act, however, attempted to deal with some of these enigmas of rate regulation by the prescription of a new rule of rate making. This new rule provided positive criteria and administrative implementation intended to serve as a means of manipulating the general body of transportation charges in terms of the revenue required by the carriers (in groups or as a system) to maintain railroad service on a satisfactory operating basis.

Criteria and administrative implementation. In the exercise of its power to prescribe just and reasonable rates the Commission was instructed to "initiate, modify, establish, or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a fair return upon the aggregate value of the railway property of such carriers held for and used in the service of transportation. . . ."¹⁷⁹ It was vested with broad discretion to determine in the first instance, and to revise as conditions warranted, the rate of return which the carriers were to be permitted to earn upon the aggregate value of their properties.¹⁸⁰ The law required, however, that the determined rate be the same for all rate groups or territories. And the Commission was specifically instructed, in fixing the fair rate of return, to "give due consideration, among other things, to the transportation needs of the country and the necessity (under honest, efficient, and economic management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation."¹⁸¹

¹⁷⁹ Interstate Commerce Act, sec. 15a(2).

¹⁸⁰ The Commission was required by law, however, for a two-year period to take 5½ per cent as the basic rate of fair return.

¹⁸¹ Interstate Commerce Act, sec. 15a(3).

Physical valuation of carrier property "devoted to public use" was prescribed as the quantitative foundation for the application of the new rate-making procedure.¹⁸² The 1920 act specifically provided that such valuations when "finally ascertained" by the Commission should be considered the true value for rate-making purposes.¹⁸³

The new rate-making policy took full cognizance of the fact that rates fixed to produce a given rate of return on the aggregate value of large groups of carriers would necessarily produce widely varying rates of return upon the property value of individual carriers composing the group. Thus, it was recognized that the favorably situated or most efficient carriers would earn a relatively high return and that the unfavorably situated or so-called "weak lines" would undoubtedly obtain less than the legally prescribed fair return. The act, therefore, provided both direct and indirect methods of levelling off such variations.

As one indirect means of equalizing earning capacity the act amplified the Commission's power to prescribe through routes and the equitable division of the revenues accruing from transportation over such routes. Prior to 1920 the Commission's authority to prescribe the division of joint rates had been utilized, primarily to adjust unreasonable and unduly preferential rate divisions. The new act, however, supplied standards of a more affirmative character, for it instructed the Commission:

. . . in so prescribing and determining the divisions of joint rates, fares, and charges . . . [to give] . . . due consideration, among other things,

¹⁸² The Valuation Act (37 Stat. L. 701) had been passed in 1913 requiring the Commission to determine and record in detail: (1) the original cost to date; (2) the cost of reproduction new; and (3) other values and elements of value, for each piece of property owned or used by common carriers (subject to the act) in common carrier service. In addition the Commission was instructed upon completion of the physical valuation project to ". . . keep itself informed of all extensions and improvements or other changes in the condition and value of the property of all common carriers, and [to] . . . ascertain the value thereof, and [to] . . . from time to time, revise and correct its valuations . . ." (p. 702).

¹⁸³ However, prior to the final determination of such valuation, the Commission was given wide latitude in determining the rate base. It was instructed merely to give ". . . due consideration to all the elements of value recognized by the law of the land for rate making purposes . . ." and was required to give consideration to the property investment account of the carriers only to the extent required by the "law of the land." Interstate Commerce Act, sec. 152(4).

to the efficiency with which the carriers concerned are operated, the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and used in the service of transportation, and the importance to the public of the transportation services of such carriers; and also whether any particular participating carrier is an originating, intermediate, or delivering line, and any other fact or circumstance which would ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another carrier of the joint rate, fare, or charge.¹⁸⁴

This provision was given a liberal administrative and judicial interpretation. In the *New England Divisions* case, for example, the Commission ordered a division of rates designed specifically to aid "weak lines" by ". . . preventing needed revenues from passing to prosperous connections. . . ." The Supreme Court, in sustaining this order, said:

. . . thus by marshalling the revenues, partly through capital account, it was planned to distribute augmented earnings, largely in proportion to the carriers' needs. This, it was hoped, would enable the whole transportation system to be maintained, without raising unduly any rate on any line. The provision concerning divisions was, therefore, an integral part of the machinery for distributing the funds expected to be raised by the new rate-fixing sections.¹⁸⁵

It was recognized, however, that the application of these devices calculated to minimize the spread between the operating fortunes of the strong and weak roads would not remove certain inherent features of railroad operation, such as variation in the quality of management, geographic location, and traffic densities, which tended to produce wide inter-carrier and inter-regional differentials in the cost of producing similar units of transportation service.¹⁸⁶ The act, therefore, made provision in the so-called "recapture clause" for direct and continuous administrative treatment of this problem.¹⁸⁷

¹⁸⁴ The same, sec. 15(6).

¹⁸⁵ Opinion of Justice Brandeis in *New England Divisions Case*, 261 U.S. 184, 191 (1923).

¹⁸⁶ In addition, as is indicated in other sections of this study, the act empowered the Commission to prescribe the joint use of terminal facilities; to authorize pooling arrangements; and to approve consolidations, mergers, and acquisition of control.

¹⁸⁷ The rationale of the recapture provision was set forth as follows: "Inasmuch as it is impossible (without regulation and control in the interest of the commerce

Under the recapture provisions, any carrier receiving in any given year a net operating income in excess of 6 per cent on the legally determined fair value of its property was required to pay one half of such excess to the Commission and to retain the other half in a special reserve fund. The portion recaptured by the Commission was to be used to establish a "general railroad contingent fund." The Commission was authorized to utilize this fund "in furtherance of the public interest in railway transportation" either by making loans to the carriers to accommodate new capital requirements or to meet maturing security obligations originally contracted for capital account, or by purchase of transportation facilities or equipment for lease to the carriers.¹⁸⁸ A carrier was permitted to draw upon its reserve fund in any year in which its net operating income fell below the 6 per cent return on its property value, but withdrawals could be made only to pay interest on its securities or to meet rentals on leased roads. However, no carrier was required to accumulate a reserve fund aggregating, at any given time, more than 5 per cent of its property valuation.

These provisions constitute the substance of the new rule of rate making which was introduced in 1920. Subsequently for more than a decade the administrative resources of the federal government and the financial resources of the carriers were applied freely to the vast and costly task of laying the "valuation foundation" for scientific rate making, and to the exacting administrative effort involved in applying the prescribed rate-making theory. At the same time all important legal obstacles to the full exercise of federal authority were removed, even to the extent of practically obliterat-

of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income substantially and unreasonably in excess of a fair return upon the value of their railway property held for and used in the service of transportation, it is declared that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to, the United States." Interstate Commerce Act, sec. 15a(5).

¹⁸⁸Elaborate specifications were provided to govern the Commission in the administration of the contingent fund. See sec. 15a(10-18) of the Interstate Commerce Act. Inasmuch as the entire recapture clause was repealed (1933) the operating details are dismissed here without comment.

ing state authority as a factor in public control of railroad rates.¹⁸⁹ The Commission, however, did not succeed in applying the 1920 rule of rate making and the corollary recapture provision as contemplated by the law. Although the rule of rate making was amended and the recapture provision was abandoned in 1933, the particular aspect of the problem of government relations to transportation with which the rule was concerned remains unsolved. It, therefore, appears appropriate to outline, in some detail, the Commission's efforts to apply this scheme.

Difficulties encountered in completing the physical valuation of carrier property and the clash of judgment between the Commission and the courts as to valuation principles imposed the most serious administrative handicaps upon the Commission in its attempt to attain the contemplated precision in rate making.

Under the mandates of the 1920 act, Commission-determined valuation became the legal foundation of rate making. But physical valuation of the carriers, begun by the Commission in 1913 under the terms of the Valuation Act, was proving to be an onerous task. The debate preceding the passage of the Valuation Act indicates that while the physical magnitude of the task was vaguely foreseen¹⁹⁰ allowance was not made for many of the legal and procedural obstacles subsequently encountered by the Commission in carrying on the project.¹⁹¹ Although by the end of 1920 field work was nearing completion, the promulgation of a final valuation

¹⁸⁹ The so-called "Shreveport doctrine," enunciated by the Supreme Court in *Houston, East and West Texas Railway Company v. United States*, 234 U.S. 342, 351 (1914) (which said in part: "Wherever the interstate and intrastate transactions of the carriers are so related that the government of one involves the control of the other, it is Congress, and not the State, that is entitled to prescribe the final and dominant rule . . ."), was given full and explicit statutory expression in the 1920 act (sec. 13(4)).

¹⁹⁰ The Commission estimated the cost at \$3,000,000 and the time for completion at three years; in 1910 Senator LaFollette estimated the cost at \$2,400,000; while Senator Elkins estimated that \$5,000,000 and five years would be required to complete the project. Actually the work required almost twenty years and cost the federal government almost \$50,000,000. The railroads estimate that their expenditures occasioned by the valuation requirements have amounted to approximately \$138,000,000. (See Moulton and Associates, *The American Transportation Problem*, p. 366.)

¹⁹¹ For detailed accounts of the valuation project see Sharfman, *The Interstate Commerce Commission*, Pt. III, Vol. A, Chap. XII; Moulton and Associates, *The American Transportation Problem*, Chap. XVII; and for a briefer account see *Interstate Commerce Commission Activities, 1887-1937*, Chap. VIII.

figure was delayed by litigation and other administrative difficulties. According to the Commission:

The submission of a tentative finding as to value of a particular carrier was the signal, in nearly half the railroad valuations, for an intensive effort to upset that finding and to increase the total amount of the valuation. The railroads, with few exceptions, extended co-operation to the Commission on all technical matters in the progress of the work. But when the final value became the issue, the Commission was confronted with a persistent attack on its methods, its policies, and its decisions.¹⁹²

Thus during the entire period from 1920 to 1933 when the declared policy of Congress was to control the rate level so as to afford the carriers, as a whole, a fair return on a fair value of their property the "keystone of the regulatory arch" was only in the process of construction.

Meanwhile the Commission was forced to rely on a combination of incomplete valuation data and railroad book investment figures for its administration of the recapture provisions and for its determination of rates designed to produce a fair return on a fair valuation of carrier property. Obviously the Commission could claim no scientific precision for determinations based on either set of data. The entire rate-making procedure was, therefore, thrown back into all the administrative and legal uncertainties which had surrounded the valuation problem since the Supreme Court declared, somewhat vaguely, in 1898, that in valuing property for rate-making purposes, various enumerated elements of value were ". . . to be given such weight as may be just and right in each case."¹⁹³ The Court failed, however, to state what weighting should be given to each element. Nor did the 1920 act provide any definitive guidance for the Commission in this matter. But since it was impossible for the Commission to arrive at a precise lump-sum valuation of a carrier's property without assigning specific weights to the various elements of value, it was forced to adopt its own weighting scheme.¹⁹⁴

¹⁹² *Interstate Commerce Commission Activities, 1887-1937*, p. 147.

¹⁹³ *Smyth v. Ames*, 169 U.S. 466, 547 (1898). For further analysis see pp. 680-84.

¹⁹⁴ The method used for assigning weights to reproduction cost, estimated original cost, value of land, and going value is explained in *Excess Income of St. Louis and O'Fallon Railway Company*, 124 I.C.C. 3 (1927).

This procedure gave rise to endless delays occasioned by legal attacks upon the Commission's methods and principles.¹⁹⁶ The carriers, as a group, naturally desired to obtain the highest possible aggregate valuation on their properties, since theoretically the general rate level was to be determined by aggregate value; and individually they stood to gain from every added element of value, as this would minimize the amount of income subject to recapture.

While the constitutionality of the basic idea contained in the recapture scheme was sustained by the Supreme Court¹⁹⁸ the Commission did not succeed in gaining judicial approval of its valuation procedure. In 1929 the Supreme Court in a sharply worded five-to-three decision disapproved the valuation methods employed by the Commission, concluding that in failing to give adequate consideration to all elements of value, particularly reproduction cost, "the Commission disregarded the approved rule [enunciated by the court in *Smyth v. Ames*, 1898] and has thereby failed to discharge the definite duty imposed by Congress."¹⁹⁷ Here again the Court declined, as it had in *Smyth v. Ames*, to lay down a rigid formula for the proper weighting of elements of value, maintaining that each case should be decided in the light of contemporary con-

¹⁹⁶ The Commission reported: ". . . Recapture is an undertaking which involves great labor and expense, both to the carriers and to the government. But more important is the fact that it invites, far more than does the regulation of rates, litigation upon the part of the carriers. This invitation is accentuated by the fact that owing to litigation which has already occurred, the process of recapture has been greatly delayed, so that recovery would in a considerable number of cases involve the earnings of several years and the payment of very substantial amounts which it would tax the credit of the carriers to provide. . . . Under such circumstances, it may be taken as certain that the carriers will resist recapture to the extent of their ability, and that much litigation will ensue." From a special report submitted on May 17, 1930 by the Commission to the Senate Committee on Interstate Commerce, as reproduced in *44th Annual Report of the Interstate Commerce Commission, 1930*, pp. 88, 89.

¹⁹⁸ *Dayton-Goose Creek Railway Company, v. United States, Interstate Commerce Commission, et al.*, 263 U.S. 456 (1924).

¹⁹⁷ *St. Louis and O'Fallon Ry. Co., et al. v. United States et al.*, 279 U.S. 461, 485-86 (1929). The Court further said: "The report of the commission [124 I.C.C. 3] is long and argumentative. Much of it is devoted to general observations relative to the method and purpose of making valuations; many objections are urged to doctrine approved by us; and the superiority of another view is stoutly asserted. It carefully refrains from stating that any consideration whatever was given to present or reproduction costs in estimating the value of the carrier's property. Four dissenting Commissioners declare that reproduction costs were not considered; and the report itself confirms their view."

ditions. Thus the entire problem of valuation and fair return resolved itself into a conflict in judgment between the Commission and the Court.

This situation placed the Commission in an administrative dilemma. On the one hand, action of some kind was required, for the recapture provision constituted an integral part of declared legislative policy which the Commission had been instructed to effectuate. On the other hand the Commission feared that if it pursued a prolonged course of administrative action based on trial and error the conflict between administrative and judicial discretion might well produce a corrosive effect upon the entire regulatory structure.¹⁹⁸ By 1931 the Commission had concluded that further efforts to apply the recapture provisions of the 1920 rule of rate making would serve no useful purpose,¹⁹⁹ and its outright repeal was recommended.²⁰⁰

Even had less difficulty been encountered in obtaining the physical valuation base the Commission would have been faced with major difficulties in attempting to attain a stable level of railroad earnings by controlling the rate level.²⁰¹ The rationale of the 1920

¹⁹⁸ It reported to Congress in 1930: ". . . To state the matter baldly and frankly, litigation over questions of valuation, accounting, and administration will arise in cases where the basic issue is whether or not, or to what extent, money shall be taken from carriers by the Government, and possibly, in some instances, under financially embarrassing conditions. The unconscious influence of the surrounding circumstances is not unlikely to be such that the result will be to establish, in the course of this litigation, certain principles relative to valuation and the like which will have an unfavorable reaction on many broader phases of public regulation." *44th Annual Report of the Interstate Commerce Commission, 1930, p. 90.*

¹⁹⁹ This decision, however, was not reached without misgiving, for it warned that "one difficulty with repeal is that the question will not stop there. From the beginning recapture has been linked in thought and theory with the other provisions of section 15a. This interconnection was emphasized by the Supreme Court. If the recapture provisions are repealed, the question will inevitably arise whether all of section 15a ought not be repealed, or at least superseded by some different statutory provision having a like fundamental purpose. Various suggestions along these lines have already emanated from responsible sources. This far-reaching question the Congress must also consider." The same.

²⁰⁰ *45th Annual Report of the Interstate Commerce Commission, 1931, pp. 107-10.*

²⁰¹ That is, (1) by predetermining the aggregate revenue required to produce a "fair return" on the full valuation of all railroad properties in use and (2) by adjusting unit charges on the various classes of traffic according to the existing or anticipated volume of movement within each class so as to produce the desired amount of revenue.

rule of rate making was defective because it erroneously assumed that the railroads as a group enjoyed an effective monopoly of the facilities for moving goods and people, and that there existed a fairly inelastic demand for the various transportation services offered by the monopoly.²⁰²

While it is true that as late as 1920 the railroads still carried the bulk of the nation's traffic, it will be recalled that national policy was specifically designed to preserve water transportation as an effective competitor of the rail system. By the prohibitions contained in the Panama Canal Act of 1912 (see page 766) railroads were effectively excluded from direct competition with inter-coastal shipping through the canal. But what is more important, it was at about this time that the federal government began energetically to strengthen the position of those transport media which were already competing with the railways, and to create new and powerful competing agencies. For more than a century the federal government had maintained an active interest in the promotion of domestic water transportation facilities. And in spite of the formal rejection of the proposed "yardstick theory" of public control, namely, that railroad rates and practices should be controlled by the expansion of competing facilities, especially water transportation, rather than by direct regulation,²⁰³ the turn of the century witnessed the re-invigoration of waterways development under the stimulation of federal administration and money. It is also significant that through section 500 of the Transportation Act, 1920, the "fostering and preserving" of both water and railroad transportation was embraced within the declared objectives of national policy (see below, page 849).

Moreover, for more than two decades, the federal government had been laying the research and "educational" foundation for the phenomenal expansion of highway transportation which occurred after 1920. Beginning in 1916 with the passage of the first major federal aid highway act, it participated directly and substantially

²⁰² For the Interstate Commerce Commission's summarization of the underlying fallacies of the 1920 rule of rate making see *46th Annual Report of the Interstate Commerce Commission*, 1932, pp. 16-17.

²⁰³ Advanced by the Windom Committee in 1874 and rejected in 1887 by the adoption of Commission regulation.

in that development. As we shall point out later there is no reason to believe that in entering the field of highway promotion Congress was wholly unaware of the possible effect of its action on the competitive relations among the various transport media. The congressional committee which studied and reported on the desirability of federal aid for road development observed with approval that

. . . a great system of rural transportation would be developed with rates regulated by actual competition, open to poor and rich alike, as no expensive privately owned terminals, roadbeds, tracks, or equipment would be required. The good wagon roads would be open everywhere to the use of everybody, and the equipment, relatively inexpensive, would be within the means of many.²⁰⁴

And it concluded significantly: "We believe that permanent highways will result in a very considerable adoption of auto-truck hauling in preference to rail transportation where the distance is within a half day's run."²⁰⁵

Through the energetic prosecution of these promotional policies the federal government was thus bringing into being and nurturing the very forces which were destined to render substantial blocks of railroad property functionally obsolete. But the 1920 rule of rate making contemplated no such development for it was grounded, as we have seen, on the explicit assumption that rates could be made to produce sufficient revenue not only to maintain the then existing railroad plant "held for and used in the service of transportation" but that they could and should be adjusted with a view to the "necessity (under honest, efficient, and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation."²⁰⁶

Failure to recognize the degree of elasticity which existed in the demand for railroad service constituted another major defect in the new rule of rate making. Inadequate consideration was given

²⁰⁴ 63 Cong. 3 sess., "Federal Aid to Good Roads," H. doc. 1510 (1915), *Report of the Joint Committee on Federal Aid in the Construction of Post Roads*, pp. 14, 15.

²⁰⁵ The same, p. 15. Subsequent events have, of course, demonstrated that the committee accurately envisioned the potential trend of highway transport but was a bit conservative in speculating on the scope of its development.

²⁰⁶ Interstate Commerce Act, sec. 15a (3) and (4).

to the influence of cyclical and structural changes in the economy on the earning potentialities of the railroads. And, wholly aside from the effect of competitive services or cyclical forces, the character of the railroad rate structure did not justify an assumption that rate relationships or the general rate level could be manipulated at will to produce a given volume of revenue without directly affecting the volume flow of traffic. This rate structure was composed of a wide variety of charges, established by the carriers under the guidance of two general principles: value of service and cost of service. Broadly stated, and leaving out of consideration "fighting rates," at one extreme rates were set according to the carriers' estimate of how high the charges could be pushed without obstructing the optimum flow of traffic; at the other extreme, rates were adjusted with a view to inducing traffic to move at any price which would cover operating costs and contribute something to fixed charges. Thus the aggregate body of railroad traffic included a substantial body of commodities which had originally been induced to move only because of favorable rates. Under these circumstances, it was unrealistic to assume that rates could be adjusted at will to produce some predetermined volume of net income for the carriers.¹⁹⁷ It appears then that the 1920 rule of rate making not only was defective in its substantive provisions, but it ran into head-on conflict with other lines of regulatory and promotional action.

In the administration of the 1920 rule of rate making the Commission was well aware of the fact that ". . . many investors seemed to have believed that the paragraph did constitute a virtual guarantee of earnings. . . ." Almost from the outset, however, it adopted the attitude that the law did not require it to "disregard what is just, reasonable, and *practicable* [italics supplied] in a vain attempt to achieve stability of earnings in that way."¹⁹⁸

Substitution of Commission's business judgment for prescribed rate-making criteria. In the first general rate case presented for consideration after passage of the 1920 act, the Commission granted

¹⁹⁷ It was not until 1933 that the law specifically instructed the Commission to have a care to the possible effect on traffic movement when determining reasonable rates.

¹⁹⁸ 45th Annual Report of the Interstate Commerce Commission, 1931, p. 109.

very material increases, both in freight and passenger rates, calculated to produce a return of 6 per cent on an aggregate property value of \$18,900,000,000.²⁰⁹ The carriers' need for additional revenue was conceded. Moreover the Commission accepted their business judgment as to the probability of securing that revenue from increased charges. In every subsequent rate case of major importance, however, the Commission found it necessary or expedient to give more weight to such factors as general business conditions and the effect of competition than to a legalistic interpretation of its statutory mandate.²¹⁰

Acting on its own motion, the Commission in 1921 began a rate investigation actuated by the unsatisfactory earnings being produced under the 1920 rate adjustments. The new theory of rate making was being subjected to the practical test imposed by the depression conditions which had prevailed since the summer of 1920. In ordering a general rate reduction the Commission held that ". . . high rates do not necessarily mean high revenues, for, if the public can not or will not ship in normal volume, less revenue may result than from lower rates."²¹¹ This rate reduction was ordered, not because the then existing structure was producing more than a fair return, but because in the economic judgment of the Commission, lower rates would tend to stimulate, or at least to sustain, the flow of traffic and would thus, even at lower unit charges, produce more satisfactory net earnings. The same general criterion of pricing railroad service has been applied in all subsequent general rate cases decided by the Commission.²¹² It should

²⁰⁹ *Increased Rates*, 58 I.C.C. 220 (1920).

²¹⁰ It should be noted that from 1920 and until 1935 all of these major rate cases dealt with freight rates. In 1920 the carriers were granted substantial increases in passenger fares. No reductions were ordered in these fares until 1935. For the Commission's defense of its general rate policy see *52nd Annual Report of the Interstate Commerce Commission, 1938*, pp. 5-7.

²¹¹ *Reduced Rates, 1922*, 68 I.C.C. 676, 732.

²¹² It should be noted, however, that in two important cases involving regional rather than general rate adjustments the Commission used somewhat different criteria in refusing to grant rate increases petitioned by the carriers and defended as necessary to produce the legal 5.75 per cent return on the value of their properties. In the 1926 case (*Revenues in Western District*, 113 I.C.C. 3) the Commission refused to grant the requested increase on the grounds that although the existing rates failed to produce the 5.75 per cent return, the carriers had failed to demonstrate the existence of any financial emergency. And in the 1930 case

be noted, however, that in recent cases the Commission has given fully as much consideration to the influence exerted by competitive transport media, particularly water and highway, upon the movement of railroad traffic as to the effect of general business conditions.²¹³ In the Fifteen Per Cent case, 1931, the carriers, while granted selected rate increases, were denied the requested 15 per cent horizontal advance. The Commission pointed out that, even though the advances allowed would fall far short of returning the carriers a satisfactory, much less "legal," return on the value of their properties, any attempt to extract more revenue from the shipping public was attended by three distinct dangers, namely:

. . . (1) that at a time when transportation costs are of vital consequence to every industry it will stimulate new competitive forces already rapidly developing; (2) that it will alienate or impair the friendly feeling toward the railroads on the part of the people of the country which is essential to adequate legislation for their protection and the proper regulation of all forms of transportation in the public interest, and (3) that it will disturb business conditions and an already shell-shocked industry, and accelerate the tendency toward a localization of production.²¹⁴

Thus after more than a decade of experimentation, the 1920 recapture provision and rule of rate making had proved incapable of furnishing the regulatory agency with ponderable criteria for its guidance in evolving a rate structure which would enable the railroad system as a whole to furnish continuous and adequate serv-

(*Western Trunk Line Class Rates*, 164 I.C.C. 1) the Commission granted some increases. While these increases were allowed because (1) the then existing rates were not producing adequate revenue, and (2) it was assumed that the traffic in question could reasonably bear the increases, the Commission made no attempt to put the rate level high enough to produce the legal fair return on the aggregate value of the property being operated by the western group of carriers.

²¹³ Recent important general rate cases are as follows: *Fifteen Per Cent Case*, 1931, 178 I.C.C. 539; *General Rate Level Investigation*, 1933, 195 I.C.C. 5; *Emergency Freight Charges*, 1935, 208 I.C.C. 4; *Passenger Fares and Surcharges*, 214 I.C.C. 174 (1936); *General Commodity Rate Increases*, 1937, 223 I.C.C. 657; and *Fifteen Per Cent Case, 1937-1938* (Ex Parte No. 123), 226 I.C.C. 41.

In the last case the Commission observed that "particularly since the enactment of the motor carrier act in 1935, our opportunities for observation have been multiplied in intensity and scope, and the keenness of competition continually has forced on our attention the effect of increased or reduced charges in influencing the movement of traffic by one or another of the several competing forms of transport agencies" (p. 78).

²¹⁴ *Fifteen Per Cent Case*, 1931, 178 I.C.C. 539, 575.

ice and to maintain a satisfactory credit position. The lessons of trial and error indicated the desirability of a new approach to the problem.

Abandonment of quantitative precision as goal in rate making. The Emergency Railroad Transportation Act of 1933²¹⁵ repealed the recapture clause of the 1920 act and substituted an entirely new general rule of rate making. The new rule, in effect, abandoned the idea that rates could be adjusted by governmental action so as to provide some specific rate of return upon a precisely measured property valuation. The criteria substituted were of a highly generalized character, providing merely that

. . . in the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service.²¹⁶

As a matter of practical procedure the Commission can apply these criteria through no other process than by weighing the carriers' revenue needs against "the probable effect of increases of the existing rates upon the future movement of traffic, as developed by consideration of the ability or willingness of individual shipping interests to meet such increased costs."²¹⁷ Obviously such a pro-

²¹⁵ 48 Stat. L. 211.

²¹⁶ The same, Title II, sec. 205.

²¹⁷ *Fifteen Per Cent Case, 1937-38* (Ex Parte No. 123), 226 I.C.C. 41, 78. It should be noted that similar criteria have been utilized by the Commission since 1910 (the first general advance rate case was decided in 1911) when it was vested with broad rate regulatory authority. In the 1938 *Fifteen Per Cent case*, for example, it said: "Ever since general revenue cases began to come to us we have given consideration to matters such as those indicated [in sec. 15a as amended and in the Hoch-Smith resolution (48 Stat. L. 801)] so far as they may throw light on the reasonableness and justness of the proposals at issue" (p. 77).

In this connection it should be noted that the Hoch-Smith resolution approved Jan. 30, 1925 constituted the only statement of rate-making policy enunciated by Congress between 1920 and 1933. It was, generally speaking, inspired by congressional desire to alleviate conditions in depressed industries, particularly agriculture. The "true policy of rate making to be pursued by the Interstate Commerce Commission in adjusting freight rates . . ." was declared by this resolution to be "that the conditions which at any time prevail in our several industries should be considered insofar as it is legally possible to do so, to the end that commodities may freely move." (For a discussion of the Commission's administration of this resolu-

cedure involves the formulation and enforcement of decisions which in the aggregate constitute the exercise of managerial discretion or business judgment.

The attempt to achieve some degree of quantitative precision in the governmental control of transportation charges has, therefore, ended in the tacit congressional recognition that the pricing of a service, especially one which can be purchased in a competitive market, involves, in the final analysis, the exercise of a high degree of business judgment. Administrative experience has demonstrated that the essentially speculative nature of the pricing function is not to be altered merely by transferring it from private to public agencies.

G. Supervision of General Managerial Policies

In addition to the major powers discussed above under which the Commission directly exercises broad controls over the quantity, quality, and price of railroad service, it possesses substantial authority to inquire into and to exercise direct control over the character of general railroad managerial policies, financial and otherwise. Some of the most important of these controls involve the prescription of uniform systems of accounting; the collection, analysis, and dissemination of statistical data with reference to the operations of the carriers subject to the Commission's authority; inquiry into the honesty, efficiency, and economy of general railroad management; supervision of employer-employee relationships; supervision of proposed financial reorganization plans for bankrupt railroads; and varying degrees of control over the flow of private and public capital into the railroad industry.

Some of these controls may be considered primarily as regulatory tools. The accounting and statistical functions of the Commission fall into this category. All common carriers subject to the Commission's control are required by law to keep their accounts according to uniform systems prescribed by the Commission. And it is

tion see Moulton and Associates, *The American Transportation Problem*, Chap. VII.) It was held by the Supreme Court, however, that the Hoch-Smith resolution added no standards for rate making to those already embodied in statutes and judicial interpretation. *Ann Arbor Railroad Company, et al. v. United States, et al.*, 281 U.S. 658 (1930).

vested with fullest authority to require such carriers to furnish annual or special reports with reference to their physical and financial operation and condition. The results of these accounting and statistical activities are of course used by the Commission to implement its substantive authority. In connection with rate making, for example, such data are utilized by the Commission to formulate judgments with reference to the need of the carriers for additional revenue, to make estimates of potential freight and passenger traffic volume and to check the carriers' judgments as to what portion of that traffic they may expect to obtain.

Inquiries into the honesty, efficiency, and economy of general railroad management have also served primarily to facilitate the Commission's rate-making functions. While this regulatory authority has recognized at the outset that ". . . to go into the question of efficiency of management in a thoroughly effective way would necessitate an organization of experts especially qualified to investigate the numerous and complex phases of railroad management . . ." and would ". . . in some degree duplicate the work of the technical staff of the railroads. . . ,"^{217a} it has been required since 1920, under the prescribed rule of rate making, to formulate some judgment with reference to these matters. The dilemma in which the Commission often finds itself in the determination of general rate cases was stated by Commissioner Eastman in the Fifteen Per Cent Rate case, 1937-38, as follows:

We have said that "it is no part of our duty to interfere with management in the fixing of rates when the question is only one of what is wise or unwise in the exercise of sound business judgment." The difficulty here is that I am left by the record in great doubt as to whether the proposal to increase all rates 15 per cent is an exercise of the "sound business judgment" of the management.^{217b}

Other powers which the Commission now possesses to control the general policies of railroad management involve broader questions of public policy affecting employer-employee relationships, the flow of private and public capital into the industry, and the reorganization of bankrupt units. We shall limit our consideration here to the

^{217a} 36th Annual Report of the Interstate Commerce Commission, 1922, p. 25.

^{217b} Concurring opinion of Commissioner Eastman in *Fifteen Per Cent Case*, 1937-38 (Ex Parte No. 123), 226 I.C.C. 41, 152.

authority exercised by the Commission over the issuance of railroad securities.²¹⁷⁰

From the time of its creation in 1887 until 1920 the Commission reiterated its contention that power to control the issuance of railroad securities was necessary not only as the means of guaranteeing that funds secured by the carriers for railroad purposes would be efficiently and honestly applied to those purposes, but as a direct means of controlling the railroad capital structure in its relationship to rate regulation. In 1908 the Commission urged that appropriate legislation be enacted to control the issuance and disposition of railroad securities and pointed out that

. . . [while] it has frequently been urged that capitalization exercises no influence upon rates . . . it is difficult to see how one can assert that the kind and amount of securities issued by a public service industry have no bearing on the problem of railroad tariffs as that problem must be regarded by the Commission and by the courts. It is in fact the setting in which the problem is most frequently submitted for judicial consideration.²¹⁷¹

It was only with the passage of the Transportation Act of 1920, however, that the Commission was given control over railroad capitalization.²¹⁷² Under the terms of this act railway carriers were permitted to issue securities or assume obligations on securities only with the approval of the Commission. Notes maturing not more than two years after the issue date are excepted from this control, provided that such notes together with all other notes outstanding do not aggregate more than 5 per cent of the par value of outstanding securities.

We have already pointed out that since 1920 and particularly since 1930 the chief concern of the Commission has been to control the general level of railroad rates in such a way that the industry can attract sufficient private capital to maintain its plant. The effects of inter-carrier competition have been the dominant considerations in rate making. Under these circumstances the Commission's con-

²¹⁷⁰ Employer-employee relationships, both those controlled by the Interstate Commerce Commission and by other governmental agencies, are discussed in Vol. 1, Chap. VIII, and consideration is given to reorganization proceedings in Vol. 1, Chap. V.

²¹⁷¹ *32d Annual Report of the Interstate Commerce Commission, 1908, p. 86.*

²¹⁷² 41 Stat. L. 474, sec. 20 a(2).

trol over the issuance of railroad securities has tended to become dissociated from the major problems of rate regulation.

A substantial portion of the total amount of railroad securities issued with the approval of the Commission between 1920 and 1936 has been to meet matured funded debt and for refunding operations.^{218b} No general criteria have been formulated by the Commission with reference to the factors to be considered in disposing of applications for the issuance of new securities. Apparently each case is decided largely upon its own merit. And while the desirability of requiring competitive bidding in the sale of railroad securities has been considered at various times by the Commission, it has made no such requirement except in the case of the issuance of equipment trust certificates.^{218c} Though there has been considerable variation in the standards applied in different cases, it appears that in general the Commission has attempted to limit outstanding capitalization to the capitalizable assets of property used in the transportation enterprise under consideration.²¹⁹ In the case of applications involving the issuance of interest-bearing obligations it has attempted to determine whether or not the earning prospects of the applicant are such that it will be able to meet its total interest obligations. Where the Commission has found that the applicant carrier's earning potentialities do not meet this requirement it has usually followed the policy of advising that the ". . . securities should be restricted to stock or to such an amount of interest-bearing obligations as the applicant's earnings would warrant."^{219a}

H. Summary

From this review of the development of the portion of national policy which has been centered in the regulation of railroad transportation it appears that the public authority, having once launched upon the course of regulation has deemed it necessary to reach out

^{218b} For classification of the purposes for which securities have been issued see *Interstate Commerce Activities, 1887-1937*, p. 168.

^{218c} I.C.C. Finance Docket No. 2588; *Western Maryland Railway Co. Equipment Trust*, 111 I.C.C. 434 (1926).

²¹⁹ For the Commission's definition of items which qualify as capitalizable assets see *Securities of Louisville and Nashville Railway*, 76 I.C.C. 718 (1923). Compare Moulton and Associates, *The American Transportation Problem*, pp. 326-33.

^{219a} *Interstate Commerce Commission Activities, 1887-1937*, p. 168.

for additional points of strategic control in order to give precision, stability, expedition, and authority to the administrative application of the declared or implied policy of Congress. From the experimental and meager beginning of regulatory action in 1887, centered almost exclusively in the prescription of general statutory standards to govern privately determined railroad pricing policies, public control had by 1933 evolved into a comprehensive and authoritative system of managerial supervision, embracing a substantial degree of control over all of the strategic points in the operation of railroad transport services. The Interstate Commerce Commission was vested with plenary authority over the extension and abandonment of physical plant; it had veto power over any proposal to combine railroad units for purposes of operation or control; it could exercise a compelling supervision over the physical standards of performance and the use of service facilities; and it could in practical effect substitute its business judgment for that of private management in the determination of a rate level calculated to supply the carriers with adequate operating revenue.^{210b}

During the long period in which both federal and state governments centered their efforts in railroad regulation, many of the objectives sought from public control have been achieved. The most obnoxious discriminatory practices have been eliminated; management has been made more responsive to the interests of

^{210b} We are aware that the Commission has formally maintained that it is not in reality exercising managerial functions. In various rate cases, for example, it has stated that ". . . it is no part of our duty to interfere with management in the fixing of rates when the question is only one of what is wise or unwise in the exercise of sound business judgment." See, for example, *Fifteen Per Cent Case, 1937-38*, 226 I.C.C. 41, 152.

And in a recent annual report the Commission stated: "There is gross exaggeration in the idea that every act of the railroads is subject to regulation. The railroads have a large degree of initiative in the making of their rates, and have freely made a multitude of reductions to meet competition. We have no power to control their passenger service, and exercise very little control over their freight service. They select and pay their officers without supervision or hindrance. Nor do we undertake to tell them what equipment and supplies they may buy, how they shall operate their shops or maintain their tracks, what rails, ballast, and ties they shall use, what stations or other buildings they shall erect, what construction contracts they shall let, or how they shall manage their affairs in many other ways." *52nd Annual Report of the Interstate Commerce Commission, 1938*, p. 7.

As we have indicated, however, the Commission, under its present powers and responsibilities cannot escape exercising extensive managerial supervision over the price, quantity, and quality of railroad service.

its patrons through the improvement of the "manners," the quality of service offered, and the calibre of financial management; life and limb of railroad employees and passengers have been made remarkably safe; and the general knowledge and understanding of the nature of the so-called "railroad problem" has been greatly advanced through the orderly collection and uniform handling of railroad operating and financial data. Moreover, through the perfection of administrative procedure and organization, through the recruitment of competent personnel, and through the gradual clarification of statutory and constitutional jurisdiction, the purely administrative aspects of the railroad regulatory problem have been made more wieldy. But with the gradual transition of regulatory policy from one designed merely to control or eliminate abuses to one designed to provide and maintain, through affirmative and authoritative governmental action, a stable and otherwise satisfactory transportation plant it has become increasingly apparent that the goal sought is an elusive one, necessitating transfer to public agencies of an ever-widening sphere of influence.

Had the objectives sought from such control been implemented with internally consistent policies and administratively feasible devices, and had it been possible to insulate the railroad transport system from the impacts of competitive media and business fluctuations, the over-all results might have been happier. More specifically, the 1920 consolidation policy, designed to relieve the railroad system from the wastes involved in duplicate plant, has failed to achieve the anticipated results. Even the threat of collapse of the railroad financial structure, occasioned by depression forces, was insufficient to break the grip of those interests which had secured vested rights in the *status quo* of railroad operating patterns. And the wide discretionary powers, including the authority to issue consolidation orders, vested in the office of Federal Coordinator of Transportation by the Emergency Railroad Transportation Act of 1933 failed to accomplish anything tangible in the way of eliminating the wastes of duplicate plant and management. For all practical purposes the problem of railroad consolidation remains unsolved; the goal of the 1920 Transportation Act has not been attained.

What is more important, the 1920 standard of scientific rate making was abandoned in 1933. Substitution of the highly generalized rule of rate making contained in the Emergency Railroad Transportation Act of 1933 amounted in effect to a belated, though only partial, statutory recognition that one phase of our transportation system was being regulated according to rigid standards of performance and public responsibility, while other transport agencies were being permitted to compete for the same traffic and freely to alter rates and quality of service according to conditions prevailing at any given moment.

The rise of competitive media had introduced new forces which necessitated either a partial abandonment of the objectives and mechanisms of managerial supervision over the railroads, or an expansion of the scope of that supervision to include control over these other forms of transportation.

V. FEDERAL MANAGERIAL SUPERVISION: HIGHWAY, WATER, AND AIR TRANSPORT AGENCIES

As we have indicated, the trend toward fanwise extension of governmental regulatory authority from the original focal point of railroad control began in 1906 with the Hepburn Act. The additional agencies affected by this act, the express companies and sleeping car companies, were railroad satellites; they performed ancillary services and were not capable of economic existence independently of the basic rail system. For purposes of regulation they were therefore dealt with merely as incidental units of the railroad operating system. But as highway, water, and air transport media reached maturity there arose a regulatory problem of wholly different proportions and character. Under the influence of extensive governmental promotional programs these media had by 1935 developed into independent transport systems. They offered complete and distinctive types of transportation services and utilized physical facilities, corporate organizations, and operating methods unrelated to railroad transportation either in economic characteristics or financial control. Their growth had created competitive forces which threatened to undermine the railroad financial structure, and which were exerting substantial influences on the country's economic and social life. In short it appeared that the

public interest in the maintenance of an "adequate" transportation plant could no longer be served solely by comprehensive governmental supervision of railroads and ancillary agencies.

Within recent years widely varying devices have been utilized in the process of adapting concepts and systems of public regulation to the demands of a fundamentally altered transportation situation. In the case of highway transportation, where competitive relations with the railroads are direct and of substantial proportions, the controls have been made an organic part, administratively and otherwise, of the main body of regulation developed since 1887. But in the case of air and water transportation regulation, diffused statutory and administrative control patterns have been established.^{219c} Some of the seemingly insoluble problems which currently harass public authority are traceable to the particularistic nature of these governmental promotional and regulatory policies.

In dealing with this phase of governmental relations to transportation we shall make no attempt to analyze in detail the legislative and administrative evolution of each area of activity.²²⁰ Our discussion will be limited to an outline of the forces which led to the extension of regulatory authority, and to a brief analysis of some major issues of public policy which have emerged.²²¹

^{219c} For example, with the passage of the Motor Carrier Act, 1935 (49 Stat. L. 543), the regulation of interstate highway transportation was articulated with railroad regulation, the Motor Carrier Act being made Part II of the Interstate Commerce Act, and its administration being delegated to the Interstate Commerce Commission.

In contrast, when in 1938 Congress for the first time brought air transportation under a comprehensive system of regulation (Civil Aeronautics Act of 1938, 52 Stat. L. 973), it established a new administrative agency, the Civil Aeronautics Authority, and charged it with exclusive responsibility for the promotion and regulation of air commerce.

Similarly, the promotion and regulation of water transportation is vested in a separate administrative agency, the United States Maritime Commission (created by Merchant Marine Act, 1936, 49 Stat. L. 1985).

There exists no effective statutory or administrative mechanism for the correlation of the activities of these agencies.

²²⁰ This has been done, among other places, in Chap. VII of 75 Cong. 1 sess., *Investigation of Executive Agencies of the Government*, S. rep. 1275, report submitted by the Brookings Institution to the Select Committee to Investigate the Executive Agencies of the Government (1937).

²²¹ Thus, various phases of traditional governmental activity relating generally to the promotion and policing of all divisions of water navigation, and of certain aspects of the merchant marine, and highway and air transport systems are not discussed, or are dealt with in other sections of the study.

Highway transportation. In no field of transportation has there been a more continuous or comprehensive exercise of public authority than in the business²²² of moving people and property over roads and highways. All divisions of government, local, state, and national, have at various periods participated in various degrees both in the construction and maintenance of highway facilities and in the regulation of their use.

Physical development of the modern highly articulated system of highways has proceeded under the exclusive auspices of governmental agencies. Since 1893, state and federal agencies have cooperated in the planning and financing of the construction of major highway routes; but direct responsibility for the actual work of construction and maintenance has remained with state and local governments. Federal activity (with the exception of forest and Indian reservation roads, memorial highways, and certain relief projects) has been limited to educational work and to the administration of grants of federal funds as provided by the federal aid highway acts. In all of this extensive development, private enterprise has not been called upon to perform any important function of promotion, financing, or management such as it undertook in connection with the early construction and operation of toll roads under state charter provisions.²²³

Combined local, state, and federal efforts²²⁴ have produced in a remarkably short period a national system of highways which, from the standpoint of physical characteristics, now permits the relatively unimpeded inter-regional movement of some 25 million passenger cars and 4 million trucks and buses.²²⁵ During the greater portion of

²²² Used here to include all phases of highway activities, the construction and maintenance of physical facilities and the control of their use whether by individuals for private purposes or by commercial organizations for purposes of business profit.

²²³ Chiefly during the first half of the 19th century.

²²⁴ Extensive federal participation in this development began in 1916 with passage of the Federal Aid Act (39 Stat. L. 355). It has since continued under the basic provisions of the 1916 act and the Federal Highway Act (42 Stat. L. 212, approved Nov. 9, 1921), and has exerted a dominating influence upon the character, direction, and speed of highway development.

²²⁵ While complete uniformity has not yet been achieved, and there exist substantial variations between states in laws regulating physical characteristics and operation of vehicles, such as gross weight, length, etc. (all presumably related to strength, width, and other physical characteristics of the highway) it has been

this period the highways were kept open to the almost unlimited use of the public generally. Non-commercial use was subjected only to police regulations and to the payment of license fees and gasoline taxes. And while various states attempted, with indifferent success,²²⁶ to regulate commercial use of the highways,²²⁷ interstate operations were not subjected to any positive system of business regulation until 1935 (see page 839).

Thus, by about 1930, there had been made available for the use of the general public not only a "great system of rural transportation . . . with rates regulated by actual competition, open to poor and rich alike" as visualized in 1914 by the joint congressional committee,²²⁸ but one almost equally well adapted to the general transportation requirements of commerce and industry.

It is a striking commentary upon the legislative process that in the federal highway policy, which has dominated the development of the national highway system, there has been no statutory recognition of the fact that promotional action in this field is part and parcel of the general transport policy of the country. There is, for example, no statutory mandate that the agency which administers federal aid (the Secretary of Agriculture acting through the Bureau of Public Roads)²²⁹ shall consider in any way the probable effects of highway development upon other transportation agencies. This, of course, does not imply that those charged with the formulation of federal highway programs are unaware of the relationships which exist between their work and the general transportation problem. The fact remains, however, that the legislative instructions under which they operate give no formal recognition to such factors.

sufficient for a decade to permit relatively free flow of interstate highway transportation.

²²⁶ Partly because of faulty character of legislation and partly because of jurisdictional conflicts between federal and state authority.

²²⁷ By contract and common carriers for hire as distinguished, for example, from operation of trucks transporting products of the owner.

²²⁸ 63 Cong. 3 sess., *Federal Aid to Good Roads*, H. doc. 1510, p. 15.

²²⁹ Pursuant to the terms of 76 Cong. 1 sess., *First Plan on Government Reorganization*, H. doc. 262, the Bureau of Public Roads became the Public Roads Administration and its functions were transferred to the newly created Federal Works Agency.

The plan was made effective on July 1, 1939. For details see *Report of the Chief of the Bureau of Public Roads, 1939*, p. 2.

Federal activities in the field of highway development are inextricably related to and affect the full sweep of governmental efforts to maintain a satisfactory transportation system.²⁹⁰ The failure of Congress to give statutory and administrative recognition to this fact has rendered sterile many of its regulatory policies designed to preserve a railroad system in "full force and vigor."

We have already called attention to the theoretical and practical contradictions between lines of public action which on the one hand were attempting to secure a stable and specified rate of earning for the privately owned and operated railroad system (based on the assumption that it possessed an effective monopoly), and on the other hand were producing publicly owned transport facilities capable of exposing the privately owned properties to effective and pervasive competition. (See page 819.)

What is more important, those competitive forces which had been operating with increasing impact upon the railway financial structure during the 1920 decade merged with depression conditions to produce another of the traditional railroad crises. The railroads suffered a drop of 33 per cent in total operating revenues between the years 1928 and 1931 and in the next year experienced a further decline of 25 per cent in freight revenues and approximately 30

²⁹⁰ In 1922 intercity highway passenger traffic amounted to only 28 per cent of rail-carrier volume. Although a substantial proportion of highway passenger traffic either would not or could not move by any other means, direct competitive relations are obvious. For beginning with 1924, in spite of a tremendously expanding travel market, rail passenger traffic declined steadily until 1933, when it reached the 1900 level. By 1933, according to the best estimates, private intercity passenger vehicles were carrying over eleven times the volume of passenger traffic handled by all rail carriers combined (stated in terms of passenger miles travelled), while intercity motor vehicle commercial "carriers" were handling 6 billion passenger miles compared with 16 billion carried by the railroads. (See pp. 111 and 112 of *Passenger Traffic Report*, prepared by the Federal Coordinator of Transportation, 1935.) Moreover, rail carriers, both on their own initiative and under compulsion of the Interstate Commerce Commission (see, for example, passenger fare reduction order issued by the Interstate Commerce Commission, No. 26550, *Passenger Fares and Surcharges*, 214 I.C.C. 174 (1936)) are now making strenuous efforts to participate in the expanding passenger-travel market.

The proportion of intercity freight carried by motor truck is less striking than the passenger ratios. But it is far more important in terms of the financial stability of the railways. Records indicate that by 1932 approximately 24 per cent of the country's freight tonnage (stated in ton-miles carried) was moving by various types of trucking operations (common, contract, and private trucking operations) over intercity highways. Approximately 54 per cent moved by rail carriers, and the bulk of the remainder by inland-water facilities. (See p. 3, 73 Cong. 2 sess., *Regulation of Transportation Agencies*, S. doc. 152 (1934).)

per cent in passenger revenues. Through the exercise of rigid operating economies, and through the use of reserves, they were able to meet their fixed charges. But in 1932 an epidemic of receiverships was averted only through the intervention of the Railroad Credit Corporation and the Reconstruction Finance Corporation.

Various private agencies addressed themselves to the task of discovering the source of the railroad plight and to the prescription of remedies.²³¹ And the incoming administration took cognizance of the pressing nature of the problem at hand by sponsoring enactment of the Emergency Railroad Transportation Act of 1933 which, among other things, created the office of Federal Coordinator of Transportation. The assignment given the Coordinator was two-fold in nature. He was instructed to assist the rail carriers in eliminating waste and unnecessary expense (see page 778); and he was charged with the responsibility for making broad investigations into and reports with respect to methods of improving transportation conditions generally.²³²

In the prosecution of the latter assignment the Coordinator conducted a series of extensive investigations.²³³ Of the numerous findings and "statements of principle" which emerged from these investigations, four supply the foundation of the regulatory program subsequently proposed by the Coordinator. First, Congress was advised that

²³¹ For example, the "National Transportation Committee" (sometimes referred to as the Coolidge Committee) undertook a general study of the railroad problem at the request of "certain business associations, savings banks, insurance companies, and fiduciary and philanthropic institutions interested in railroad securities." See Report of the National Transportation Committee, dated Feb. 13, 1933, reprinted in Moulton and Associates, *The American Transportation Problem*, p. xv.

At about the same time a group representing the railroads and highway users' organizations released a report containing recommendations as to the principles which should govern public policy in the transportation field, particularly with reference to the competitive relations between the railroads and highway transport organizations. See *Recommendations of the Joint Committee of Railroads and Highway Users*.

²³² 48 Stat. L. 211, Title I, sec. 4.

²³³ The results of these major investigations are embodied in the following documents: 73 Cong. 2 sess., *Regulation of Railroads*, S. doc. 119 (1934); 73 Cong. 2 sess., *Regulation of Transportation Agencies*, S. doc. 152 (1934); 74 Cong. 1 sess., *Report of the Federal Co-ordinator of Transportation, 1934*, H. doc. 89 (1935); 74 Cong. 2 sess., *Fourth Report of the Federal Co-ordinator of Transportation on Transportation Legislation*, H. doc. 394 (1936).

the ultimate objective [of national transportation policy] is, of course, a system of transportation for the Nation which will supply the most efficient means of transport and furnish service as cheaply as is consistent with fair treatment of labor and with earnings which will support adequate credit and the ability to expand as the need develops, and to take advantage of all improvements in the art. This system of transportation must be in the hands of reliable and responsible operators, whose charges for service will be known, dependable, and reasonable, and free from unjust discrimination.²⁸⁴

Second, the Coordinator concluded that such a goal could not be "... attained or even approached without public regulation and the guiding hand of the Government in the operation and development of all important forms of public transportation."²⁸⁵ Third, he stated that, principally as a result of the extensive promotional activities carried on by government agencies since 1920, the country had been oversupplied with transportation facilities.²⁸⁶ And fourth, he argued that the resulting competition was "destructive and wasteful" and therefore incompatible with attainment of the stated "transportation objective."

Chief among the factors which led to the characterization of such competition as "destructive and wasteful" were (1) its alleged disruptive effect upon established methods of production and distribution in industry and trade generally, (2) its tendency to introduce elements of instability into a transportation rate structure which had attained a high degree of stability (or rigidity as the case may be) under public regulation, and (3) the destruction or sterilization of capital invested in both the older and newer forms of transportation.²⁸⁷ The failure of government to subject all competing forms

²⁸⁴ 74 Cong. 1 sess. Pt. 1, p. 50, *To Amend the Interstate Commerce Act*, Hearings on S. 1629, S. 1632, and S. 1635 (1935).

²⁸⁵ The same.

²⁸⁶ See 73 Cong. 2 sess., *Regulation of Transportation Agencies*, S. doc. 152, p. 2. It was stated for example that the amount of new capital which had been invested between 1930 and 1932 in forms of transportation (highways, canals, etc.) competitive in one degree or another with the railroads approximated the capital investment in railroads as of 1920.

²⁸⁷ "The transportation of the country is in a period of grave unsettlement pending important changes. New transportation agencies have appeared on the scene in great force. It is a period of strife, confusion, and instability." Testimony of Commissioner Eastman, 73 Cong. 1 sess., *Emergency Railroad Transportation Act*, Hearings before Committee on Interstate Commerce on S. 1580 (1933), pp. 52, 53. In later testimony the Commissioner stated: "The result [investment in new

of transportation to the same standards of performance and public responsibility was advanced as the basic explanation for the development of these competitive situations which were considered to be subversive of the general public interest.²³⁸ As has been pointed out by various interested parties it would have been possible to seek the desired "parity of regulation" or "equality of competitive opportunity" as among the different transport media either by relaxing the rigid system of railroad supervision or by imposing substantially the same controls on other media. With reference to the merits of these alternatives, the Coordinator observed:

Past experience with free competition of unregulated railroads proved it would be folly to abandon the system of Federal regulation, built up in response to public demand over a long series of years. It was also clear that the evils which had created this demand for railroad regulation were breeding rapidly in the other forms of transportation, to the alarm of a large proportion of the water and motor carriers as well as of many of the more far-sighted shippers. Study of the situation, reinforced by a growing public sentiment, made it plain that the choice should be in favor of extending the system of regulation impartially over all important forms of transportation.²³⁹

In line with these general findings and conclusions²⁴⁰ the Coordinator submitted to Congress a three-fold program involving (1) a comprehensive scheme for the regulation of interstate highway transportation similar to that already in force relative to the railroads; (2) a similar system of regulation applicable to coastal,

forms of transport between 1920 and 1932] has been an oversupply of transportation facilities and a tremendous increase in transportation competition, all of which has been greatly accentuated by the depression. The present situation is, in my judgment, satisfactory to nobody. Certainly it is not satisfactory to the carriers or to investors; there is strong and continually growing evidence that it is not satisfactory to shippers; and it is not satisfactory to labor." 74 Cong. 1 sess., Hearings on S. 1629, S. 1632 and S. 1635, Pt. 1 (1935), p. 50.

²³⁸ 74 Cong. 2 sess., *Fourth Report of the Federal Co-ordinator of Transportation on Transportation Legislation*, H. doc. 394, p. 4.

²³⁹ The same.

²⁴⁰ It should be noted that we are describing and not subjecting to critical analysis the Co-ordinator's "findings." Some of them were supported by factual and theoretical analysis; and some were only statements of what were deemed to be socially desirable lines of action, based upon opinion and arbitrary statement of principle. An example of the latter is the unsupported assumption that the public interest would necessarily be served by the preservation of existing rate "stability" as reflected in the then existing railroad rate structure.

intercoastal, inland river, and Great Lakes water transport operations; and (3) the statutory internal reorganization of the Interstate Commerce Commission in line with the new duties and responsibilities with which it would be charged under the proposed regulatory program.²⁴¹

The Motor Carrier Act of 1935 was the only immediate legislative product of the Coordinator's proposed program. It reflects the Coordinator's central thesis that there should be provided both unified and uniform regulatory treatment of the major transport agencies. Unified administrative treatment is assured so far as railroad and motor carrier regulation are concerned, for the Motor Carrier Act was made Part II of the Interstate Commerce Act; and exclusive responsibility for the administrative application of the expanded system was delegated to the Interstate Commerce Commission. And it appears that Congress sought to establish uniformity of regulatory treatment by making interstate motor transportation subject to a system of public managerial supervision similar in degree and extent to that applied to rail carriers for many years.

In the first place the Motor Carrier Act declares in broad terms that it is the policy of Congress

to regulate transportation by motor carriers in such manner as to recognize and preserve the inherent advantages of, and foster sound economic conditions in, such transportation and among such carriers in the public interest; promote adequate, economical, and efficient service by motor carriers, and reasonable charges therefor, without unjust discriminations, undue preferences or advantages, and unfair or destructive competitive practices; improve the relations between and co-ordinate transportation by and regulation of, motor carriers and other carriers; develop and preserve a highway transportation system properly adapted to the needs of the commerce of the United States and of the national defense; and cooperate with the several States and the duly authorized officials thereof and with any organization of motor carriers in the administration and enforcement of this part.²⁴²

In the second place the substantive provisions of the act empower the Interstate Commerce Commission to exert supervision

²⁴¹ These recommendations were embraced in S. 1629, S. 1632, and S. 1635 upon which hearings were held before the Committee on Interstate Commerce, 74 Cong. 1 sess., from Feb. 25 to Mar. 6, 1935.

²⁴² 49 Stat. L. 543, sec. 202 (a).

over all of the essential operating features of interstate motor carrier business. As in the case of railroad supervision, the quantity, quality, and price of service are subject to authoritative regulation by the Commission. No new "for hire" service may be inaugurated without Commission authority. In passing upon such applications the Commission may exercise virtually unlimited discretion in deciding whether the "public interest" will be served by the inauguration of a new truck or bus line between the specific points named in the petition. The Commission must decide, among other things, whether or not existing service is adequate in terms of amount, character, and price; what effect the proposed service would have upon established services; whether or not the applicant is "fit and willing" to render the proposed service according to prescribed standards of performance. Moreover, consolidations or acquisitions of control either of motor lines or rail and motor companies may not be effectuated without authority of the Commission.

The Commission is also authorized to formulate and prescribe rules and regulations governing all factors bearing on safety of operation. Mechanical characteristics of vehicles, operating rules, and hours of labor, may be prescribed and their observance enforced by the Commission. In addition, the financial responsibility of motor carriers for damage to individuals and property is subject to regulation.

As in the case of railroad supervision, however, the cornerstone of the Commission's authority over motor transportation is rate regulation. In this area of control its power is for all practical purposes coterminous with that exercised over railroad rates.²⁴⁸ Interstate common carriers by motor vehicle are required to keep on file with the Commission, and open to public inspection, tariffs stating the exact rates and conditions under which they offer their services

²⁴⁸ However, it should be noted with respect to the Motor Carrier Act that: (1) the Shreveport principle (see p. 815) was specifically made inapplicable to Commission regulation of motor carrier rates; therefore, that agency has no power to control intrastate rates in any manner (sec. 216(e)); (2) theoretically, at least, only the *minimum* rates of contract carriers are subject to regulation; (3) the Commission may establish through routes and joint fares only for common carriers of passengers; and (4) the Motor Carrier Act contains no provision corresponding to the long and short haul clause of Part I of the Interstate Commerce Act (see p. 800).

to the public. Any attempt on the part of a common carrier to obtain a rate of compensation different from that stated in the filed tariff constitutes a violation of the law. Proposed changes in filed schedules are subject to suspension, pending investigation as to their lawfulness. This action may be taken by the Commission either on complaint by an interested party or on its own motion. Moreover the Commission is empowered, either on its own initiative or on complaint, to investigate the lawfulness of any tariff in force. If after such an investigation the Commission finds that such tariff comprehends a charge for service which ". . . is or will be unjust or unreasonable, or unjustly discriminatory or unduly preferential or unduly prejudicial . . ." it is directed by the law to ". . . determine and prescribe the lawful rate, fare, or charge or the maximum or the minimum, or maximum and minimum rate, fare, or charge thereafter to be observed. . . ." ³⁴⁴

In the exercise of this rate-fixing power the Commission is required to give

. . . due consideration, among other factors, to the inherent advantages of transportation by such carriers, to the effect of rates upon the movement of traffic by such carriers; to the need, in the public interest, of adequate and efficient transportation service by such carriers at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable such carriers, under honest, economical, and efficient management, to provide such service. ³⁴⁵

No mention is made of the effect of motor carrier rates upon the movement of traffic by rail or other carriers.

Interstate contract carriers are subject to approximately the same filing and publication obligations as are common carriers. But technically, at least, the Commission's powers over contract carrier prices are limited to the prescription of minimum rates. ³⁴⁶ Moreover, according to current Commission interpretations of the act, the purpose of contract carrier regulation, rate and otherwise, dif-

³⁴⁴ 49 Stat. L. 543, sec. 216(c).

³⁴⁵ The same, sec. 216(i).

³⁴⁶ Under the principles formulated by the Commission to govern the filing of contracts of contract carriers it appears that the legal distinction between minimum and precise contract carrier rate regulation will have no practical meaning. See *Contracts of Contract Carriers*, 1 M.C.C. 628 (decided Apr. 21, 1937).

fers fundamentally from common carrier regulation. In a leading case it stated that the

. . . underlying purpose [of the Motor Carrier Act] is plainly to promote and protect adequate and efficient common-carrier service by motor vehicle in the public interest, and the regulation of contract carriers is designed and confined with that end in view.²⁴⁷

Under the guidance of such a theory, regulation of contract carriers is punitive rather than affirmative in purpose; and few limitations are imposed on the Commission in the exercise of this power.²⁴⁸

Although it is evident that the Motor Carrier Act constitutes an integral part of a regulatory program designed to obtain unification and uniformity in the regulatory treatment of the major transport agencies it is impossible at this time to determine precisely what ultimate transportation objective Congress is seeking. On the one hand, the substantive provisions of the Motor Carrier Act and the circumstances surrounding its enactment indicate that the intended goal of national action is the maintenance of independently owned and managed, and fully competitive systems of transportation. On the other hand, there is equally good evidence that Congress viewed motor carrier regulation as one step in the gradual development, under governmental guidance, of an articulated or "co-ordinated" national system of transportation in which the separate media would lose their identity.

In attempting to discover the rationale of regulatory policy in this field it should be realized that in contrast with unregulated railroad service, in which competition had tended to disappear, motor carrier competition tended to operate pervasively.²⁴⁹ Moreover, in the motor carrier field competition did not tend to destroy itself and run into monopoly control of routes, for no private operator could secure proprietary interest in the publicly owned right of way; it was neither difficult nor expensive to organize a new unit, and cost conditions were not such as to promote the elimination of

²⁴⁷ 1 M.C.C. 628, 629.

²⁴⁸ The only significant one is that in the prescription of minimum rates for contract carriers the Commission ". . . shall give due consideration to the cost of the services rendered by such carriers and to the effect of such minimum charge, . . . upon the movement of traffic by such carriers." (49 Stat. L. 543, sec. 218(b).)

²⁴⁹ Mainly, of course, because the motor carrier "right of way" reached every county seat and every village in the country.

competition. Under these circumstances organized shipper groups found no immediate cause for complaint as to the character of service being offered by motor transport agencies.

Thus, viewed independently of its effect upon transportation service as a whole, there was no problem of public control over motor carriers which could not have been met by the exercise of relatively simple functions. The immediate requirements of the public interest could have been served merely by the prescription and enforcement of police regulations designed to preserve highway property and to secure optimum utilization of that property, measured in terms both of safety and traffic flow. The public could have been informed as to the rates and practices of the numerous operators by publication of classifications and rate schedules, and by the collection and dissemination of operating data. Under this concept of governmental responsibility, public authority would not seek to impose the same regulations upon all competing agencies. It would merely seek to guarantee that each would furnish the public with safe, dependable, and adequately priced service, measured in terms of the economic characteristics of each agency. This principle would tend to develop a series of independently functioning transportation systems, that is, a motor vehicle, a water, a railroad, and an air transportation system, highly competitive with one another. Each form of transport would compete for public patronage on the basis of prices related to its own costs, the peculiar advantages of the service which it could offer, and upon the ingenuity and energy of its own management. The issue of competitive survival would be determined by the manner in which the shipping and travelling public distributed its patronage among the competing agencies. Public control would be highly differentiated both in terms of comprehensiveness and method with respect to the various media of transportation. It would be assumed that if any economically and socially offensive practices which might arise in the operation of each form of transportation were controlled, the general public interest in the preservation of satisfactory transportation service would be accommodated. Such a line of public action would disavow any effort to pre-determine the field of service to be occupied by any given transport agency, and would satisfy the tests of "fairness."

In some respects the Motor Carrier Act of 1935 may be said to embrace this theory of regulation. One of its declared purposes is to preserve the inherent advantages of motor transportation. Moreover its consolidation and acquisition provisions appear to be intended to maintain effective competition between the rail and highway systems, although rail carriers are not wholly excluded from the highway field, as they are in effect from water carrier operation under the provisions of the Panama Canal Act.

However, the circumstances surrounding the passage of the Motor Carrier Act, viewed in conjunction with some of its major provisions, seem to indicate that the extension of managerial supervision to motor transport was motivated to some extent by a different and incompatible theory of regulation, that of transport articulation or "co-ordination." While the rationale of this concept is extremely elusive, the central idea is contained in the observation that the proper place for each of these [competing transport] agencies must be found, and in some way they must be co-ordinated and welded into a well-knit whole, into a transportation system operating much more nearly as a unit, without cross purposes and all manner of lost motion.²⁵⁰

Under a regulatory program following this principle, efforts would be made to integrate rather than to differentiate regulatory action. It would proceed from some predetermined judgment of the type of general transportation service necessary to meet the economic, social, and military requirements of the nation, and would attempt to restrict each transport agency to a sphere or area of service in such a way that the operations of the various parts would produce the type of national transportation plant determined upon as the goal of national action.

If in the practical application of such a theory, it were decided by statute, or assumed by regulatory authority, that the existing railroad rate structure and physical plant should either be retained intact or should be protected against a too rapid disintegration under the competitive impact of newer forms of transportation, rate determination with respect to these agencies would be made on the basis of criteria which would have no relationship, or only an

²⁵⁰ 73 Cong. 1 sess., testimony of Commissioner Eastman in Hearings on S. 1580 before the Commission on Interstate Commerce, p. 53.

accidental relationship to their costs of performing a particular service.²⁵¹ Similarly the extension and abandonment of service by any of the various transport agencies would be controlled, not by the free distribution of shipper patronage among those agencies, but rather by the determination of the regulatory authority as to the need of the general public for that particular service.

Some of the most significant powers delegated to the Commission by the Motor Carrier Act of 1935 can be explained only if they are viewed as essential mechanisms of such a general program of public action designed to articulate or "co-ordinate" the separate forms of transportation into some sort of a unified transport system.²⁵² There is evidence of such an objective in the report of the Senate Interstate Commerce Committee which recommended passage of the motor carrier bill. "This bill [which without fundamental amendment became the Motor Carrier Act, 1935] is part of a complete and co-ordinated program of legislation touching all forms of transportation. . . . The ultimate objective of the entire program [that proposed by the Federal Coordinator of Transportation] is a system

²⁵¹ In a recent report the Commission said: "While we are convinced that the principal means of coping with this situation [rise of motor transportation and the extension of water and pipe-line competition with railroads] is to give more weight to the cost-of-service factor, it must be realized that the process cannot be approached with the hope of making abrupt changes, or that rate making can become a mere process of applying cost formulæ. It may prove that the economic life of the nation requires continued play of the principle that, for the good of the whole, the burden of maintaining carrier services must be distributed in part in disregard of relative costs and in proportion to ability to pay." *Report of the Interstate Commerce Commission to the President of the United States on Certain Aspects of the Proposed Lake Erie-Ohio River Canal, October 3, 1939* (mimeo.), p. 13.

²⁵² In this connection it should be noted that the term "co-ordination," by which this concept is ordinarily described, is not accurately descriptive of that goal of regulatory action. "Co-ordination" in strict usage means the bringing of parts of equal rank into reciprocal relation. Regulatory devices designed to integrate the various parts of the transportation system into a unified whole never proceed on the assumption that the parts to be integrated are of equal rank or importance so far as the public interest is concerned. On the contrary they assume that each agency possesses some inherent economic advantage over the other in a particular sphere of transport activity, that it is the function of public authority to discover that area of economic superiority and retain each agency within those limits. As a matter of fact the concept almost uniformly assumes—because of the need for establishing some criteria for administrative actions—that one agency either by virtue of its occupancy of the field, or by virtue of some inherent economic characteristic, should form the "backbone" of the system and that the other agencies should be attached to that basic structure and perform ancillary service.

of co-ordinated transportation for the Nation.”²⁵³ Moreover, the controls provided in the Motor Carrier Act are designed more to buttress up and improve the system of managerial supervision over railroad transportation than to foster and preserve motor transportation or to protect shippers and the general public against abuses growing out of the operation of highway transport services. Brief reference to the problem of rate regulation will serve to illustrate this point.

Under the guidance of public authority there had been developed a railroad rate structure under which a wide range of commodities at one extreme paid according to the “value of service” concept of pricing, and at the other extreme another group of commodities paid according to various adaptations of the “cost of service” theory. In general, rates applicable to the former group had been instituted to induce the movement of low-grade commodities unable to bear a higher charge, or to prevent diversion of traffic to competitive media. Not only the railroad operating and financial structure, but to an important extent the location of producing areas and trade channels of the country had been conditioned by this rate structure. But as we have seen, the development of an articulated national system of all-weather highways, which occurred between 1920 and 1930, gave rise to a form of transport which differed fundamentally from railroad transportation in all essential operating features. The chief point of difference lay in the fact that highway transport functioned as a pervasively competitive industry. Each operator was under constant pressure to adjust his rates to operating costs, not only because of the continuing competition encountered from numerous other commercial operators in the same area,²⁵⁴ but because rates which reflected any substantial deviation from the cost of performing a particular service immediately stimulated private operation. The highways were open to any producer who chose to purchase equipment and supply his own transportation as an integral part of his major business operation.²⁵⁵

²⁵³ 74 Cong. 1 sess., *Motor Carrier Act*, S. rep. 482 (1915), p. 3.

²⁵⁴ Resulting chiefly from the fact (1) that only a small capital investment was required to enter the field and (2) that few effective legal checks were exercised by the states over the commercial use of the highways.

²⁵⁵ The same type of situation prevailed, although to a lesser extent, on the inland waterways.

All of these developments subjected the railroad rate structure to an erosive process, starting with the commodities whose rates bore the least relation to highway transport costs and gradually moving down the scale as the scope of highway transport service expanded as to length of haul and the range of commodities handled.

The advocates of comprehensive motor carrier regulation, administratively articulated with rail transport supervision, in effect proposed that public authority should be utilized to establish a price and service parity between railroad and motor transport agencies. Some of the substantive provisions of the Motor Carrier Act were clearly intended to be used to achieve this objective. However, others are so ambiguous that a regulatory commission would be justified in utilizing them in the pursuit of wholly different objectives.

The major current problem in the administration of the Motor Carrier Act, therefore, arises out of the fact that congressional intent as to the objective of the system of regulation has not been clearly defined, even to the extent of distinguishing definitely between basically different objectives. Until these fundamental questions of public policy are clarified, at least so far as the road-rail transport problem is concerned, it is difficult to see how the Commission or any other regulatory agency can proceed with any consistency or confidence in the managerial supervision of the price, quality, and quantity of motor carrier service.

We do not undertake in this study to express a judgment as to whether it is sound public policy to attempt the preservation of thorough inter-agency competition, or whether it is better socially to seek an articulated national system operated under the managerial supervision of public authority. We do believe, however, that the lessons of trial and error accumulated, especially since 1920, through the application of a system of managerial supervision to railroad operation have conclusively demonstrated one point—namely, that such a system can never be expected to function effectively unless it encompasses, under a unified direction, compelling authority over every essential operating feature of all of the agencies which produce any significant portion of the coun-

try's commercial transportation service.²⁵⁶ Recent extension of managerial controls over water and air carriers has not, however, provided either unified administration or well co-ordinated policy.²⁵⁷

Water transportation. The wide range of activities which the government performs with respect to the various forms of water transportation²⁵⁸ may be classified roughly into (1) those designed to facilitate all forms of water transportation through the development and maintenance of such physical facilities as canals, river and harbor improvements, and lighthouse service, and through the protection of life and property against the hazards of water navigation, and (2) those designed specifically to promote and regulate the business phases of water transportation.

The activities comprehended within the former of these categories have been performed by federal authority in one degree or another since the formation of the central government. Their administration is centered in the Corps of Engineers of the United States Army (War Department), the Bureau of Lighthouses (Department of Commerce),²⁵⁹ the Bureau of Marine Inspection and Navigation (Department of Commerce), and the United States Coast Guard (Treasury Department). Activity dealing with the supply of such aids to navigation as lighthouse service and the enforcement of safety regulations have traditionally been considered inappropriate fields for the functioning of private enterprise. Consequently such activity raises no current questions of national transportation policy.²⁶⁰ On the other hand, the construction and maintenance of canals and river and harbor improvements, as in the case

²⁵⁶ This does not mean that such implementation of managerial supervision would solve the underlying issues involved in authoritative regulation of privately owned transport services.

²⁵⁷ Compare below, pp. 852-56.

²⁵⁸ The four main divisions of water navigation are: (1) foreign or overseas; (2) coastwise and intercoastal; (3) Great Lakes; and (4) inland river. The latter three classes comprise what is customarily referred to as domestic water transportation.

²⁵⁹ Under the terms of the *Second Plan on Government Reorganization*, 76 Cong. 1 sess., H. doc. 288 (1939), the Bureau of Lighthouses was transferred from the Department of Commerce to the Treasury Department and was consolidated with the Coast Guard.

²⁶⁰ The problem of proper allocation among executive agencies of administrative authority and responsibility for the performance of these activities is considered at length in 75 Cong. 1 sess., *Government Activities in the Field of Transportation*, S. rep. 1275, Chap. VIII.

of highway promotion, have created competitive forces which conflict with private business interests, and have given rise to important issues of public policy.

For more than a century the federal government has followed a policy of encouraging the development of domestic water transportation.³⁶¹ In the prosecution of this activity Congress has never formulated a specific policy, nor has it stated the precise goal of waterway development. The present system of waterways has evolved from a long series of "project" authorizations made by Congress and executed by the Corps of Army Engineers.

As we have noted, during the latter half of the nineteenth century large-scale waterway as well as highway programs were generally neglected in favor of railroad expansion. But around the turn of the century renewed interest was displayed by governmental agencies in the development both of water and of highway transport systems. In both cases this interest crystallized into permanent legislative policy soon after the World War, coinciding with the revision of national regulatory policy concerning the railroads. Congressional policy with respect to water transportation was stated as follows in 1920:

It is hereby declared to be the policy of Congress to promote, encourage, and develop water transportation, service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation.³⁶²

This policy has been carried out both by increasingly vigorous prosecution of river, harbor, and canal improvement projects,³⁶³ and by the direct governmental operation of water transport services. The Inland Waterways Corporation was created in 1924 to operate a common-carrier barge line on the Mississippi and other rivers. This service has since been extended materially under legislative action which evidences an intent to make such service a permanent part of the nation's transportation plant.³⁶⁴

³⁶¹ Compare pp. 747-50.

³⁶² Sec. 500 of the Transportation Act, 1920.

³⁶³ For a detailed analysis of the methods used by Congress and the Corps of Engineers in furtherance of the work see 75 Cong. 1 sess., S. rep. 1275, Chap. VIII.

³⁶⁴ Under the Dennison Act, 1928, 45 Stat. L. 978, the Secretary of War, who is technically responsible for the management of the Inland Waterways Corpora-

It is difficult to state with precision the rationale of the policy which has directed the vigorous governmental promotion of waterway facilities and services, especially since 1920. Those who have been most active in promoting the program have usually advanced three general arguments: (1) that transportation by water is inherently cheaper than by other media,²⁸⁵ (2) that water transport facilities are required in the public interest to serve either as potential or actual regulators of railroad rates and services,²⁸⁶ and (3) that water service is needed to supplement that furnished by the railroads. On the latter point the House Committee on Interstate and Foreign Commerce observed, in reporting out the bill which created the Inland Waterways Corporation: "It has become apparent that the railroads cannot possibly furnish adequate transportation facilities to take care of the future commerce of the country."²⁸⁷

As we have already pointed out the combined efforts of governmental and private enterprise have created such a plethora of transportation facilities that the chief objective of public policy in certain fields of transportation at the moment is to curb so-called destructive competition by restricting the production of service and by putting a floor under price competition. But in the face of this situation there has been no modification of promotional policy in the competing fields. Now, as in the past, no effective attempt is made to correlate the waterway with the highway promotional programs, or either of these programs with the controls imposed on railways and motor carriers. So long as this situation prevails the

tion, is authorized to extend the service to tributaries (other than the Ohio) of the Mississippi and to other connecting waterways. An act of 1937, 50 Stat. L. 304, permits him to extend the service to the Savannah River.

Pursuant to the terms of the *Second Plan on Government Reorganization* (76 Cong. 1 sess., H. doc. 288), the Inland Waterways Corporation was transferred to the Department of Commerce. This plan was transmitted to Congress on May 9, 1939 and was made effective July 1, 1939 by a Joint Resolution of Congress, Pub. res. 20, 76 Cong.

²⁸⁵ This argument would appear to support the position that the service could be expected to develop privately.

²⁸⁶ This contention was advanced by the Windom Committee in 1874 as a basis for the national treatment of the entire transportation problem. Its central thesis was rejected in the Cullom Committee report in 1886, and in congressional adoption of the policy which was embodied in the 1887 Act to Regulate Commerce.

²⁸⁷ 68 Cong. 1 sess., H. rep. 375 (1924), p. 5.

nation's promotional and regulatory policies will continue to work at cross purposes.

The area of potential friction engendered by these incompatible lines of action has recently been increased materially by the establishment of a separate administrative agency for the exercise of a wide range of promotional and regulatory powers over water transport services. The United States Maritime Commission²⁶⁸ now exercises such major functions as (1) the administration of construction and operating subsidies designed to expedite the development of an "adequate" merchant marine, (2) the operation of vessels belonging to the United States government, (3) the supervision of maritime labor relations, and (4) the regulation of rates of all common carriers by water,²⁶⁹ except those operating on inland rivers.²⁷⁰ Direct supervision of safety, however, remains with the Bureau of Marine Inspection and Navigation. While there is considerable question as to the validity of combining into a single agency, such as the Maritime Commission, functions of a purely promotional character with those of a regulatory nature (involving the exercise of judicial powers and procedures), our chief interest here is in the problems created by the division of regulatory authority over water transport services among several agencies.

As we have already observed, the Interstate Commerce Act is applicable to "the transportation of passengers or property wholly by railroad, or partly by railroad and partly by water when both are used under a common control, management, or arrangement for a continuous carriage or shipment."²⁷¹ The Interstate Commerce Commission, therefore, has power to fix maximum, minimum, or precise rates, fares, and charges, of railroad-controlled water car-

²⁶⁸ Created by the Merchant Marine Act of 1936 and given expanded powers under the Merchant Marine Act of 1938.

²⁶⁹ As defined in the Shipping Act of 1916; for analysis see 75 Cong. 1 sess., S. rep. 1275, Chap. VIII.

²⁷⁰ Minimum rates of common carriers operating on the Great Lakes are not subject to regulation.

²⁷¹ The extent to which rail carriers may own and operate water carriers is defined by law under the terms of the Panama Canal Act of 1912 under which (1) use of the Panama Canal by rail-controlled water carriers is altogether prohibited, and (2) common carriers subject to control by the Interstate Commerce Commission may otherwise operate water carriers only with the permission of that agency. For details see 75 Cong. 1 sess., S. rep. 1275, p. 408.

riers.²⁷² Moreover, it may require an independent water carrier to enter into an arrangement for continuous service at joint rates with common carriers subject to the Interstate Commerce Act,²⁷³ and may control the various features of the through operation.²⁷⁴ Through operations voluntarily entered into by independent water carriers and carriers subject to the Interstate Commerce Act are also subject to the control of the Commission. In no case, however, does the Commission exercise control when the transportation service is carried on wholly by water.

Federal regulation of those phases of water transportation which are not related to rail service through ownership, control, or coordinated service was inaugurated in 1916 with the passage of the Shipping Act.²⁷⁵ Since that date the scope of jurisdiction and objectives of regulatory activity have been expanded and altered through a series of supplementary enactments,²⁷⁶ culminating in the Merchant Marine Act of 1938.

The regulatory authority vested in the Maritime Commission to supervise water transport is not now so comprehensive as that exercised by the Interstate Commerce Commission over rail and motor media.²⁷⁷ There is, however, no reason to believe that it will not eventually develop into a complete system of managerial supervision. In any event the difference is one of degree and not of

²⁷² Rail-controlled water carriers are also subject to various other provisions of the Interstate Commerce Act. Determination of which of the provisions of the act are to apply to these carriers is left to the Interstate Commerce Commission. It has ruled, for example, that the provisions of the act which refer specifically to common carriers by railroad do not apply to the water carriers. Sec. 1, relating to certificates, and sec. 20(a), concerning issuance of railroad securities are, therefore, not applicable to rail-controlled water carriers. See *Procedure under Barge Line Act*, 148 I.C.C. 129 (1928) and numerous other cases, such as 91 I.C.C. 455 (1924); 109 I.C.C. 529 (1926); 83 I.C.C. 160 (1923).

²⁷³ Under the terms of secs. 1(1) and 15(1) of the Interstate Commerce Act; the Panama Canal Act, 1912; and the Dennison Act, 1928.

²⁷⁴ For general discussion see 73 Cong. 2 sess., S. doc. 152, pp. 162-64.

²⁷⁵ 39 Stat. L. 728.

²⁷⁶ Merchant Marine Act, 1920, 41 Stat. L. 988; Merchant Marine Act, 1928, 45 Stat. L. 689; and Merchant Marine Act, 1936, 49 Stat. L. 1985; Merchant Marine Act, 1938, 52 Stat. L. 953.

²⁷⁷ For example, inland waterway transport, carried on independently of rail control or joint arrangement, is subject to no effective regulation. And the Maritime Commission has only indirect power to control the volume of coastal and inter-coastal service, through the granting of construction and operating subsidies and the fixation of rates.

substance. The significant point is that this line of regulatory action has been developed legislatively and is now administered as a separate and distinct policy apart from the organic body of national transportation policy embraced in the Interstate Commerce Act and its most important recent amendment, the Motor Carrier Act, 1935. As a result, the federal government is committed to wholly divergent lines of regulatory procedure, for, as we have seen, the regulation of motor transport services was undertaken either as a means of establishing a parity of regulation between rail and road media or as a move toward the ultimate goal of developing an articulated national system of transportation. To achieve either purpose it was deemed necessary to centralize in a single agency the administration of both systems of regulation. Considerations which motivated the adoption of such a congressional policy are equally applicable to the regulatory treatment of water transportation. In this particular sphere of government relations to transportation there is, therefore, an obvious need for reorientation of policy and procedure. If water transportation is to be promoted and regulated as an independent system with no official regard to goals being sought through other lines of public action, considerations of consistency and equity suggest that other transportation agencies should be accorded similar treatment. Logically the adoption of such a principle would lead to the creation of a railroad, a highway transport, a waterways, and an aeronautics commission, each charged with the special advocacy and regulation of a particular form of transportation.

That precisely this is the trend in transportation policy is indicated by the character of recent legislative action in the field of air transportation.

Air transportation. Prior to 1938, government relations to this most recently developed transport medium were centered in (1) the promotion of air navigation as an arm of national defense, (2) the promotion of commercial air transport through air mail subsidies, and (3) the safety regulation of all classes of air navigation.²⁷⁸ In fact, before 1915 Congress had indicated no official

²⁷⁸ Civil air transportation in the broader sense of the term includes: (1) scheduled commercial air transport service; (2) miscellaneous commercial flying; and (3) private or noncommercial flying.

interest in this medium of transportation. Between 1915 and 1926, however, provision was made for a variety of aids, designed primarily to develop aviation for military purposes. And since 1926, the federal government has been promoting all phases of air transportation by the use of a wide variety of devices. At the same time it has imposed varying degrees of regulatory control over all divisions of the industry.

Beginning with the Air Commerce Act of 1926,²⁷⁹ Congress has evolved a policy in which emphasis has progressively shifted from the military to the economic aspects of air transportation. All recent adjustments of federal policy in this field have uniformly tended to increase the extent of governmental responsibility for the encouragement of air transportation as an integral part of the transportation system of the country.

This trend culminated in the enactment of the Civil Aeronautics Act of 1938,²⁸⁰ which not only extended the scope of public control but established a novel type of administrative organization to effectuate the purposes of the act. All the basic functions, both of a promotional and regulatory nature, formerly distributed among several government agencies, were centralized in a single administrative agency—the Civil Aeronautics Authority. This administrative agency is made up of three distinct divisions: (1) the "Authority" itself, composed of five members appointed by the President with the advice and consent of the Senate, (2) a single Administrator, appointed in the same manner, and (3) the Air Safety Board composed of three members appointed by the President with the advice and consent of the Senate.²⁸¹

²⁷⁹ 44 Stat. L. 568.

²⁸⁰ 52 Stat. L. 973.

²⁸¹ Prior to enactment of the Civil Aeronautics Act, 1938, primary control over air transportation was vested in the Bureau of Air Commerce of the Department of Commerce, the Division of Air Mail of the Post Office Department, and the Bureau of Air Mail of the Interstate Commerce Commission. Other federal agencies which contribute in a more indirect manner to the accomplishment of the air-transportation objectives are the National Advisory Committee for Aeronautics, the Weather Bureau of the Department of Agriculture, the Coast and Geodetic Survey of the Department of Commerce, the National Mediation Board, and emergency units such as the Public Works Administration and the Works Progress Administration.

On April 11, 1940 the President sent to Congress Reorganization Plan No. IV (issued pursuant to authority granted in Public No. 19, 76 Cong. 1 sess.). Among

While the Administrator and the Air Safety Board are instructed to "co-operate with the Authority in the administration and enforcement of the Act," it appears that in actual practice each division will function as a semi-autonomous agency. The law specifically states, for example, that "the Board shall exercise and perform its powers and duties independently of the Authority and shall not be assigned any duties in, or in connection with, any other section or unit of the Authority."²⁸² Moreover it appears that, under the substantive provisions of the law, the Administrator in his capacity as a promotional agent and the Authority in its capacity as a regulatory commission, will each function as a self-contained operating unit. Neither has any effective power to direct or control the functioning of the other.

Regardless of how these lines of administrative authority and responsibility may work out in practice, the provisions of the Civil Aeronautics Act evidence a clear intent on the part of Congress to deal with air transportation as a specialized field. They are designed, first, to promote the development of an independent system of air transportation, without particular reference to lines of promotional or regulatory activity being pursued with respect to other transport media; and, second, to regulate air transport companies so as to preserve the "inherent advantages" of transportation by air, also without reference to the controls adopted in the other transport fields. In carrying out his mandate for "the encouragement and development of an air-transportation system properly adapted to the present and future needs of the foreign and domestic commerce of the United States, of the Postal Service, and of the national defense,"²⁸³ the Administrator is charged with no responsibility to condition his recommendations or actions by consideration

other things this plan abolishes the Civil Aeronautics Authority as an independent agency and transfers all of its functions to the Department of Commerce. The work now performed by the Air Safety Board is combined with the regulatory functions of the newly designated Civil Aeronautics Board which, under the new plan, is supposed to operate as an "independent" agency within the framework of the Department of Commerce. In addition, the Weather Bureau is transferred from the Department of Agriculture to the Department of Commerce.

Since Congress did not disapprove, it appears, as this book goes to press, that the plan will become effective June 11, 1940.

²⁸² 52 Stat. L. 973, Title VII, sec. 702(b).

²⁸³ 52 Stat. L. 973, Title I, sec. 2(a).

of the transportation problem as a whole. Under these circumstances the Administrator will naturally function as a special advocate for air transportation, just as do the Public Roads Administration and the Corps of Army Engineers in the respective fields of highway and waterway promotion.

Similarly, the Authority is not required to consider competitive conditions (as between air and rail, highway, or water services) in the performance of its statutory duty to regulate air transportation “. . . in such manner as to recognize and preserve the inherent advantages of, assure the highest degree of safety in, and foster sound economic conditions in, such transportation, and to improve the relations between, and co-ordinate transportation by, air carriers. . . .”²⁸⁴ Inter-carrier relationships are not mentioned. By contrast, it will be recalled that while one of the declared purposes of the Motor Carrier Act of 1935 is to “. . . recognize and preserve the inherent advantages of, and foster sound economic conditions in, such transportation [by motor carriers] and among such carriers in the public interest,” another corollary purpose is to “improve the relations between, and co-ordinate transportation by and regulation of, motor carriers and other carriers.”²⁸⁵

It will be seen from this brief review that governmental relations to highway, water, and air transportation are governed by a heterogeneous set of legislative purposes and by widely divergent theories of administrative organization and procedure. As the case now stands the Federal Works Agency through the Public Roads Administration (formerly the Bureau of Public Roads of the Department of Agriculture) is engaged in the active development of improved highway facilities. The War Department, through the Corps of Army Engineers and the Department of Commerce through the Inland Waterways Corporation, are constructing, maintaining, and operating facilities which tend to increase the competitive range and effectiveness of water transport agencies. The Treasury Department and the Department of Commerce, through the Coast Guard, the Bureau of Lighthouses, and the Bureau of Marine

²⁸⁴ The same, Title I, sec. 2(b).

²⁸⁵ 49 Stat. L. 543, sec. 202(a).

Inspection and Navigation are supplying general aids to all forms of water navigation. And the Maritime Commission is empowered to subsidize the construction and operation of foreign and inter-coastal shipping facilities. Finally, in the field of air transportation, the Civil Aeronautics Authority is charged with the construction and maintenance of aids to air navigation, the administration of air mail subsidies, and, in general, the encouragement and development of an "adequate" system of air transport.

These extensive and diversified promotional activities are constantly adding to the aggregate of the nation's physical transportation plant. What is more important, during the past two decades these additions to the plant of the various transport media have produced dislocations in the relative competitive positions of major transport industries. In an effort to control the impact of these economic dislocations and frictions, public authority has not only extended the range of previously adopted schemes of supervision but has devised different types of control machinery. Regulation of motor carrier transportation has been co-ordinated, administratively at least, with railroad regulation by vesting in the Interstate Commerce Commission similar degrees of managerial supervision over both agencies. But supervision over water and air transportation agencies has been delegated to separate governmental units. The prosecution of these lines of promotional and regulatory action has never been unified by the adoption of a national policy directed toward a definable transportation goal. As a consequence there exists a clear need for reconciliation of the numerous divergent lines of governmental action with the operating facts of the existing transport situation.²⁴⁶

VI. SUMMARY OF MAIN ISSUES

In reviewing the evolution which has occurred in government relations to transportation during the past half-century we have observed that constructive results of substantial proportion have been achieved in the areas both of regulation and promotion. The

²⁴⁶ Bills designed among other things to bring domestic water carriers under control of the Interstate Commerce Commission and to facilitate railroad consolidation have passed both houses of Congress and are now in conference. Air transportation, however, is not affected, exclusive control being left with the Civil Aeronautics Authority.

full effectuation of regulatory objectives has, of course, been hampered by all of the administrative, judicial, and legislative problems which are normally encountered by public authority in attempts to require the managers of privately owned enterprises to perform according to governmentally prescribed standards. From the outset, jurisdictional conflicts have arisen concerning the division of authority between the federal and state governments on the one hand, and among the co-ordinate branches of the federal government on the other. Many of these conflicts have been resolved through the assumption by the federal government of almost exclusive regulatory authority over railroad transportation, and through the increased weight which the courts have given to the Interstate Commerce Commission's findings of facts and the exercise of regulatory judgment based upon those facts. And, although, in many instances, legislative correction of major defects in the substantive provisions of regulatory law was not effected until many years after the need for remedial action had been demonstrated, the general tendency has been toward a gradual clarification and filling out of the Commission's authority. Moreover, its administrative effectiveness has been progressively advanced through the perfection of procedure and organization and through the recruitment of competent personnel. Public action has thus contributed substantially to the modification of those obnoxious discriminatory practices which originally motivated the assertion of regulatory authority. Railroad management has been made more responsive to the interests of its patrons; the general quality of the service has been improved; various phases of financial management have been subjected to control; and the collection and interpretation of transportation data have greatly facilitated public discussion and understanding of the nature of the so-called "transportation problem." In addition to these constructive results which have flowed from the pursuit of regulatory activities, government enterprise has played an active and substantial role in the physical extension and maintenance of the transportation plant.

We have also noted, however, that while public authority has achieved marked success in various phases of its regulatory activity and in the physical extension of the transportation plant, the chang-

ing character and broadening scope of its regulatory jurisdiction and the methods by which its promotional activities have been pursued have created stresses in the entire transportation structure. Although there have been numerous contributing forces, we believe that in final analysis the aggregate magnitude of these stresses may be explained by the problems which have grown out of the substitution of public managerial supervision for remedial control of privately managed transport enterprises and by the emergence of important conflicts between public regulatory and promotional policies.

The concept of public managerial supervision has been gradually substituted for the original concept of public regulation which consisted mainly in the attempt to maintain competition and to control discriminatory practices. But this development has not been accompanied by the establishment of criteria or mechanisms capable of testing the quality of public performance, or of holding public agencies directly accountable for the results of their decisions.

Since 1920, the federal government has been committed to a policy of fostering the development of a unified system of railroad transportation adequate to serve the "present and future" requirements of the country. It has, however, divided the responsibility for effectuation of this policy between private management and public authority. In the matter of consolidation of properties, for example, the initiation of specific proposals rests wholly with private management. The Interstate Commerce Commission is vested only with power to formulate a broad consolidation plan and to approve or disapprove specific proposals made by private management. Moreover, in the exercise of that power the Commission is governed by statutory specifications looking toward the preservation of competition and existing trade channels.

In other respects, however, Congress has delegated to the Commission powers which in the final analysis require or enable it to make the basic decisions, either initially or through the process of review, with reference to pricing and quality of transportation service. In the exercise of such powers the Commission no longer functions merely as the regulator of transport enterprises. Regardless of its own inclination, the Commission in administering the

broad discretionary powers contained in the present rule of rate making, is by the nature of the function it performs forced to make decisions of a managerial character.

In recent years, general railroad rate cases have involved only one fundamental question, namely, the determination of the rate level which, under an existing or anticipated level of general business activity, taking account of probable inter-carrier competition, may be expected to produce the maximum amount of net revenue for the carriers concerned. To arrive at a decision, the Commission must forecast general price and production trends, the flow of traffic, and the changes in the relative competitive position of alternative media. Moreover, it must formulate criteria as to what constitutes "honest, economical and efficient management," and determine whether or not standards of managerial performance prevailing at any given time conform with those criteria. None of these essential factors is subject to quantitative measurement. The evaluation of each, whether made by the majority vote of commissioners sitting as a public regulatory body or by the concerted action of railroad management, must be based largely on business judgment.²⁸⁷ Precision is not achieved merely by couching these expressions of judgment in language drawn from broad concepts of equity, justness, and reasonableness.

When private management and the Interstate Commerce Commission arrive at divergent business judgments as to the economically desirable level of railroad charges, as they frequently do, the Commission possesses and has consistently exercised the power to substitute its judgment for that of private management. The exercise of this type of managerial supervision is producing a situation in which neither private management nor public authority can be held clearly accountable for the financial solvency and general operating effectiveness of the regulated enterprises.

On the one hand, private management is definitely and in many respects narrowly limited in its freedom to take such action as it deems advisable in the discharge of its responsibility to the private

²⁸⁷ We are not here discussing the problem of rate regulation designed specifically to prohibit discriminatory charges, nor general rate cases involving exorbitant charges in the sense that excessive profits are being made on the performance of transportation services.

owners of railroad properties. On the other hand, the regulatory commission cannot be held fully responsible for any failure to achieve the financial stability and unification of the nation's railroad system. In some important respects its initiative is circumscribed by constitutional and statutory limitations. But what is more important no legislative consideration has been given to the fundamental problem of holding regulatory authorities directly responsible for the financial results of their managerial decisions. Thus fundamental contradictions have developed between the stated objectives of railroad regulatory policy and the means provided for achieving those objectives. Not only are the resultant frictions operating with corrosive effect upon the forces which animate a system of private enterprise; but they are also negating many of the public managerial functions which were intended to supplant or supplement private initiative.

These difficulties, many of which appear to be inherent in any system of governmental managerial supervision, have been intensified by recent depression conditions. But even aside from the influence of cyclical factors, recent promotional and regulatory policies in the field of highway, water, and air transportation have increased the ordinary difficulties encountered in the managerial supervision of railroad transportation; and they have produced conflicts among important phases of regulatory and promotional policy.

The lines of promotional and regulatory action pursued especially since 1920 have not been directed toward any unified transportation objective. Promotional activities in the fields of highway, water, and air transportation have been pursued as independent legislative and administrative programs. In appropriating public funds to be utilized in the extension of the country's transportation plant, Congress has not been governed by any general criteria of the country's need for transportation facilities. The net effect of these activities has been the development of intensive inter-agency competition. There has, therefore, developed a fundamental conflict between public policies which on the one hand seek, through both promotional and regulatory policies, to expand or preserve a substantial degree of interline and inter-agency competition, and on the other hand undertake, through public managerial supervision,

to prescribe the amount, character, and price of each of the major types of transportation service which in the judgment of public authority will serve the general public interest. In recent efforts to deal with this situation public policy has been influenced by two basically opposed theories.

One school of thought advocates an articulated system of public control designed to co-ordinate all major transport agencies into a unified national system. Under this theory it is maintained that the regulatory system should facilitate the limitation of each agency to its so-called economic sphere of operation. Specifically, this program calls for the application to all major forms of transportation of a unified regulatory system similar in intent and scope to that which has been evolved for the control of railway transportation.

Another school of thought contends that the rise of effectively competitive transport media has rendered obsolete the general theory of unified managerial supervision, that competition can be depended upon to produce an adequate volume of service and reasonable rates without the aid of a unified system of affirmative public control. It is proposed in effect that each agency shall be subjected only to such controls as may be necessary to eliminate the abuses arising out of its individual operating practices, leaving each otherwise free to establish its position competitively.

At present, government relations to transportation are governed by a confused set of concepts drawn from both of these theories. The unified system of managerial supervision applicable to railroad and motor carrier agencies may be characterized as dominated by the former, although, as we have indicated, the declaration of policy and substantive provisions of the Motor Carrier Act, 1935, give evidence of having been substantially influenced as well by the latter theory.

Recent public action in the field of water and air transportation has, however, been characterized by a particularistic approach. In each of these fields Congress has created a separate governmental agency, charged both with promotional and regulatory duties and powers. These enactments establish a definite trend away from unified legislative and administrative treatment of transportation serv-

ices as an organic entity and thus tend further to widen the divergencies between the various lines of action now pursued by government in relation to transportation.

We have not considered it appropriate to the purposes of this study to express any judgment as to the social merits of the several lines of promotional and regulatory activity which may be loosely referred to as constituting the national transportation program, nor to propose a plan under which the different lines of procedure might be reconciled. It appears reasonably certain, however, that continued pursuit of the numerous divergent lines of action which now constitute government relations to transportation bids fair to deprive the public both of the major benefits which might be expected to accrue from private management of competitive enterprise and of many which are normally expected to flow from public managerial supervision of a monopoly.

CHAPTER XXIII

AGRICULTURE

It is governmental actions of the post-war era—and particularly those of the past ten years—that, in the main at least, constitute the reason for including agriculture in the list of industrial areas specially treated by government. There has, of course, throughout our history been a certain amount of special legislation for agriculture, as for every other important industry, and a large amount of special application of public policies which related to our economic life in general. But, for the most part, agriculture has operated under the same legal framework, legal opportunities, legal requirements, and legal responsibilities which have applied also to other industries in America. During the past ten years, however, the role of the government in relation to agriculture has been strongly modified and extended. These recent changes, it should be recognized, grow to no small extent out of conditions and attitudes which run back a considerable distance in our history. Hence, we need to examine several features of the situation during earlier years, particularly the period between the Civil War and the World War.

I. PRE-WAR GOVERNMENTAL RELATIONS TO AGRICULTURE

Prior to the Civil War many activities of government were essentially stimulative of the agricultural industry. But this was in the general sense of diffused support of settlement and development rather than in a particular sense as giving definite geographic direction, determining the choice of crops, or creating unique types of economic institutions for agriculture. With some exceptions during the colonial period, effort was not directed toward restricting settlement to the better lands, to instructing or directing the farmer as to the methods of cultivation or marketing which he should follow, or to determining the amount of production. Feudal institutions and mercantilist practices largely gave place during the colonial period to freedom of enterprise as the keynote of government policy. From the adoption of the Constitution to the Civil War

the government sought to make agricultural land easy of access, both through the acquisition in full ownership of family-size parcels at low cost and through tying these with the market by means of constantly better transportation facilities.

The half-century that intervened between the Civil War and the World War witnessed the passing of the frontier and the transition of our national economy from one in which extractive industries—and particularly agriculture—were dominant, to one marked by a great and growing degree of industrialization. This introduced a new factor into the agricultural situation in that farmers were becoming more class conscious, were forming agricultural organizations of large size and geographical spread, and were exerting their political influence at various points to secure special governmental treatment.

During the decades immediately following the Civil War, the business of agriculture was affected in considerable degree by government policies developed or conditions created by the war itself. As a means of finding placement for demobilized troops, land settlement under the Homestead Act was stimulated and the building of railroads, particularly completion of transcontinental lines, encouraged and subsidized. This led to a rapid growth in the total output of agriculture, with strong emphasis on the staples most easily adapted to the prairie and plains region, namely wheat and livestock. It operated strongly to increase agricultural exports but on levels of price which were disastrous to capitalized values in the older farming sections and which meant meager returns even in parts of the new low-cost farming areas and generally in poor crop years.

Local or general agrarian distress did not, however, lead to a movement on the part of government to deal in special ways with the agricultural industry. Farmers on their part, though they formed large organizations of a protective character, such as the Grange, the Farmers' Alliance, Wheel, Equity Society, and Farmers' Union, did not actively seek such special treatment. Part of the activities of these organizations were directed toward commercial enterprises—buying, selling, and even manufacture—designed to enable individual farmers by joining together to do

business on more favorable terms with traders, processors, transportation agencies, and others—many of which were gaining concentrated power in great corporations. In the political sphere, they sought to secure the curbing of these agencies at points where the farmer conceived their activities to be inimical to his interest.

Thus agrarian influence was active or even pre-eminent in the agitation for railroad regulation which culminated in the setting up of various state railway commissions and the passage of the federal Interstate Commerce Act. It was active also in the "anti-monopoly" crusade of the seventies and eighties which eventuated in the passing of the Sherman Anti-Trust Act. Agrarian interest likewise aligned itself at times during these decades with industrial labor against "the capitalists." A particular manifestation of this class alignment was seen in the farmers' leaning toward "soft money" during both the "greenback" movement and the free silver campaigns. All this, however, merely shows the farmer's position with reference to governmental policy or action affecting the whole economy or applying special treatment to other industries. It is mentioned here only as affording the background of class consciousness and group organization out of which grew subsequent demands for special treatment of agriculture, some of which were acted upon by government.

To understand the trend of evolution since the World War—and particularly since 1929—we need to consider a great range of developments in the closing decades of the nineteenth century and the first decade of the twentieth in the perspective of three major characteristic features of our agricultural economy. These were: (1) the family farm as the unit of operation; (2) the co-operative movement as a commercial complement to the pattern of small, separate operating units; and (3) the distinctive educational agencies built up as an overhead organization to serve agriculture.

The family farm as the basis of our economic organization in the agricultural industry. Our way of dealing with agriculture from the beginning of our national history down to the recent past constitutes an outstanding illustration of preservation of private enterprise in economic organization. That is to say, the assurance of free access to natural resources, freedom of migration, freedom in the

choice of enterprises, and the maintenance of free access to market have been the basic pattern of most that was done. Where the government responded from time to time to the demands of organized agricultural groups for special railroad legislation, the regulation of commodity exchanges, or the standardization of commodities, packages, or the trade practices of marketing agencies, the purpose was primarily to maintain equality of economic opportunity under which free enterprise in agriculture could function effectively. Regulatory measures to some extent circumscribed the action of the farmer as to methods of handling his product, sanitary care of his livestock or premises, or other details in the operation of his farm, but this was essentially with the purpose of protecting society in general against diseases, fraud, discrimination, or waste in distributive practices.¹

We have already alluded to land policy as the outstanding means by which government sought to encourage freedom of individual enterprise in the expansion of agriculture. The Homestead Act of 1862 was designed to give farmers the readiest access to tracts of a size suitable for the support of a family. As settlement pushed beyond the frontier of adequate rainfall, the policy was modified to one of "enlarged homesteads" which permitted the settlers to acquire 320, and later 640, acres of land in sub-humid or arid areas. Whatever the economic wisdom or technological feasibility of these measures,² they were definitely designed to give the

¹ Certain instances of a different type of legislation significant for agriculture—though applied elsewhere—may be noted. An example is the restrictive legislation on the manufacture and sale of oleomargarine. The licensing of manufacturers of this product, the prohibition of the use of artificial coloring (freely employed by butter manufacturers), the invidious requirement that stores where it was sold should be placarded, and finally the levying of taxes which were almost, if not quite, prohibitory, constitute a type of protection for dairymen which must be regarded as giving them "special treatment" by government. For further discussion of some of these regulations, see Chap. XXVI.

² To a considerable extent, it appears that this policy had the effect of encouraging settlers to attempt farming on tracts unsuitable under the prevailing moisture conditions for conducting crop and livestock farming, and interfering with ranch farming, to which the section was adapted, because it resulted in undue cutting up of range lands.

It may be noted at this point that the government also followed a practice of making lavish land grants to railways. This resulted in an amount of excellent land coming into their hands for speculative holding which was large as compared

farmer and his family an opportunity to settle wherever he chose and follow whatever type of farming he thought suitable to his labor force, his capital resources, and the character of the land.⁹

In seeking thus to stimulate or at least facilitate the largest productive use of our resources, the government took one further step which might be regarded as constituting special treatment of agriculture. This was in its various "reclamation" operations. Here it made liberal outlays for the purpose of irrigating (or occasionally draining) lands which would become productive only if large initial outlays of capital were made. While in varying degrees these outlays were to be repaid out of the purchase price of the land, water rights, or rentals, such enterprises entailed considerable ultimate cost to the government. Whatever advantage this may have conferred on the particular farm groups or on the nation as a whole in the way of cheap and abundant supply of agricultural products, the introduction of these new areas sharpened the competition which had to be met by farmers in older sections.

While the technological conditions and requirements of agriculture are the chief protection of the small-scale character of the industry, government during the period under consideration took many positive steps to preserve its individually free and competitive character. On the one hand, it took steps to check the growth of private or corporate concentration of control, and on the other, it refrained from governmental regulation or direction of farmers. A few states dallied with the idea of progressive taxation as a means of preventing the accumulation of large land holdings or

with what went into the hands of working farmers under the Homestead Act. Permanent working ownership was also interfered with by later modifications in the Homestead Law, nominally in the interest of the holding operator in that it shortened the time within which he could acquire full ownership. In effect, this shortening was largely used as a device by which lands could be proved up by "dummy" owners within the shortest space of time and then turned over to speculative holders, who were thus enabled to acquire tracts much larger than had been contemplated under the Homestead policy.

⁹ Though proposals were actively pressed to protect the settler against himself by restricting his right to alienate his homestead, such action was not taken. As a result, the Homestead Acts implemented land speculation as well as settled farming. Sometimes this was small-scale speculation of great land companies, using "dummy" entrants to amass large holdings. In part, however, this feature of the Homestead Acts had the precise effect of permitting the consolidation of an economic operating unit where even 640 acres was too small to support a family, notably in sub-humid regions.

sought to restrict the right of corporations to engage in farming operations.⁴ Likewise, from time to time, as it appeared that traders, processors, or transportation agencies that handled farm commodities were operating to the disadvantage of the farmer, various protective steps were taken, such as the establishment of official grades and standards and public inspection.

Special steps were taken also to see that the farmer should not merely have physical access to markets through equitable railroad service and be provided with a comprehensive system of "farm-to-market" highways and that trading practices in these markets should, so far as possible, give the small seller equal bargaining opportunity in dealing with the large buyer. Beyond this, government action went far toward improving conditions of communication, first through the inauguration of rural delivery of mail and, second, through the development of an extensive system of crop and market information. This was at first delivered in mimeographed form by mail, with up-to-the-minute quotations telegraphed to primary marketing points. This brought current market information within reach of those farmers who had telephones; with the coming of the radio this service has been given a much wider spread and greater frequency. Since these services have become an integral part of the educational overhead organization of the agricultural industry, we shall return to them under our third subdivision.

Finally, the government sought to assist small-scale operators in gaining the advantages that came to other industries through large-scale operation, by enabling individual farm operators to join together for the performance of commercial, credit, and even operative functions which could not be performed effectively, economically, or at all within the limits of a family-size farm. The co-operative association, therefore, became a characteristic element in the structure of American agriculture. It is significant for our purposes because of the fact that eventually co-operative agencies became one of the most important avenues through which government began to deal with agriculture as an area of special treatment.

The co-operative movement. Many forms of pioneer community

⁴ In some 14 states the farm homestead (up to varying amounts) is exempt from state taxes; in a few, from local taxes also.

enterprise such as barn raisings, corn huskings, and cattle drives probably constituted the background out of which simple co-operative associations in agriculture arose. Apparently a few attempts had been made at setting up formal organizations for continuous operation in the selling of staple commodities prior to the Civil War. But it was as part of the Grange movement following the Civil War that agricultural co-operation began to expand and take on definite structure and practices. Rather than being fostered by government at the start, it encountered considerable difficulties, negative in that suitable statutes for the incorporation of such enterprises were lacking and positive in that the various state anti-trust laws were invoked against the co-operatives.⁶

A few crude enabling acts appeared in several states during the period from 1866 to 1911. At the latter date a new wave of co-operative activity began, which resulted in putting laws of the "Rochdale" type⁶ on the statute books of Wisconsin and Nebraska. These were widely copied by other states—eventually some 24 in number. Meanwhile the issue of conspiracy in restraint of trade had been raised against the co-operatives, and they had been outlawed by decisions handed down by two state supreme courts.⁷ As a result, agrarian interests called upon the federal government to define national policy on the matter. This was done in 1914 in section 6 of the Clayton amendment to the Sherman Anti-Trust Act, in the following language:

Nothing contained in the anti-trust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof; nor shall such organizations, or the members thereof, be held or construed to be illegal combinations or conspiracies in restraint of trade, under the anti-trust laws.

⁶ In order to dispense with numerous particular citations in this section, the reader may be referred to Edwin G. Nourse, *Legal Status of Agricultural Co-operation* (1927).

⁶ That is, based on personal membership with small contributions to working capital, one-man-one-vote, no proxies, and earnings returned to patron members in proportion to the volume of their patronage.

⁷ *Ford v. Chicago Milk Shippers' Association*, 155 Ill. 166, 39 N. E. 651 (1895); *Reeves v. Decorah Farmers' Co-operative Society*, 160 Ia. 194, 140 N. W. 844 (1913).

This provision has been widely though erroneously referred to as "exempting co-operatives from the provisions of the anti-trust acts." As a matter of fact, study of the legislative history of the provision as well as subsequent developments⁸ shows clearly that this was not intended to make agricultural co-operative associations an exception from a general rule applying to business organizations but was merely designed to prevent such groups from being discriminated against under a law designed to prevent monopolistic concentrations of economic power. Since the farmer who participates in a co-operative association retains the individual independence of his business enterprise rather than merging it in a larger corporate entity, literal interpretation of the Sherman Act would bring any organization of this character for joint selling, even by a mere handful of farmers, within the prohibition of the statute;⁹ and both federal and state anti-trust laws were in fact so invoked. The Clayton amendment simply declared that the mere fact of association in a joint enterprise would not make a co-operative (if non-stock and non-profit) illegal, but left the subsequent actions of these associations subject to the prohibitions of anti-trust statutes.

In sum, the course of legislation, federal and state, during the late pre-war years had been such as to remove many legal disabilities from the path of the co-operatives and to provide, over most of the area where interest was active, enabling acts which facilitated the formation of this distinctive type of farmers' commercial organization. The war itself furnished a period of intensive organizational activity so that the conditions were ripe for the emergence of agricultural co-operation as an area of special treatment after the war.

Educational and advisory relations of government to agriculture. Agricultural education has had a distinctive development in this country, with large emphasis on all phases of research. It has stressed extramural as well as intramural activities and adult as well as adolescent teaching.¹⁰ A foundation for government's edu-

⁸ See p. 887.

⁹ Compare Vol. 1, pp. 283-84.

¹⁰ For detailed discussion of the development of educational agencies for agriculture, see A. C. True, *A History of Agricultural Extension Work in the United States, 1785-1923*, U. S. Department of Agriculture Miscellaneous Publication No. 15 (1928); *A History of Agricultural Experimentation and Research in the United States, 1607-1925*, U. S. Department of Agriculture Miscellaneous Publica-

cational leadership in agriculture had been laid in 1862 when a rather obscure agricultural secretariat was raised to the dignity of an executive department under a commissioner.¹¹ The duties laid upon this department were to acquire and preserve all the information concerning agriculture which it could "obtain by means of books and correspondence and by practical and scientific experiments . . . by the collection of statistics . . . and by other appropriate means . . . to collect as [the commissioner] may be able, new and valuable seeds and plants, to test by cultivation the value of such of them as may require such tests, to propagate such as may be worthy of propagation, and to distribute them among agriculturists."

This was the beginning of activities on the part of the federal Department of Agriculture which have included a great amount of research work at home, exploration in foreign countries to secure plants and practices suitable for introduction here, and development of statistical work—both collection and interpretation. Under the Morrill Act of 1862, "land grant colleges" were authorized for all the states, and they grew rapidly in number and in the funds given for their support, this burden being shared by the federal and state governments. While they were set up as "colleges of agriculture and mechanic arts," the agricultural activities very greatly overshadowed the engineering activities, and in 1887 the agricultural side of the work was still further strengthened through the establishment of agricultural experiment stations. These, like the teaching branch, have been supported jointly by federal and state funds.

In conducting this research on behalf of agriculture, the government has carried the burden of technological exploration and improvement much more fully for this industry than it has for others, although such agencies as the Bureau of Mines and the Bureau of Standards are comparable, and after the lapse of some years engineering experiment stations have also been established at the land grant colleges. In recent years, moreover, the pro-

tion No. 251 (1937); and Edward Wiest, *Agricultural Organization in the United States* (1923).

¹¹ Not attaining the rank of a Cabinet position until 1889.

gram of the agricultural experiment stations has been broadened to include economic and social as well as technological lines of investigation. Through devices which we shall examine presently, the results of this latter type of research work were so assiduously brought to bear upon the thought and action of farmers as to have a considerable influence in guiding the course of the industry and determining the character of its organization. But, though government became a more active influence in shaping the actual structure and functioning of this industry than of others, except those where regulatory commissions have been set up, it was by way of implementing rather than superseding free enterprise. The individual farm operator was still free (except for certain sanitary requirements) to farm precisely as he pleased.

In addition to college teaching and experiment station research, a third distinctive feature of the American system of agricultural education grew up in the form of what is known as "extension service." From 1870 on, an increasing number of states conducted agricultural discussion meetings among farmers, and after 1900 the United States Department of Agriculture joined in the support of such work. By the early years of the twentieth century, a well-developed system of publicly supported "farmers' institutes" covered practically the whole country. Gradually this extramural teaching came to include "demonstration" work on individual farms and to employ a considerable number of peripatetic specialists attached to the state institution but working with single farmers or small groups wherever local problems developed or local interest was manifest.

During the years just before the World War, this developed into a system of organized county and community groups or "farm bureaus," with a continuous program of discussion and with resident local workers, known as "county agricultural agents" or "farm advisers." With the passage of the Smith-Lever Act in 1914 federal funds were made available on a broad scale for the support of such work in every state. Thus the whole agricultural industry so far as it cared to avail itself of government educational assistance was put in touch with a nation-wide system of investigation and education. The individual farmer through his county farm bureau,

with its resident county agricultural agent, could call upon the traveling extension specialists, who could draw upon the resources of the state experiment station. State work in turn was co-ordinated through the Extension Service and the federal Office of Experiment Stations and drew upon the investigational, service, and regulatory work of the United States Department of Agriculture.¹²

While this development of educational and investigational work on behalf of agriculture was extensively and intensively greater than that undertaken for other industries,¹³ the tradition of free enterprise was fully maintained. Services were made freely available to those who were interested in using them but no one was compelled to do so. A large farmer actively in touch with govern-

¹² Individual states also maintain state boards or departments of agriculture, bureaus of markets, and other agricultural agencies. Some of these participate in educational activities, others do statistical work; but in the main they are limited to the holding of a state agricultural fair and the exercising of certain regulatory functions not significant for the purposes of this study.

¹³ It is obvious that the work of adult education in agriculture is far from matched by comparable activities among manufacturing or other non-agricultural groups. On the other hand, there was a pronounced feeling in the rural quarters that the general character of education in the secondary schools gave undue emphasis to non-agricultural subjects and "educated children away from the farm." The Smith-Hughes Act of 1917 provided federal funds for the development of vocational education in agriculture and home economics in the high schools of rural areas. Besides classroom teaching this involves "project work" on the home farm and employment of the teacher during the summer months as well as the regular school term.

As for investigational work in agriculture, public funds have defrayed practically the whole cost, whereas in most non-agricultural industries, a substantial part of this burden is borne by large corporations, trade associations, and investigational organizations which sell their services on a commercial basis. The scale on which investigational work has been provided at government expense to the agricultural industry has been justified by its proponents largely on two grounds. (1) Agriculture, being inherently a small-scale industry, had no means of setting up, manning, and financing research organizations of the sort necessary to develop the scientific fact-gathering, experimentation, and analytical work required to keep step with the pace of modern scientific development as is done in the industrial laboratories and research departments of many large corporations. (2) In the earlier days it was felt that thus to develop and disseminate the science of agriculture was necessary if we were to maintain the volume of our agricultural exports and provide cheap and abundant sources of raw materials for domestic industry and for supplying the consumptive needs of urban populations. More recently, the emphasis has been on the expansion of economic and social research in the hope of maintaining or raising the economic welfare of the agricultural population. In this change of emphasis, however, further improvement of the technique of agriculture has not been neglected, but emphasis merely shifted from maintaining or expanding the volume of production to lowering of costs.

ment agricultural services might receive gratis during a year some hundreds of dollars worth of laboratory or consultative service which might save him from substantial losses or add considerably to the profitableness of his operations, whereas other farmers might continue to follow as primitive or slovenly methods as they chose except as the harmful results of such practices might call for the imposition of certain regulatory measures. On a wide and expanding scale the government agencies became mentors of the individual farmer though without impairing his freedom of enterprise.

One final aspect of extension development should be noted if we are to understand the current situation. This concerns the development of the state and national farm bureau federations.¹⁴ As already noted, community and county farm bureaus were set up as local outposts for the conduct of extramural teaching and the identification and treatment of problems calling for the investigational attention of the experiment station staffs. County farm bureaus operated under the general guidance of a resident "demonstration agent" or "farm adviser." This corps of county demonstration agents became an integral part of the state agricultural college extension organization, under the direction of a state "county agent leader." However, a substantial part of the funds which supported the farm bureaus were derived from membership dues, augmented in some states by a grant from the county commissioners. Where this happened, the county farm bureau took on a somewhat autonomous character, and the extension director and staff ordinarily encouraged it to contribute as largely as possible of its own thought and initiative in drafting the county agricultural plan each year and in determining the lines of activity which the county farm bureau would follow. Its concerns embraced not merely soil improvement, disease eradication, or other of the wide variety of production problems encountered on the individual farm, but also local tax adjustment, the support of local co-operative enterprises, and other commercial or political activities.

¹⁴ No adequate critical history of this movement is available, but there is a useful early study by O. M. Kile, *The Farm Bureau Movement* (1921).

A recent book, *The County Agent*, by Gladys Baker, though not dealing with the Farm Bureau organization as such, sheds significant side lights on the movement and is invaluable as a portrayal of the complex interrelationships between Farm Bureau and Extension Service.

Some further implications of this line of development became apparent when in 1917 the county farm bureaus began joining together in state-wide organizations and, still more, when in 1919 these state federations coalesced into the American Farm Bureau Federation. Both the national organization and the constituent state bodies were set up as agencies for commercial and political action rather than mere educational guidance. They focused their attention primarily on the commercial enterprises of their members and on propaganda and legislative activity on behalf of tax, credit, marketing, transportation, or other types of state and national legislation which they conceived to be in the interest of their members. There was thus built up in those states where the relation of local farm bureaus to Extension Service was most dependent, an ambiguous relationship under which the county agents were in constant doubt as to whether they should take orders from the extension director at the state college or the officials of the state farm bureau. In such areas, the whole system, instead of being an educational effort in which government played no role beyond that of counsellor, went far toward organizing agriculture as a pressure group to secure governmental action,¹⁵ much of which tended to put agriculture still

¹⁵ There were other implications which derived from this farm bureau development. The Extension Service had generally welcomed the growth of the local group, not merely because it built up an organized and permanent body which could be counted on to back adequate appropriations for the support of both the Extension Service and the other parts of the experiment station and college set-up, but also because it made a permanent local nucleus for studying and dealing with the several agricultural problems in their local aspects. In varying degrees in different states the effort was made to have this organization sponsor the extension program within the county by assuming the local responsibility for formulating and conducting it and by contributing to its financial support. While it would, of course, draw freely upon the resources made available by the state institution on equal terms to all individuals or agencies, it would not be merely a satellite agency. In proportion as the relations between the local farm bureau and Extension Service became close, it contributed to rivalry between the Farm Bureau Federation and older general farm organizations. This tended to remove from happy and fruitful relationship with the state college organization those farmers who had previously been allied with some other general farm organization, notably the Farmers' Union, which also maintained state, national, and local organizations. The Farmers' Union was particularly critical of the use of public funds in support of the farm bureaus and prided itself on being a "self-help" agency. This rivalry, as well as considerable differences in general economic and political philosophy, caused the Farmers' Union in the states very frequently to operate in both the commercial and the legislative sphere independently of or even in opposition to the Farm Bureau, and in national

further into the area of special treatment. At this point, we need merely note the nature of this development. Its subsequent results will appear as we proceed.

Rural credit. One other field in which government began to accord special treatment to the agricultural industry during the late pre-war period relates to mortgage credit. President Theodore Roosevelt's Country Life Commission (1909) gave recognition to the fact that agriculture suffered from the lack of long-term financing comparable to that which was made available to corporate industry through the device of bond issues and the services of investment houses. President Taft sent a commission to Europe to study the rural credit institutions of various countries, and several bills were introduced in Congress designed to provide a system of long-time amortized mortgages, financed through the sale of bonds in the central money markets at the lowest rates comparable with the character of the security and a virtual government guarantee. Such an extension of government activity in the credit field was eventually undertaken under the federal Farm Credit Act of 1916. With the low rate of interest carried by land bank bonds and the low cost of operation under a semi-co-operative scheme of administration, this institution brought substantially lower rates and considerably greater security to those sections of the country where capital had been scanty and rates high.

With reference to land credit, it should be borne in mind further that government aid on a considerable scale had for some time back been extended directly to settlers on reclamation projects. Not only were such settlers given a relatively long time in which to pay for their land and water rights without interest, but, when payment according to the original schedule proved difficult, the time was quite generally and quite liberally extended. With the advent of dry farming, moreover, there was a tendency to introduce a new form of government activity in financing farmers. In years of crop failure, which proved to be frequent and widespread, seed and sometimes feed would be supplied to keep the farmers on the land. Since this was done even at times when prospect of ultimate repay-

propaganda activity frequently to adopt different lines of attack and support different legislative proposals. The matter is developed further on p. 883.

ment was not too bright, this type of credit shaded over into virtual subsidy. Discussion of these more extreme types of credit extension will, however, be deferred to the post-war period.

The forest service. Since forestry has been developed largely within the Department of Agriculture and since cropping, grazing, and forestry often overlap, brief comment must be made on the special treatment of forest lands by federal, state, and local governments. Reservation of small forested areas within the public domain had been made as early as 1817 for the purpose of ensuring a supply of high-grade naval timber. After the Civil War, several states began to encourage tree-growing through exemption from taxation or the giving of actual bounties, and by 1885 the state of New York began the acquisition of forest reserves of substantial size in the Adirondack and Catskill regions. Responding to public agitation voiced through such bodies as the Association for the Advancement of Science and the American Forest Congress, the federal government provided for research in forestry in the Department of Agriculture, and in 1891 passed a law for the withdrawal of forest areas in the public domain from further private entry. Under the latter act a forest reserve of some 17.5 million acres was quite promptly set aside and, in 1897, President Cleveland set up thirteen more national forests with a combined area of 21 million acres. By 1905 the area of the national forests had risen to 63 million acres and an act was passed transferring these lands from the Department of the Interior, where they had been administered, to the Department of Agriculture, where the scientific investigation of forestry problems had been going forward. During the next year another 44 million acres were added to the national forest reserve, but Congress thereupon (March 4, 1907) said that no further national forests should be set up or old ones enlarged in the six principal forest states of the West except by its special act. However, two days before this act became effective, President Theodore Roosevelt set aside 21 new forest reserves with a total area of 40 million acres.

This phase of government policy by which 147 million acres of forest land were transferred from the area of private enterprise to that of government control and, to a considerable extent, opera-

tion represents a substantial reversal of the old free-land policy. While it has been followed in part as a means of dealing with the lumber industry, it has also contemplated the protection of sources of water supply for farmers and ranchers, the checking of erosion, and the conservation of grazing lands which are interspersed among strictly forest areas. It needs to be borne in mind as the small beginning of a special type of government treatment which in recent years has been considerably expanded. (See p. 932.)

II. RELATIONS OF GOVERNMENT TO AGRICULTURE DURING THE WORLD WAR

While the slogan "Food will win the war" came into vogue almost immediately after our entry into the World War, we relied for agricultural results on maintenance and perhaps quickening of the free enterprise of individual farmers rather than on schemes of governmental control or regimentation. With demand for various agricultural commodities stimulated by military needs and with difficulties of transportation from the remoter sources of supply, natural advances in market prices were in the main found a sufficient stimulus to production. Advance in market prices of the war essentials drew land and labor from the production of non-essentials so that it was not regarded as necessary to restrict the latter. Two outstanding war-time products, however, furnished exceptions to this rule—wheat and sugar.

In August 1917 Congress passed the Food Control Act and, to carry out its provisions, the President immediately appointed a Food Administrator and set up the United States Grain Corporation. The Food Administrator established a price of \$2.20 per bushel for No. 1 northern spring wheat at Chicago as "fair" to both producer and consumer, though the act had guaranteed only \$2.00. To support this fair price, the Grain Corporation bought wheat in substantial quantities during the heavy fall marketing season and entered into contracts with mills and grain dealers guaranteeing them against declines below the fair price. During the early months of 1918, the Grain Corporation, by selling its accumulated stocks at the fair price, precluded advance above that figure and, after the exhaustion of its stocks, used its influence to check enhancement by "profiteering" dealers. For the 1918 crop,

the minimum price was advanced to \$2.26 at Chicago and the guarantee was extended to include the 1919 crop. On March 4, 1919, Congress, in view of the cessation of purchases by the allies and the prospect of a very large crop, appropriated 1 billion dollars to maintain the wheat price guarantee. With the subsequent deterioration of the crop and improvement of commercial conditions, market prices rose above the guaranteed level and no losses were incurred by the government. However, the Grain Corporation found it necessary to make purchases from time to time (totaling more than 138 million bushels of wheat) and to hold these stocks for short periods in order to protect the guaranteed price.¹⁶

War-time control of sugar was somewhat more rigorous than that of wheat.¹⁷ After attempting to handle the situation on a voluntary basis through an International Sugar Committee, a Sugar Equalization Board was established under the direction of the Food Administrator in July 1918. In order to stimulate domestic production of beet sugar, it raised the price to nine cents per pound to producers. It purchased a large part of the Cuban crop at a much lower figure and averaged the two in a controlled domestic wholesale price. At the same time, it undertook to restrict consumption by allocating supplies to industrial users and putting a limit of two pounds per month on household consumers.¹⁸

The Department of Agriculture undertook in 1918 to estimate the need for certain agricultural products, notably wheat, and to suggest the areas in which such expansion could most easily or most wisely take place. This went to the extent of allocating quotas to individual counties and using the agricultural agent in each such county (or special war-time agent placed there) to exhort or counsel with farmers in the endeavor to attain these quotas. The whole extension and county agent force, much augmented, was used during this period as a means of both stimulating and directing agri-

¹⁶ See Frank M. Surface, *The Stabilization of the Price of Wheat during the War and Its Effect upon the Returns to the Producer* (1925).

¹⁷ See Frank M. Surface and Raymond L. Bland, *American Food in the World War and Reconstruction Period* (1931), pp. 19-20.

¹⁸ Besides these two control undertakings, Mr. Hoover as Food Administrator used the full powers of the Food Administration to support the price of hogs, not at a fixed level but as a ratio (considerably above normal) to the price of corn. This effort was not very successful and led to considerable controversy.

cultural production, but entirely on a propaganda basis rather than one either of legal mandate or financial subsidy.¹⁹ War-time experience, however, remained in the minds of farmers and agricultural leaders as affording patterns of more aggressive special treatment of particular industries which became the basis of various agricultural demands for special treatment by government during the subsequent years.

III. THE TRANSITIONAL YEARS 1920-28

After the World War, agriculture was promptly confronted with a need for sweeping adjustment of its organization and operations to meet drastically changed conditions. Some of these changes had been incipient before the war broke out. But the war checked any process of slow and orderly adjustment to the new forces which might then have been undertaken. War gave an artificial stimulus to the agricultural market and diverted production into rather abnormal channels at the same time that it contributed to important developments in the technology of the industry and of other industries on which it depends. By 1920, it began to be apparent that demand in our former export markets would not be restored promptly, if at all, and that rival sources of supply were offering keener competition in what had formerly been our best overseas markets.²⁰ Domestic demand felt the limiting effects of a reduced rate of population growth (through decline in natural increase as well as curtailment of immigration) and was checked also by changes in consumer habits. The great development of the automotive industry, which had been stimulated by the war, not only brought about the rapid mechanization of agriculture but also the extensive displacement of horse and mule power in construction work, city hauling, and commercial and pleasure driving—both urban and rural. This drastically curtailed the horse-raising industry and also the outlet for hay, oats,

¹⁹ "Among the satisfactory achievements in 1917 was the transfer, through co-operation of the Bureau of Animal Industry and the county agricultural agents, of 300,000 head of cattle from drought-stricken localities in western Texas to the states farther east where there was plenty of pasturage. Assistance was given to the owners of livestock remaining in Texas by locating supplies of feed and arranging for their purchase." True, *A History of Agricultural Extension Work*, p. 140.

²⁰ Edwin G. Nourse, *American Agriculture and the European Market* (1924).

and other important feedstuffs. While the progress of industrial chemistry created some new markets for agricultural products, it destroyed others through the substitution of wood pulp for cotton fiber, light sheet metal for fabrics, and the like.

These changes, piling cumulatively one upon another, overtaxed the powers of agriculture to effect orderly and adequate readjustment from its over-extended and over-capitalized war position and threw it into a severe depression. As a means of meeting this situation, two general lines of action were followed. First there was redoubled activity along the old lines of education and government counsel to farmers in effecting adjustments of their individual enterprises which would add up to a wholesome adjustment of the entire industry. Second, proposals were brought forward in great numbers for dealing with agriculture as an industry whose special difficulties demanded special governmental treatment.

In January 1922 President Harding called at Washington a National Agricultural Conference to discuss this problem. It urged the federal government to make loans to Europe to revive the export market, use its powers to reduce freight rates and "excessive retailers' profits," and investigate immediately the "practicability of establishing a government-guaranteed price on the more important farm products." The Conference admonished the farmer to help himself through reduction in costs of production, diversification in the direction of subsistence crops rather than export staples, and the development of co-operative marketing. There was also a recommendation to reduce acreage of crops so as to "avoid having surpluses greatly in excess of the demand." A "permanent farm policy" was recommended by the Conference under 25 heads; it stressed cheaper transportation, better credit facilities, government economy, tariff adjustment, further agricultural research, and the stimulation of foreign markets. A permanent National Advisory Council was recommended, and the government was asked to investigate the practicability of government crop insurance and the possibility of establishing a "stabilized dollar."

This conference was widely regarded as a triumph for the forces of conservatism—advocating further research, co-operative organization, and better individual farm management—against the more radical proposals for government action in the line of production

control or direct price-fixing which were then emerging. The National Farmers' Union in particular was critical of the results, and through its Washington representative continued to press for more aggressive treatment of the problem. The National Grange had established a permanent legislative representative at the capital in 1919, followed the next year by the newly formed American Farm Bureau Federation.²¹ The two latter organizations were inclined to take a more conservative view but all pressed for positive action on the part of Congress. From 1921 forward, a definitely recognized "farm bloc" in Congress worked with these legislative bureaus of farm organizations to urge in Congress a vigorous program of action for the relief of agriculture.²² A spirited effort was made to get the President's Agricultural Conference to endorse the program of the "farm bloc," but in the end it refused to do so.

Besides utilizing for amelioration of the agricultural situation certain devices of general applicability, such as protective tariffs and transportation rate adjustments, old agencies extended governmental treatment to agriculture in three significant directions.²³ One concerned rural credits, a second the co-operative movement, and a third the facilities offered the farmer for intelligent adjustment of his operations to changing conditions.

Following the price collapse of 1920, agricultural interests be-

²¹ Subsequently, these three were joined by the American Co-operative Council, a national secretariat representing a large number of co-operative marketing and purchasing organizations in all parts of the country.

²² Arthur Capper, *The Agricultural Bloc* (1922).

²³ During these post-war years, there was considerable extension of an earlier movement toward standardization in the field of agricultural commerce. Beginning with the Standard Barrel Act of 1916, it included the Grain Standards Act of 1916, the Cotton Futures Act of 1916, and the Cotton Standards Act of 1923, and extensive development of a federal inspection service. Regulation of trade practices also was extended in the Cotton Futures Act of 1916, the Packers and Stockyards Act of 1921, the Grain Futures Act of 1922, the Produce Agency Act of 1927, and the Perishable Agricultural Commodities Act of 1930. Many of these measures were paralleled by or copied into the legislative and administrative developments of various individual states. No detailed discussions of these measures is undertaken here for the reason that they did not set out agriculture as an area of special treatment by government but were, in the main, part of a general effort to promote economy and efficiency in business transactions and prevent fraud and waste. (For further discussion see Chaps. IX and XI of Volume 1.) In several phases of this legislation, however, there is discernible a trend toward somewhat more active participation by the government which was the forerunner of certain more extreme changes to be noted in subsequent Farm Board and Agricultural Adjustment periods. See pp. 893 ff., 904 ff.

gan agitation for a new type of credit intermediate between mortgage and commercial bank credit, to meet more adequately their needs in the financing of growing, feeding, and marketing operations. These require credit of from six months to two or possibly even three years. The Agricultural Credit Act of 1923 extended the field of government action into this area by the use of devices broadly similar to those of the Federal Farm Loan system, by which many small credit extensions could be financed through the sale of quasi-governmental debentures or notes or through the Federal Reserve banks. While this intermediate credit activity constituted an area of special treatment of agriculture by the government at the time it was initiated, there has subsequently been a somewhat analogous development of intermediate credit to industrial and mercantile agencies under the Federal Reserve System so that the treatment of agriculture now appears rather less different than it was when first undertaken. On the other hand, new differentiations in the treatment of agriculture have appeared since 1933, to whose examination we shall return presently.

As for post-war co-operative legislation, its significance as an expression of public policy can be grasped only in the light of the changed character which the co-operative movement had assumed during the years just preceding. Up to about 1916, co-operative organizations had been limited practically to local and federated co-operative associations, which directed their efforts toward economy and efficiency in the distribution of their product, with little thought of exploiting the possibilities of wide-scale collective bargaining.

Early co-operative associations had been of a very loose "voluntary" type used chiefly for the assembling of commodities at local shipping points and their prompt consignment to organized commodity markets or other wholesale trading centers. Different groups, however, had experimented with various devices for extending control over the product as to both time and space. These more aggressive and more highly centralized operations involved crop contracts, commodity pools, storage operations, and regional or industry-wide collective bargaining.

From 1916 to 1921, however, partly as a result of these experiments, there developed a more ambitious phase of co-operative

endeavor, commonly referred to as "the commodity marketing movement." It expressed itself tangibly in a new type of co-operative statute, which it sought to make uniform in all the states. Though numerous modifications were introduced in the parent act passed in 1921,³⁴ its general features were so widely copied that by 1928 the situation as to co-operative legislation was broadly similar in forty-six states of the union. The distinctive features of this legislation, therefore, require examination.

The so-called "uniform marketing law" contained elaborate provisions for an "iron-clad contract" covering a term of years up to ten, which the courts were instructed to enforce not merely by liquidated damages but also through orders of specific performance.³⁵ Title to product passed to the association upon delivery by the member, and the association used its centralized control to follow a program of "orderly marketing," in which it became the arbiter of the distribution of the product among the different markets and over the whole marketing season or, if the non-perishable character of the commodity permitted it, from year to year.

It was held that organization should be co-extensive with the whole commercial producing region. For instance, there was a tri-state organization for certain types of tobacco, eleven state cotton associations federated into a single American Cotton Growers Exchange, and a dozen state wheat growers' associations undertook to form a national wheat marketing organization which they thought would be capable of virtually naming the price of this commodity. It was expected that the strength of these commercial organizations of farmers on so wide a scale would put them in a position to secure whatever credit they needed from the central money markets on

³⁴ Acts of this type were passed in Arkansas, Idaho, Texas, Arizona, Kansas, Montana, North Carolina, North Dakota, Washington, Georgia, and Alabama in 1921. The Bingham Act of Kentucky (1 Acts of Kentucky 1922) is generally regarded as the "model" form of the law.

³⁵ The law did not rely merely on equitable relief in the form of injunctions against any person or corporation which sought to secure the withdrawal of members or product from the association but declared such an act to be a misdemeanor subject to a fine ranging from \$100 to \$1,000 besides civil liability of \$500 for each such offense. Any warehouseman accepting or receiving members' product for sale otherwise than by the association was also liable "in a civil suit in the penal sum of \$500 for each such offense" besides "reasonable attorneys' fees and all costs involved."

the collateral security of commodity suitably warehoused.

The "model" marketing law began with a declaration of policy "to promote, foster, and encourage intelligent and orderly marketing of agricultural products through co-operation; and to eliminate speculation and waste; and to make the distribution of agricultural products between producer and consumer as direct as can be efficiently done; and to stabilize the marketing of agricultural products." A later section in the act showed how it was conceived as a means of implementing the old family-farm philosophy in the following terms:

It is here recognized that agriculture is characterized by individual production in contrast to the group or factory system that characterizes other forms of industrial production; and that the ordinary form of corporate organization permits industrial groups to combine for the purpose of group production and the ensuing group marketing and that the public has an interest in permitting farmers to bring their industry to the high degree of efficiency and merchandising skill evidenced in the manufacturing industries; and that the public interest urgently needs to prevent the migration from the farm to the city in order to keep up farm production and to preserve the agricultural supply of the nation; and that the public interest demands that the farmer be encouraged to attain a superior and more direct system of marketing in the substitution of merchandising for the blind, unscientific and speculative selling of crops.²⁶

This law was promptly upheld by the highest courts in a considerable number of the states in which it had been passed in substantially the same terms as the model act, and the constitutionality of the Kentucky statute was affirmed by the Supreme Court of the United States in 1928.²⁷ The mere recital which we have just made of its various provisions must make it clear that, in accepting this type of marketing organization for agriculture, state governments were putting that industry in the area of special treatment; the federal government concurred by affirming the constitutionality of these new acts. The farmer who participated in an organization of this type divested himself of all responsibility or discretion in the marketing of his crop and limited his functions entirely to those of

²⁶ The Bingham Co-operative Marketing Act, 1 Acts of Kentucky 1922.

²⁷ *Liberty Warehouse Co v. Burley Tobacco Growers Co-operative Marketing Association*, 276 U. S. 71, 48 Sup. 291 (1928).

tillage, harvesting, and the mode of delivery to the designated receiving point at a designated time. In some cases, both in this and in the earlier and milder forms of co-operation, however, he might have methods of delivery, harvesting, or even production stipulated by the co-operative association. In fact, the latter might take over the rendering of these services to its members on a fee basis, such, for example, as hauling milk, picking fruit, spraying or fumigating orchards, or furnishing uniform seed or nursery stock of approved variety.

The trend toward dealing in special ways with marketing and price aspects of the agricultural industry is to be found in federal as well as state laws of this period. In February 1922 Congress passed the Capper-Volstead Act²⁸ with the active support of the Farm Bloc. This statute provides "that if the Secretary of Agriculture shall have reason to believe that any such association²⁹ monopolizes or restrains trade to such an extent that the price of any agricultural product is unduly enhanced by reason thereof, he shall serve upon such association a complaint stating his charge in that respect," conduct hearings, and utilize the resources of his department to ascertain the facts. If he finds the charge to be sustained, he shall issue a "cease and desist" order. If the association shall fail to obey such order, the Secretary shall petition the federal district court for an order of enforcement. While the court may affirm, modify, or set aside the Secretary's order, or "enter such other decree as the court may deem equitable," the Secretary's findings as to the reasonableness of the price enhancement "shall be *prima facie* evidence of such facts, but either party may adduce additional evidence."

The logical relationship of this act to previous co-operative legislation is interesting. The Clayton amendment enunciated the principle that the mere formation of a joint agency by farmers for the economical conduct of their own business (not for profit from handling the products of others) did not fall within the prohibitions of the anti-trust acts. State laws favorably adjudicated by the United States Supreme Court upheld structure and practices de-

²⁸ 42 Stat. L. 388.

²⁹ The definition of co-operation contained in the Capper-Volstead Act was different from—and much looser than—that in the Clayton amendment.

signed to get the maximum effect from collective bargaining according to the co-operative pattern. In the Capper-Volstead Act, Congress clearly took its position on the rule of reason as the proper criterion for applying anti-trust doctrine in this particular field. But in setting up the Secretary of Agriculture as the special expert to supersede the knowledge and judgment of the courts as to what constitutes unreasonable enhancement of prices, a subtle ambiguity of policy is introduced. It may be (and was) argued that both the purpose and the effect of this novel device are protection of the public against the possible abuse by co-operatives of the larger powers of aggressive joint action which have been conferred upon them. This would be somewhat analogous to the device of the Consumers' Counsel subsequently incorporated in the Agricultural Adjustment Administration. Or it may be (and was) argued that Congress feared that the problem of what constitutes a reasonable price in agriculture involves such subtle technicalities that the courts could not reasonably be expected to arrive at consistently sound answers to the questions which might be presented as a result of co-operative price-determining activities and therefore furnished this special agency of expert guidance. At best, this would mean the high technical competence which would keep the scales of justice evenly balanced. At the worst, it might mean an "expert" with such sympathetic leanings toward one of the parties in the controversy as to afford little or no safeguard against the possible abuse of the powers conferred in the increasingly liberal co-operative laws.³⁰

A further step toward strengthening the position of co-operative collective bargaining associations followed four years later with the passage of the Co-operative Marketing Act of 1926.³¹ This act provided for a Division of Co-operative Marketing in the federal Bureau of Agricultural Economics designed to conduct research and educational work in the principles and practices of co-operative marketing. Though the division was small, it afforded a nucleus for the fostering of this particular type of commercial enterprise in ways which approached, if they did not actually attain, the status

³⁰ Although the Capper-Volstead Act has been on the statute books for more than 18 years, no action has been brought under its terms. As to its present status, see p. 912.

³¹ 44 Stat. L. 802.

of propaganda. Second, it definitely authorized agricultural co-operative agencies to exercise certain powers in the handling of statistical materials not granted by statutes to other industries and specifically denied them by the courts in numerous instances when they sought to exercise them through trade associations. This provision of the Co-operative Marketing Act of 1926 read as follows:

Persons engaged as original producers of agricultural products, such as farmers, planters, ranchmen, dairymen, nut or fruit growers, acting together in associations, corporate or otherwise, in collectively processing, preparing for market, handling, and marketing in interstate and/or foreign commerce such products of persons so engaged, may acquire, exchange, interpret, and disseminate past, present, and prospective crop, market, statistical, economic, and other similar information by direct exchange between such persons and/or such associations or federations thereof, and/or by and through a common agent created or selected by them.²²

Examination of the co-operative movement, therefore, makes it clear that from the 1890's up to 1928 several steps had been taken which had the effect of placing agriculture in the area of special governmental treatment. The Agricultural Marketing Act of 1929 was simply an extension of this line of action. That act will be discussed presently.

A third step by which the government during the early years of the twenties assumed a more active role in the affairs of agriculture was in the form of "outlook work." This move was one of evolutionary modification of previous activities rather than one introducing any strikingly new or revolutionary change. It sought further to implement private enterprise in agriculture, but at the same time the logical effect would be to influence or modify the individual's decision to an increasing extent.

Beginning shortly after the World War, the attention of agricultural agencies, both national and state, was directed particularly to the problem of what changes in their farm management individual proprietors should make in the interest of liquidating wartime development and of readjusting the operations of their farms as effectively as possible to changed conditions following in the

²² The same, sec. 5.

wake of the war. In his annual report for 1922, Secretary Henry C. Wallace described the work of "commodity councils" which had been set up in the Department for the purpose of "making comprehensive studies of the conditions which influence the profitable production of various crops." This expressed the Department's "desire to be of the greatest possible service in the task of restoring agriculture to a prosperous basis." To the same end there had been in July of that year a consolidation of the Office of Farm Management, the Bureau of Crop and Livestock Estimates, and the Bureau of Markets into a single Bureau of Agricultural Economics as a unified agency capable of dealing more comprehensively and aggressively with the economic problems of the agricultural industry. These moves reflected an intention to rely on traditional educational procedures in dealing with the problem of post-war readjustment rather than accepting any of the more drastic proposals which by this time were coming forward in considerable numbers (see pp. 882, 892).

A particular concern of the newly created Bureau of Agricultural Economics was to improve its facilities for building up an adequate factual and analytical background against which the individual farmer could decide on the wisest course to follow in his own farm management. To serve this need, the Bureau of Agricultural Economics began the preparation of what were called "outlook reports," in which were assembled data as to prospective demand, production conditions, carry-over, price trends, and the like. Outside experts were called into consultation with specialists of the Department as to interpretation of these data, with a view to making a comprehensive statement of the general outlook for agricultural business during the ensuing year. At first, the Bureau undertook to make application of these analyses only to a very limited number of staple commodities important in the export market. But in time the range of the reports came to include not only all the major staples but quite a number of important specialty crops.

As the work developed, efforts were not limited to the use of familiar types of statistical data such as had been so highly developed by the Bureau of Crop and Livestock Estimates. Special attention was extended also to the securing of full and prompt reports of conditions in the foreign markets, and agricultural attachés

were stationed at several of the principal foreign embassies. These agents were charged with the task of keeping in touch with the development of foreign demand conditions, the course of production in the several foreign countries, and the export and import movement of the principal farm products. Experimentation was pushed into a new field through the gathering of "hot" data on the current trend of agricultural operations, through questionnaire reports covering farmers' "intentions to plant" and livestock growers' "intentions to breed" or "intentions to feed."

The national outlook reports were used as the basis for state outlook work, which re-interpreted the general analysis in the light of local conditions and brought the results to the attention of farm operators. Recommendations were frequently made for the increase or decrease in acreage of particular crops or number of particular kinds of livestock. The effect of all this was not in any sense to constrain the action of the individual farmer but rather to give him the fullest and freshest information possible as to the larger economic conditions upon which he should make his personal decisions as to choice of crops and how much of each to produce. There was, however, a systematic effort to help farmers work out in the several areas a sustained program of sound farming under the counsel of the county agent or extension specialist and with such wisdom as might be derived from discussion among neighbors at many local meetings.³³ The goal was the highest attainable intelligence of voluntary action, not the gaining of outside control.³⁴

³³ "Whatever may or may not be done by government, it is perfectly clear that the success of the individual farmer will depend on his own efforts. That he must work hard goes without saying, but under present conditions it must be work with the head as well as the hands. The crops to be grown and the kind of farming to be followed must be determined not alone with an understanding of the conditions which influence production but with some knowledge of the prospective demand for those crops and some study of the conditions which are likely to influence the price. The Department of Agriculture is trying to help the farmer help himself both in determining what to grow and how to grow it and in putting in his hands the kind of information concerning domestic and foreign conditions which he needs to produce and market to the best advantage." *Report of the Secretary of Agriculture, 1923*, p. 20.

³⁴ From time to time opposition to outlook work (and also market news service) developed from producer groups. It was claimed that such activities put valuable factual information into the hands of the farmer's "enemies," that they could and did use it to his hurt (for instance in price manipulation) more effectively than

While these developments were proceeding steadily but cautiously, proposals of a different character were not lacking. It was argued that it was proving impossible to adjust the agricultural industry with sufficient speed or to an adequate extent by any of the conventional devices, or by all of them pressed in combination, so as to restore agricultural prices to such a level as to cure the agricultural depression. It was therefore proposed to support the domestic price level on a plane dissociated from the world market. The two plans for accomplishing this end were actively sponsored by agricultural groups. One was an "export debenture" plan of using tariff revenues to subsidize agricultural exports. The other was the McNary-Haugen plan to "make the tariff effective for agriculture" by giving the farmer when he sold his product not merely the current market price but also scrip which would eventually be redeemed out of the proceeds of an "equalization fee" levied on all domestic processors of the product but not paid by that part which moved into export.⁸⁵

It was never possible to secure passage in Congress of the export debenture plan, but the equalization fee plan was passed in 1927 and in slightly different form in 1928, but was on both occasions vetoed by President Coolidge.⁸⁶ Thus we see that at the close of 1928 an extensive crusade had been under way for eight years to secure special governmental treatment of the agricultural industry but that only moderate concessions to this pressure had up to that time been made. As Secretary of Commerce, Herbert Hoover had exerted vigorous opposition to the equalization fee and export debenture plans. He was, however, elected to the presidency on a

he could use it to his own benefit. The gathering and dissemination of certain types of statistical information were curtailed as a result of this opposition.

⁸⁵ "The essence of the McNary-Haugen idea was that farmers were to be given the centralizing power of the federal government so they could dump enough of their surplus abroad to raise prices in the domestic market. In some versions the price was to be raised so that producers of export crops could enjoy the full benefit of the tariff. In other versions the criterion was a price to be raised until it was as high relative to prices of things purchased by farmers as prevailed during 1909-14." Henry A. Wallace, *New Frontiers*, pp. 147-48.

⁸⁶ Gradually emerging from the background after 1926 was a third plan known as "domestic allotment." It did not get into the field of active legislative discussion until much later (see p. 913) but was discussed at length in John D. Black, *Agricultural Reform in the United States* (1929). This book is a valuable source to consult with reference to the post-war problem and the several remedial measures up to 1929.

platform which pledged vigorous aid to the agricultural industry, and his previous utterances and actions had given some indication of the sort of plan which he would favor or, at least, accept. This was embodied in the Agricultural Marketing Act which was passed in June 1929.

IV. THE FEDERAL FARM BOARD

The Agricultural Marketing Act of 1929 set up a Federal Farm Board, invested it with broad powers, and financed it with sums which at that time seemed extremely large. In this measure the government took a new step in dealing with our agricultural industry as an area of special treatment. At the same time, the act of 1929 rested quite evidently on measures previously taken for dealing with the marketing phases of the agricultural problem, and was supported by a considerable public sentiment (whose roots went back some distance) that aggressive governmental steps for dealing with this industry should be taken. Before proceeding to discussion of the provisions of the act and of the activities undertaken by the Farm Board, we should note some of the sources of the public concern and the arguments advanced.

As early as 1922, Senator Capper had undertaken to define the agricultural bloc as

that group of members of Congress who have recognized that an economic upheaval threatens the nation if the foundations of our prosperity are weakened. They recognize that American welfare depends upon the land and upon a permanent and prosperous agriculture. . . . They recognize that we have passed into a new era in our national history in which we cannot allow the balance of real production which comes only from the land to get out of balance with the dependent manufacturing industries, commerce, banking, and government. . . . They recognize that an agricultural interest cannot in the end be a selfish class interest since nature allows no monopoly in agriculture. Better food production benefits all; commerce is increased; trade is stimulated; banking must expand and progress is promoted as the people on the land increase in affluence and net revenue which must be spent for the products of the labor of city workers.³⁷

The questions to be dealt with actively by government were, as he listed them: financing agriculture, education, transportation, and distribution improvement or better marketing.

³⁷ Capper, *The Agricultural Bloc*, pp. 3, 4, 5.

In 1926, the National Industrial Conference Board published the findings of an extensive study of the agricultural problem which they had conducted.⁸⁸ This volume began with the declaration:

The position of American agriculture is of vital concern to all the people of the United States, not only for today but for the future as well. Our farmers are more than a class of our population. Farming is more than an industry. The significance of agriculture in the life of the nation is far deeper than this. It touches something vital and fundamental in the national existence. It involves the national security, the racial character, the economic welfare and the social progress of our people. The development of sound, far-sighted national policies in respect to agriculture is, therefore, one of the most important problems before the country today. Our agriculture is now going through a crucial transition in its character and in its relationship to our national economic life. The success or failure of this readjustment will be of the greatest significance for our future (p. v).

The report refrained from recommending specific measures, limiting itself to statement of the problem and analysis of the issues. In the general summary and conclusions it was urged:

Despite the serious and long-continued adverse conditions that have confronted agriculture, there is no ground for believing that they are insurmountable . . . it would seem proper and desirable in the national interest for leading representatives of American industry, commerce, transportation and finance, in conjunction with leaders of agriculture, to study jointly and sympathetically, on the basis of the Conference Board's report, the agricultural situation and its causes, to appraise its consequences and to present for the consideration of the public their mature judgment of the possibilities and desirable avenues of remedy and readjustment. In this way it is possible that, apart from the disturbing and transient influence of partisan politics, there may be provided a constructive and practical plan for mutual understanding and full co-operation between agriculture and all other groups in our productive life, as well as a basis upon which may be developed a sound and far-sighted national policy embracing and justly balancing all the interests involved (pp. 149-50).

In furtherance of this purpose, the National Industrial Conference Board joined, the following year, with the Chamber of Com-

⁸⁸ *The Agricultural Problem in the United States.*

merce of the United States in setting up a "Business Men's Commission on Agriculture" "to study the condition of agriculture in the United States and to suggest measures for its improvement." This commission consisted of ten executives of industrial, railway, and banking corporations under the chairmanship of Charles Nagel, who had been Secretary of Commerce and Labor in the cabinet of President Taft. It "secured the assistance of an economic adviser . . . not committed to any particular theory"—a professor whose connection with the staff of Princeton University assured his freedom from any partisanship of which an agricultural college economist might have been suspected.

The report of the Business Men's Commission³⁰ came to the conclusion that

the evidence is clear that American agriculture has undergone a prolonged and trying readjustment to post-war conditions; in the course of which those engaged in it have suffered seriously in their relative economic prosperity in comparison with those engaged in other fields. . . . Since the war the prices of farm products have persisted in an uneconomic and unfavorable adjustment to the general scale of prices of other goods and services. Though the relative price of agricultural products has increased, the costs of production in agriculture have risen or tended to remain high in comparison with the agricultural income, so that the readjustment of price relationships alone does not assure real improvement in the relative economic position of agriculture as a whole (pp. 20-21).

The Commission dissociated itself from the idea

commonly accepted that the farmer's problem may be approached and solved like any other business, industrial or economic question. . . . Elements of business are ever present, it is true, and business methods must be observed; but the pursuit of agriculture presents other features so peculiar, indeed so unique, that the failure to take account of them must lead to gravest miscalculation (p. 6).

They viewed with alarm the "abandonment of the proud role of the independent proprietor," saying:

³⁰ Business Men's Commission on Agriculture, *The Condition of Agriculture in the United States and Measures for Its Improvement* (1927).

At present the farmer's unique privilege is to combine a way of living with the chance for material profit. A degree of success in both is essential. The first aim cannot be surrendered to the second ambition without revolutionizing the undertaking and surrendering what has seemed dearest to the farmer's heart. . . . His is a proud heritage, last bulwark of true democracy. As a sane conservative, it is for him to hold his ground in this never ending evolution. Others may and should, in their own interest as well as in his, render aid. . . . Here as everywhere the watchword is co-operation. . . . That means for the national government a broad economic policy, with the farmer's interests as an integral part, wisely administered and generously adjusted to state and private activities. For the states it means a revival of the sense of authority and responsibility, both of which have been sadly neglected (pp. 17-19).

. . . Agriculture was left largely to the mercy of *laissez faire*, while governmental support went to the building up of commercial and industrial enterprises. . . . The pursuit of agriculture, however, has at no time enjoyed protection such as was extended from the very beginning to commerce and industry through national legislation. It was, therefore, long after the natural evolution of economic relations had been shifted—even dislodged—by direct legislative interference, that we came to suspect the inevitable effect upon the system as a whole. Only now have we come to recognize the need of more equitable conditions, if agriculture is to sustain its position of relative importance in the entire system. . . . It constitutes a challenge to modern statesmanship; and whatever else may be true, it is clear that the solution will not be had upon conventional lines (p. 7).

. . . *Laissez faire* is of the past, and the practical question is how far shall we be driven in the other direction. As has been said, the true province of legislation probably lies somewhere between *laissez faire* and price fixing—neither extreme is to be recommended. . . . If agitation for price-fixing legislation is to be avoided, may it not become necessary to revise our economic [tariff] policy? If we are unwilling or unable to do that, will we not be challenged to find for the farmer an economically true equivalent of industrial protection? (p. 11).

. . . We dare not forget what has been done for financial and industrial development. Why not for agricultural interests? . . . [The Commission] feel that the farmer's cause is their own, from both the humanitarian and the economic point of view. They are forced to the conclusion that the accepted economic measures do not fit, at least do not cover the farmer's case; and that this situation presents a new challenge to economic and political advisers that cannot be evaded or met with slogans (pp. 15-16).

Agriculture is not merely a way of making money by raising crops;

it is not merely an industry or a business; it is essentially a public function or service performed by private individuals for the care and use of the land in the national interest, and farmers in the course of their pursuit of living and a private profit are the custodians of the basis of the national life. Agriculture is therefore affected with a clear and unquestionable public interest, and its status is a matter of national concern calling for deliberate and far-sighted national policies, not only to conserve the natural and human resources involved in it, but to provide for the national security, promote a well-rounded prosperity, and secure social and political stability (p. 20).

Believing that there was an imperative demand for a "continuous, far-sighted national policy toward agriculture which shall be expressed not only in terms of co-operation among all important economic groups in the nation, but also in terms of carefully planned governmental measures," the Commission recommended: (1) reconsideration of "protective [tariff] policies which tend to place artificial obstacles in the way of the natural and normal extension of markets for farm products and which tend to increase the domestic costs of their production;" (2) lower product costs; (3) co-operative buying and selling organization; (4) carefully planned policy for the utilization of land; (5) tax reform; (6) improved agricultural credit; (7) readjustment of transportation charges, and (8) expanded research work. These proposals approached the matter along traditional paths. Novel, not to say startling, was the Commission's proposal for "measures which tend to reduce the wide fluctuations in prices and the hazards of loss due to changing natural and market conditions." To this end the Commission suggested that

. . . a Federal Farm Board, consisting of a small number of men appointed by the President, should be established to aid in the stabilization of prices and production in agriculture by advising farmers and farm organizations fully and promptly regarding the planning of production and the marketing of crops. This Board should make use of the facilities of the U. S. Department of Agriculture and be assisted in its work by Advisory Committees composed of persons adequately representing each important branch of agriculture and directly responsible to farmers and farm organizations, who would co-operate with it both in supplying information and advice and in making its influence effective in the production and marketing of crops.

With the advice and assistance of the Federal Farm Board, effort

should be made to organize stabilization corporations to engage in the buying and selling of farm products for the purpose of stabilizing prices. Such corporations should be established through the co-operation of farm organizations, of private business organizations and of the government acting through the Federal Farm Board, each of these supplying a part of the capital necessary. The Federal government should at no time hold a controlling interest in the corporations, although it should participate in their management and be in a position to exercise such supervision over them as it does over the national banks, the Federal Land Banks and the Intermediate Credit System.

The working capital necessary to finance the operations of these corporations in handling of surpluses should not be supplied by the government but should be made available by private banking sources, preferably through the Intermediate Credit System. A relatively large amount of such capital would be necessary, but the relation of the government to such corporations would make their credit standing much better than that of unsupported co-operatives or other marketing organizations, while it would be in the interests of business men and of the banking system to aid in the successful operation of such corporations in order to prevent sudden curtailment of the buying power of agriculture and to stabilize general business and credit conditions.

Cotton, wheat, and perhaps corn appear to be the only commodities in which stabilization corporations of this sort could successfully operate, at least at the outset of the experiment. As these corporations became strong enough and gained sufficient experience, it might be possible for them to carry price stabilization one step beyond the mere handling of emergency surpluses due to weather conditions and to attempt the gradual control of production, so far as this can be accomplished by influencing planting intentions and programs. To this end it might eventually be possible for these corporations to announce in advance of the planting of crops a price at which they would stand ready on a specified date after the production of the crops in question to purchase any surplus which might then be offered, this price being such as would induce the desired proportion and volume of the crops concerned (pp. 32-33).

The extent to which these "suggestions" of the Business Men's Commission set up in 1927 by the Industrial Conference Board and the Chamber of Commerce of the United States were embodied in the Agricultural Marketing Act of 1929 is striking. The act set up a Federal Farm Board of nine members representing the principal agricultural commodities, with the Secretary of Agriculture *ex officio*. In the preamble to the act, it was

declared to be the policy of Congress to promote the effective merchandising of agricultural commodities in interstate and foreign commerce, so that the industry of agriculture will be placed on a basis of economic equality with other industries . . . by aiding in preventing and controlling surpluses in any agricultural commodity, through orderly production and distribution so as to maintain advantageous domestic markets and prevent such surpluses from causing undue and excessive fluctuations or depressions in prices for the commodity.

This general mandate was particularized in the enumeration of five special powers conferred by the act upon the Board as a sort of economic planning agency as follows:

- (1) to promote education in the principles and practices of co-operative marketing of agricultural commodities and food products thereof;
- (2) to encourage the organization, improvement in methods, and development of effective co-operative associations;
- (3) to keep advised from any available sources and make reports as to crop prices, experiences, prospects, supply, and demand, at home and abroad;
- (4) to investigate conditions of overproduction of agricultural commodities and advise as to the prevention of such overproduction;
- (5) to make investigations and reports and publish the same, including investigations and reports upon the following: land utilization for agricultural purposes; reduction of the acreage of unprofitable marginal lands in cultivation; methods of expanding markets at home and abroad for agricultural commodities and food products thereof; methods of developing by-products of and new uses for agricultural commodities; and transportation conditions and their effects upon the marketing of agricultural commodities.⁴⁰

The Federal Farm Board thus became a special propaganda and service agency to agricultural co-operative associations. It took over the Division of Co-operative Marketing established in the Bureau of Agricultural Economics under the Co-operative Marketing Act of 1926, greatly enlarged the staff, and undertook to build up national distributive organizations for the several agricultural commodities capable of carrying on centralized collective bargaining, backed up by storage operations in non-perishable commodities. In order that the operations of co-operative associations—national or local—might not be cramped for lack of plant facilities or working

⁴⁰ 46 Stat. L. 11.

capital, the Board was supplied (besides an operating fund) with a revolving fund of 500 million dollars, to be used as loans to co-operative associations or in the financing of stabilization corporations. This was in all essentials the old "commodity marketing" program newly implemented by government action.⁴¹

In spite of the aggressive action of the Farm Board in supporting local and regional co-operative marketing organizations and in combining them into national selling agencies, their power to determine prices in the staple markets proved to be slight. Cotton co-operatives had handled some 9 per cent of the crop; this rose to nearly 17 per cent in 1930-31, but thereafter declined again.⁴² As to wheat, the nature of the statistics does not permit of accurate estimate of the volume sold collectively in the terminal markets, but it was not of such size or strategic placing as to give it price-making significance. Livestock co-operatively marketed by selling agencies of the National Livestock Marketing Association at its peak amounted to perhaps 20 per cent of hogs and much less of sheep and cattle. At particular terminal markets, co-operative commission firms in a few instances handled a somewhat larger percentage of hog receipts and had significant influence on short-run price changes or local differentials but hardly on the general level of hog prices. The tobacco co-operatives had a mushroom growth under the "commodity marketing" movement of the early twenties, and controlled nearly half the volume during 1923 and 1924. They had wielded significant price power as long as they were financially willing and able to carry increasing unsold stocks. But the levels at which they had thus supported prices were stimulative to acreage and they were in a state of collapse when the Farm Board began operation.

The outstanding feature of the Farm Board development therefore was to bring the federal government in as the underwriting

⁴¹ See Carl Williams, Edwin G. Nourse, and others, "General Discussion of National Cooperatives and the Federal Farm Board," *American Cooperation* 1932, pp. 115-43.

⁴² For valuable and voluminous data concerning the scope and growth of the co-operative movement, see R. H. Elsworth, *Statistics of Farmers' Cooperative Business Organizations, 1920-1935*, Farm Credit Administration Bulletin No. 63; *A Statistical Handbook of Farmers' Cooperatives*, F.C.A. Bulletin No. 26 (1938); and *Statistics of Farmers' Marketing and Purchasing Cooperatives, 1938-39 Marketing Season*, F.C.A. Miscellaneous Report No. 21 (1940).

agency to carry such farm products as could not be sold at the prices which the co-operative managers, acting upon the counsel of the Board, felt to be the proper level. The successful use of these "stabilization" operations in meeting minor emergencies was shown in the butter loans of 1929-30. They enabled the major co-operative to withhold its own product and offer to purchase in the market till some 5 million pounds were impounded (about one-eighth of total storage holdings at the time). After two and a half months, market prices strengthened and the stored butter was sold by the co-operative at prices which yielded it a small profit.

Another minor stabilization operation took place in the grape industry in 1930-31. Its significant difference from the butter stabilization operation lay in the fact that it supplemented the holding of stored stocks by imposing certain measures of control on the supply coming on the market. In the past, banking groups who were heavily extended in the raisin and wine industries had underwritten pool operations under which a limit would be placed on the amount of the crop to be harvested, and a co-ordinated administration would determine the volume and time of what went to the chief uses—raisins, wine, table use, and by-products. In the present instance, the government superseded the private bankers as the financing and control agency, funds being advanced by the Board, and its staff counselling with a "control board" selected by the industry to conduct actual operations. Eighty-five per cent of the grape tonnage of California was set as the minimum which must be under contract to the control board, or the pre-existing raisin pool, raisin co-operative, and winery association. The limitation of market supplies was effected by levying a "stabilization fee" on all participants and using this to pay producers for grapes which they were required to leave on the vine. This was designed to be a continuous device for handling the difficulties of large crop years; contracts drawn in 1930 were for a ten-year period but with privilege of withdrawal after the expiration of three years. It proved, however, to be short-lived.

The less successful use of stabilization operations in the major emergencies by which the Board was confronted concerns the cotton and wheat stabilization corporations, both of which were set up in the fall of 1929. To the Cotton Stabilization Corporation, the Farm

Board advanced at various times a total of 166 million dollars, of which 94 million were not repaid. Against this deficit, there were credited 78 million dollars as the value of relief cotton donated by congressional action to the American Red Cross, leaving a net deficit of 16 million dollars for cotton stabilization operations. To the Wheat Stabilization Corporation, the Board advanced a total of 580 million dollars, of which 498 million were liquidated by credits for Red Cross wheat (119 million) and by repayments up to the end of 1933. There were also as of that date assets in the form of 175,000 bags of coffee received from the Brazilian government in a barter transaction involving a total of 1,050,000 bags,⁴³ approximately 9 million dollars of Chinese government notes, and 4 million dollars of German government notes received on credit sales of wheat to these two countries. These assets eventually reduced the loss on wheat stabilization operations by some 12 million dollars, but \$2,661,000 of the German notes are still outstanding,⁴⁴ no curtailment of this loan having been made since 1936. If this should eventually be paid off, the final loss chargeable to both stabilization corporations would be approximately 83 million dollars.

While the objective enunciated in the Agricultural Marketing Act of 1929 was stated to be "orderly production" as well as "orderly marketing," the means proposed focused definitely on the upbuilding of co-operative associations, which are essentially marketing agencies. Whatever the thought of Congress as to the relative importance of the production problem or the adequacy of co-operative organization as a means of dealing with it, the Board, in its first annual report, in explaining that its work had been "centered in the upbuilding of co-operative marketing associations" observed that "such organizations, well managed and properly financed, will enable farmers to control their industry both as to production and marketing." This statement palpably ignored the historic fact that co-operative associations had exercised no control and negligible influence over the scope and direction of members' production activi-

⁴³ This coffee was taken in trade at approximately 8 cents per pound and realized 9.5 cents net when sold.

⁴⁴ *Fifth Annual Report of the Farm Credit Administration* (1937), p. 83.

ties. Faced by conditions of declining market demand during a severe and widespread depression, the Farm Board early sought to exert its influence in the direction of production control.

Chairman Legge and Secretary Hyde in the summer of 1930 undertook a personal campaign amongst the wheat growers, particularly in the Southwest, to persuade them to reduce their production. Mr. Williams conducted a similar crusade to deter cotton farmers from putting in an unduly large acreage in 1931. When this proved barren of results, he proposed the plowing under of every third row of the growing crop without compensation.⁴⁵ Mr. Denman proposed a plan of differential prices for hogs according to weight, designed to penalize over-production. And Mr. Stone, after becoming chairman of the Board, gave evidence of lively interest in the problem of land use and the possibility of this approach to the development of an adequate machinery for the regulation of agricultural production.⁴⁶

When the Board's third annual report appeared (December 1932), it contained two sections entitled "Production Adjustments Involve Land Utilization" and "Surplus Control Methods," the latter of which closed with the following comment:

Experience with stabilization thus demonstrates that no measure for improving the price of farm products other than increasing the demand of consumers can be effective over a period of years unless it provides a more definite control of production than has been achieved so far. In a few limited and specialized lines, co-operative associations have made progress toward such control. For the great staple products, however, the problem still remains for future solution.⁴⁷

Thus the matter stood when the Agricultural Marketing Act of 1929 was superseded by the Agricultural Adjustment Act of 1933. The Federal Farm Board during its brief and tragic lifetime had not dealt with agriculture entirely within the traditional patterns. It would be a mistake to think of its activities as merely implement-

⁴⁵ He coupled this advice with pointed hints that unless supplies were restricted at the source, the Board would have to abandon its efforts to support prices by financing the holding of constantly increasing stocks.

⁴⁶ E. G. Nourse, *Marketing Agreements under the AAA*, pp. 10-11. The reader should bear in mind also the Board's participation in the grape stabilization scheme, which included payment for grapes left on the vine under instructions of a control committee.

⁴⁷ *Third Annual Report of the Federal Farm Board (1932)*, p. 62.

ing private enterprise in agriculture by furnishing farmers facilities for strengthening voluntary co-operative associations such as had been known and gradually growing over a period of at least sixty years. The Agricultural Marketing Act of 1929 assigned the government a role of market manipulation and price support far beyond anything achieved by private co-operative associations. It provided large government funds to underwrite the withholding from the market of such supplies as could not be sold at a government-sponsored price level, using some of these stocks in an international barter operation, and diverting others to relief uses. This act was novel in moving government from the informational and analytical role in relation to individual enterprise in farming to one of vigorous propaganda as to specific courses of action implemented, to a degree at least, by the power of this government agency to grant financial assistance to or withhold it from national organizations through which individual producers made contact with the market. Novel too was the use of government credit in support of international sales of particular commodities.

V. AGRICULTURE AND GOVERNMENT SINCE 1933

While the Agricultural Marketing Act of 1929 had gone considerably beyond the limits set by previous national policy, there had, with the progress of the depression, been extensions of government's active role in the special treatment of agriculture even beyond the point apparently contemplated at the time the law was passed. In part these extensions had been the result of an aggressive policy and broad interpretations introduced by the Board into the administration of the act. In part, however, they had been the result of further congressional action, such as the diversion of stabilization holdings of wheat and cotton to relief uses through the Red Cross. Congress likewise had pushed out the frontier of government action somewhat further in aid also of distressed industries, for example, through the setting up of the Reconstruction Finance Corporation in 1932. This agency ministered to agriculture in only a minor way, its major extensions of extraordinary credit aid being to industrial and banking concerns.

The exigencies of the depression period led the country to utilize

government agencies more aggressively in the aid of many parts of the economic system even under a President and a party which in principle were opposed to such extensions. With the advent of the Roosevelt administration a different philosophy of government came to vigorous expression.

The Farm Credit Administration. From Inauguration Day forward, swift and drastic steps were taken with reference to many phases of the nation's economic structure. On the agricultural front, this led to the setting up on May 27, 1933 of the Farm Credit Administration, which consolidated the old Federal Farm Loan system with the financing activities of the Federal Farm Board.⁴⁸ To the Federal Land Banks and the Intermediate Credit Banks there was added a system of productive credit corporations (with underlying credit associations) and a Central Bank for Co-operatives with regional banks for co-operatives paralleling the Land Banks and Intermediate Credit Banks of the twelve Land Bank districts.

In the main this reorganization simply co-ordinated previous lines of government activity in a comprehensive system of agricultural credit. The Production Credit Division took over the work of agricultural credit corporations brought into being under the Intermediate Credit Act of 1923, and the Banks for Co-operatives institutionalized lending operations which had been initiated and developed through their early stages by the Federal Farm Board. Under the Production Credit Division of the Farm Credit Administration there was now set up an "Emergency Crop and Feed Loan Section," which took over and attempted to systematize the administration of emergency types of financing which had been going on sporadically under specific acts of Congress for many years.

From 2 million dollars in 1921, such emergency loans dropped to \$224,000 made in 1926, from which point they rose to a peak of 64 million dollars extended in 1932,⁴⁹ dropped to 16.6 million in 1936, rose again to 32.5 million under the drought conditions

⁴⁸ The Board as such was scrapped, and the stabilization corporations put into liquidation. Service activities for co-operative associations are combined in the Co-operative Division of the F.C.A., but the more ambitious types of effort to influence prices were transferred to the A.A.A. Compare p. 911 ff.

⁴⁹ There were no such loans during the years 1923, 1927, and 1928.

of 1937, and dropped to 19.6 million in 1938. Besides these secured loans there were also unsecured "drought relief loans" during 1934 and 1935 to the amount of 72 million dollars, of which 76 per cent were still outstanding at the close of 1938. These lending operations were, as their name indicates, regarded as primarily relief measures. The crop and feed loans on the other hand have been primarily intended as rehabilitation loans designed to keep farmers in a position to produce even when they could not secure the necessary credit from banking institutions. Of such loans made during 1938 and which had matured on December 31 of that year, 62.4 per cent had been paid. "Such loans are, in effect, a mixture of credit and relief."⁵⁰

In the field of mortgage lending also, the normal operations of the farm loan banks were, through the Farm Credit Administration, supplemented by "land bank commissioner loans" extended to farmers not in a position to qualify under the regular lending provisions. Such loans might be made up to 75 per cent of the "appraised normal value" of the property. Where such loans were used for refinancing old mortgages, the proceeding often involved a scaling down of previous indebtedness. This process of "debt adjustment" (analogous to corporate reorganization) was used quite extensively by the Farm Credit Administration (and the Resettlement Administration, discussed later) and to some extent by state and local agencies, insurance companies, and other lenders as a means of squeezing out the water which had been injected into land values by the war-time real estate boom or by local speculative land developments.⁵¹ Land bank commissioner loans rose sharply from the 71 million dollars extended during the latter part of 1933 to 553 million granted during 1934, after which they dropped rapidly to 40 million loaned in 1937. The power to issue such loans expires in 1940. As these are in the form of long-term mortgages, it will be many years before the financial outcome can be known. Approximately 9 per cent of accrued interest obligations were in arrears as of December 31, 1937.

⁵⁰ *Second Annual Report of the Farm Credit Administration (1934)*, p. 6.

⁵¹ Even so, time may prove that some of the mortgages were inadequately supported by the earning power of the lands. While this lending was nominally in aid of agriculture, no small part of it represented a "bailing out" of distressed banks.

The Farm Credit Administration represented only a partial acceptance of the agrarian demands of the period. Measures such as the Frazier-Lemke bill, strongly pressed in Congress, were designed to have the government take over the whole burden of financing agriculture at rates definitely below the market level. The policy expressed in the setting up of the Federal Land Banks in 1916 had been to complement existing credit agencies by a federal service which should enable all farmers and farmers' associations to secure access to the central money markets at the lowest competitive rate justified by the character of the risk and service when property was appraised, security handled, and operation systematized under careful supervision of a government agency. During the depression, however, Congress yielded to the demands for extremely low government rates of interest to the extent of inaugurating an emergency rate of 4.5 per cent in 1933, and subsequently reducing it to 3.5 per cent.

When this subsidized rate was to expire on July 1, 1937, Governor Myers of the Farm Credit Administration fought valiantly against the clamor being made to have it renewed. He argued that the task of emergency financing had been essentially completed and that

subsidizing the interest payments of Federal Land Bank borrowers helps less than one-eighth of all farmers, and most of these are no longer in financial distress. . . . Permanently subsidized rates would increase the violence of land booms. They would also tend to discourage private lending institutions from operating in competition with subsidized agencies and thus would tend to increase, perhaps to a dangerous degree, the already heavy concentration of the farm mortgage debt in the hands of a single agency. While courage is required for the elimination of any subsidy, the time has come for facing the fact that these direct government subsidies must be tapered off if the goal of a business credit system for agriculture is to be obtained.²²

The 3.5 per cent rate, however, was renewed, and agitation for a permanent 2 per cent rate reappears in every session of Congress.

It had been the desire of Governor Myers and of his successor, Governor Hill, to see the Farm Credit Administration put in the

²² W. I. Myers, "Farm Credit Administration Policy," *Journal of Farm Economics (Proceedings)*, Vol. 19 (1937), pp. 85-86.

position of a sound banking institution complementary to, rather than competitive with, private agencies.⁵³ To this end, it was regarded as essential not merely to remove the interest rate subsidy but also to get rid of the marginal operations which transcend the limits of sound banking and introduce an element of emergency relief. "To the extent," said Governor Myers in the address just quoted, "that national welfare justifies the extension of credit to farmers who cannot meet reasonable credit standards for financing the purchase of farms or for other purposes, special agencies should be established to handle the problem rather than to jeopardize the operations of this business credit system."

In April 1939, as a step in the administrative reorganization of the government, the Farm Credit Administration was transferred to the Department of Agriculture. On May 22, Secretary Wallace issued a statement to the effect that this did not mean that the Farm Credit Administration would "become an integral part of the Department of Agriculture." Its Governor would in the future report to the Secretary of Agriculture rather than to the President, but "for carrying out the many federal statutes which form the basis for the several types of farm credit, for information and execution of operating policies, for control of fiscal, personnel, legal, informational, and related affairs . . . the Farm Credit Administration will be an autonomous federal agency as heretofore." By December, however, a controversy over policy had arisen; it was charged that F.C.A. maintained the "hard-boiled" attitude of a banking institution and failed to co-ordinate its operations with the policies of the Secretary, the Adjustment Administration, and other agencies of the Department. Governor Hill's resignation was demanded, and one of Secretary Wallace's closest associates transferred from charge of marketing and regulatory work in the Department to the governorship of F.C.A.

The significance of these developments cannot yet be appraised.

⁵³ The quantitative position of the Farm Credit Administration in the field of farm mortgage finance is indicated by the fact that its \$2,735,000,000 (Dec. 31, 1938) of mortgage credit covers approximately 40 per cent of the total mortgage load of all farms in the United States. In 1928, it constituted about 12 per cent of the total farm mortgage debt. Credit extensions of the Intermediate Credit Banks amounted to an additional 203 million dollars.

Opponents of the reorganization plan express the fear that extension of credit will be tied up with participation in adjustment and conservation programs; proponents say it will merely be "humanized." Meanwhile several new measures have been actively promoted in Congress which would provide for making a 3 per cent rate permanent, extend maturities to 40 years, prevent deficiency judgments, allow defaulting borrowers five years within which they might recover their farms, and provide for more comprehensive plans for the readjustment of the principal amount when interest payments could not be met. A major purpose of these measures appears to be the forestalling of widespread foreclosures by the government in case of low commodity prices during the next few years. Opponents of the measures characterize the policy as one of "cheap money and no foreclosures" which would put all farm mortgages in the government's hands and, by leaving the operator on the farm under lease when interest payments were defaulted, put the government in a position to assure compliance with any production program which it might inaugurate. The nature of these issues will become more clear as we discuss the several features of the Agricultural Adjustment Act and other measures which have stemmed from it.

Marketing agreements and orders. In the same month that the Farm Credit Administration was set up Congress passed the act establishing the Agricultural Adjustment Administration. Deferring for the moment discussion of its major "production adjustment" and "income adjustment" features, we may note that the marketing agreement and licensing sections of this measure superseded and modified the character of government's relation to marketing and price-making activities as exercised under the Farm Board. The distinctive feature of marketing agreements was that they provided for a three-cornered determination of price policy and the manipulation of supplies which would achieve the price objectives agreed upon by processors and distributors (who, by virtue of the inclusion of co-operatives, embraced a large part of the producers' group⁴⁴) counselled by representatives of the Secre-

⁴⁴ Owing to the nature of agricultural marketing agreements, even the private processor or distributor frequently represented the producer in a sense not essen-

tary of Agriculture, to whom was reserved the right to approve or disapprove their proposed action.

In principle, the marketing agreement does not mark any extension of control of the marketing process as undertaken under the auspices of the Federal Farm Board. Indeed, it might be viewed as a moderation of that policy in that processors and private distributors were now made active parties at interest in formulating price objectives and determining the strategy of market distribution. On the other hand, it embraced the power to license all handlers to bring their operations in line with a policy and procedures adopted by the majority; this represented a new departure.⁵⁵ Co-operative association of farmers had been purely voluntary though sweetened by the honey of Farm Board finances and expert personnel. But the license makes participation in such joint programs mandatory.

The licensing provision of the original act was ambiguous and from the start subject to varied judicial interpretation. Through amendments passed in August 1935, Congress substituted "Secretary's orders" for licenses, defined procedures, and limited the scope of the act to exclude apples and canning crops other than olives and asparagus. If a referendum of the growers shows that two-thirds of them are in favor of a given marketing agreement program, a "Secretary's order" making its terms binding on all handlers of the product is prepared. When this is signed by handlers of at least one-half the market volume, the Secretary may thereupon put

tially different from that of the co-operative. Through subsequent amendments to the act, the producer has become more directly a party to the action taken by the marketing agreements. For details, see E. G. Nourse, *Marketing Agreements under the AAA*; E. G. Nourse, J. S. Davis, and J. D. Black, *Three Years of the Agricultural Adjustment Administration* (1937), Chap. XII.

⁵⁵ The licensing device, however, had previously been used by both state and federal governments for less ambitious purposes. Beginning about 1910, there was a considerable wave of legislation designed to enforce financial responsibility and check unfair commercial practices among handlers of agricultural commodities. In several of the states passing legislation of this sort, licensing was used as a means of enforcement. Under the Grain Futures Act of 1922, commission merchants and brokers were required to register with the Secretary of Agriculture and the Perishable Agricultural Commodities Act of 1930 required the licensing of all commission merchants, dealers, and brokers handling fresh fruits and vegetables in interstate commerce. The use of licensing as a means of securing comprehensive participation in a scheme of planned distribution, however, marked a distinct extension of control of individual business enterprise.

the order into effect. If less than one-half sign, it may still be put into effect upon approval by the President.⁵⁴

The means by which control of movement of the particular commodity is to be effected under a marketing agreement and Secretary's order involve a variety of devices, including increase in the strictness of grading and inspection requirements, "shipping holidays" at times of market glut, temporary withholding of stocks of non-perishable products from harvest time till later in the marketing year or even to a subsequent year, and diversion of "surplus" stocks to by-product or other non-competitive uses.⁵⁵ The agreement or order does not contain any provisions designed to control the actual production of the product.

Marketing agreements have been used to regulate the flow of agricultural commodities into the market and the trade practices to be followed by the various distributing agencies, to the end that the amplitude of price movements should be reduced and the level of prices brought as close as possible to an objective mutually agreed upon by the three parties—producers, trade agencies, and government officials. The fixing of specific prices has been used to only limited extent (in milk marketing agreements),⁵⁶ the procedure in general being the naming and frequent revision of price "goals" to be sought through the co-ordinated manipulation of supplies. Nominally, at least, the goal of such enchancement has been the same as

⁵⁴ The similarities to N.R.A. codes are obvious; in fact, in the early days the two procedures overlapped or were intertwined.

⁵⁵ Where such diversion operations involve only moderate volumes of product, they may be carried through as part of the ordinary marketing agreement procedure and within their general price strategy. Where volumes are large, the administrative agencies under the marketing agreement may invoke the assistance of the Federal Surplus Commodities Corporation, or a subsidy for diversion by the use of "section 32 funds" allocated to the Secretary out of tariff receipts, discussed on pp. 927-28.

⁵⁶ From the agricultural depression of 1920 forward, all sorts of schemes for governmental price fixing of agricultural products had been advanced. Such measures are in fact still being brought forward in every session of Congress. In this connection, it is worth noting that in the Packers and Stockyards Act of 1921, the Secretary of Agriculture was empowered to fix rates and charges of stockyards companies and commission firms so as to be "just, reasonable, and non-discriminatory." This power has been exercised in several instances. Marketing agreements also give the Secretary a large measure of influence in seeing that marketing charges shall be reasonable and non-discriminatory and in eliminating unfair trade practices.

for the staple commodities (see p. 913), that is, "parity," or the attainment of pre-war purchasing power through prices that would stand in the same ratio to prices of what the farmer buys as they did in 1909-14.

The marketing agreement and "Secretary's order" device appears to be limited in usefulness practically to a relatively small number of cases of highly specialized production far from terminal markets and in which co-operative organization has already been carried to a high degree of strength and efficiency, and to the application, still somewhat uncertain as to its ultimate success, in fluid milk.⁸⁹

Owing to the complicated relationships between various milk markets, the line of cleavage between interstate and intrastate business has been extremely difficult to determine. States and municipalities have for some time sought to deal with the milk problem from the local end. Some dozen states have established state milk boards to complement the schemes of regulation evolved in the various fluid milk marketing agreements. Proposals have not been wanting that, in view of the peculiar conditions surrounding this

⁸⁹ The marketing agreement provisions of the Agricultural Adjustment Act were further amended and re-enacted in 1937 as a separate Marketing Agreement Act. On July 13, 1939, a United States district court (Northern District of Illinois, Eastern Division) held (in *United States v. The Borden Company et al.*) that "by the Agricultural Marketing Act the Congress has committed to the Executive Department, acting through the Secretary of Agriculture, full, complete, and plenary power over the production and marketing, in interstate commerce, of agricultural products, including milk." Hence the court dismissed a case brought by the federal Department of Justice under the anti-trust acts on the ground that Congress had deprived them of jurisdiction on all such matters so far as producers and distributors of agricultural products are concerned. This view seems to the writer to present a strained interpretation of the statute, and the Secretary of Agriculture in addressing the Institute of Co-operation on Aug. 7, 1939, took occasion to indicate that he did not share this view. He said: ". . . the policies of the Department of Agriculture and the Department of Justice in trying to cope with the Chicago milk situation are in harmony with each other. Both are designed to protect the public interest. . . . Even if a marketing agreement is placed in effect in the Chicago market, it can deal with only a part of the problem. The Marketing Agreement Act does give the Department of Agriculture authority to regulate milk prices paid by distributors to producers. But the Department of Agriculture has no authority whatever to regulate resale prices. Consequently, if monopolistic practices exist in the milk distribution industry, the only agency of government having any authority to act is the Department of Justice."

The U.S. Supreme Court in October 1939 agreed to hear argument on appeal of the Chicago case. Dismissing the view of the district court as to lack of jurisdiction, the Supreme Court returned the case for re-hearing on the merits of the issue. It came up on the calendar in April, but was then postponed.

commodity, the supplying of fluid milk be declared a public utility and all phases of production and marketing closely regulated.

State governments have been active during recent years also in other marketing fields. Laws governing quality standards—such as the ripeness which must be attained by fruit before it can be shipped—or controlling cold storage, use of preservatives or spray materials may be cited. But recently there have even been measures controlling the market flow, such as the state “prorate act” of California, under which market quotas may be established, and a state marketing agreement act which extends many of the provisions of the federal act to the field of intrastate business.

Production and income adjustments. The major features of the Agricultural Adjustment Act of 1933 were designed to effect enlargement of farmers’ incomes directly through cash disbursements or indirectly through measures designed to enhance the market price of those “basic” products—wheat, cotton, corn, hogs, rice, tobacco, and milk—dealt with in the act. This measure by no means turned its back on the educational approach traditional in government’s relation to agriculture. But it adopted many of the proposals of more positive action which had been advanced by agriculturists and others during recent years. Notably it undertook to implement the mandate given by Congress to the Federal Farm Board to promote “orderly production” which, in the Board’s latter days, had turned toward investigation of the possibilities of land use programs or other types of production control. The Adjustment Act also picked up many of the proposals contained in the equalization fee and domestic allotment plans, which had been rejected in 1929 in favor of the Farm Board experiment. Spokesmen for these measures had continued active in support of their several proposals and had finally been driven by the force of the depression to get together on a compromise measure which would give the Secretary of Agriculture a considerable latitude of power to apply to the problem any of the devices which appeared to him likely to “effectuate the purposes of the act.”

Two distinctive features were embodied in the act of 1933. (1) The Adjustment Administration undertook to make cash income (“benefit payments”) to farmers, supplementing what they could realize for their crops in the market. In part, these payments were

financed directly from the public treasury, but in the main it was intended that they should be collected from processors and thus paid either out of the processor's margin or shifted by him to the consumer's shoulders in the form of a price advance. (2) These payments were conditioned on farmers' compliance with control plans designed to bring the total supply of a given commodity down to a point where its market price would give the farmer a sufficient return (1909-14 "parity") without benefit payments.

Thus it will be seen that the Agricultural Adjustment Act of 1933 put the government in two positions which went beyond any which it had occupied before with reference to the agricultural industry. In many previous measures it had sought to ameliorate the lot of the farmer by raising his technical efficiency or improving his marketing or credit facilities. Now it was definitely said that the government accepted responsibility for restoring the material well-being of farmers as a whole to the level that they had occupied in their most favored previous peace-time period. This was not undertaken as a drive to benefit agriculture regardless of its effects on other parts of the system but as one related phase of a four-point program which embraced also currency and banking measures, industrial revival, and the supplementation of private employment through public works, the C.C.C., and other agencies.

In part this action appears to have been motivated by the view that restoration of the purchasing power of agriculture would have a quickening effect on the whole economy, such as would, in conjunction with other recovery measures, soon reduce if not obviate the demand for further direct income payments. In part, also, it appears to have been motivated by the view that agriculture since the war had been a disadvantaged economic area in a society becoming increasingly industrialized and, therefore, needed special treatment by government if the standard of living of farmers were to be kept up to the level of other classes. Up to the present time, general recovery has not been so extensive or well sustained as to remove the deficiency in agricultural income as measured by the standard accepted as the official criterion,⁶⁰ and the subsidy features of the agri-

⁶⁰ "The ratio of prices received to prices paid" by farmers as based on the 1909-14 average stood at 95 for the year 1929, declined to 61 for 1932, rose to

cultural program have tended to receive more rather than less emphasis, as will appear in our subsequent discussion.

The second change in the character of government relation to the agricultural industry as embodied in the Agricultural Adjustment Act was in its passing from the role of advisory guidance to one of over-all planning and implemented activity designed to determine both the direction and the magnitude of agricultural enterprise. It should be noted, however, that even this degree of governmental control did not entirely supersede the personal judgment of individual farmers. They might—and many of them did—remain outside the control programs, on the ground either that they disapproved in principle, that they were unwilling to undertake the “red tape” involved in participation, or that they could in particular cases make a better income by unrestricted production. But in the main, the financial inducements offered in the various adjustment programs, plus a certain amount of group pressure, have been sufficient to outweigh such independence of action.

In the case of cotton, the program was made virtually compulsory

93 in 1936-37 and dropped to 78 in 1938. U. S. Department of Agriculture, *Agricultural Situation*, December 1939.

Income from farm marketings averaged 10,666 million dollars during the 5-year period 1924-28, and for the following years it was, in millions of dollars:

1929	11,221	1935	6,969
1930	8,883	1936	8,212
1931	6,283	1937	8,744
1932	4,682	1938 (prelim.)	7,599
1933	5,278	1939 (prelim.)	7,711
1934	6,273		

During the last seven years income from marketings has been supplemented by government payments as indicated below, in millions of dollars:

Year	Government Payments	Cash Income Including Government Payments
1933	131	5,409
1934	447	6,720
1935	573	7,542
1936	287	8,499
1937	367	9,111
1938 (prelim.)	482	8,081
1939 (prelim.)	807	8,518

U. S. Department of Agriculture, *Cash Farm Income and Government Payments in 1939* (mimeo.), Jan. 30, 1940.

by the passage of the Bankhead Act of 1934. This act levied a practically prohibitive tax on the ginning of cotton in excess of individual quotas, whose national total in 1934 was not to exceed 10 million bales and, in 1935, 10.5 million. Small producers (up to five acres in 1934 and two bales in 1935) were exempt. The Kerr-Smith Tobacco Control Act also supplemented the Adjustment Act proper by levying a high tax on the tobacco sold by producers in excess of the allotments for which they were eligible under the voluntary control features of the Adjustment Act. Here a purpose was to prevent non-participants from benefiting by increasing their production.

A series of special sugar acts applied the quota idea in a somewhat different way. Instead of holding total production down to a maximum, they undertook to see that a certain part of the sugar consumed in the United States should be produced by domestic farmers, maintaining the existing acreage of sugar beets and sugar cane in the continental United States but limiting further expansion. The quotas were also designed to stabilize production in our insular areas and to check the decline of imports from Cuba, thereby restoring her purchasing power for agricultural imports from the United States. Another distinctive feature of these sugar acts was that they required domestic producers who received benefit payments under them to pay specified minimum wages to their laborers and not to employ child labor.

Great emphasis was placed by the Administration on the democratic participation of farmers themselves in the determination of the adjustment programs for the several commodities and in their subsequent enforcement. It stressed also the fact that the programs did not contemplate coercion but simply the setting up of pecuniary inducements. However, the extent to which these subsidized production control programs circumscribed farm managers' operations caused statutes and programs to be widely criticized as "governmental regimentation." When the Adjustment Act came before the United States Supreme Court, it held by a six to three decision that such control as was exercised under the Adjustment Act constituted "federal regulation of a subject reserved to the states."⁶¹ The major-

⁶¹ In the light of this decision, Congress promptly repealed the Bankhead Act and the Kerr-Smith Tobacco Act.

ity took the view that purchased compliance constituted control no less than would a specific legislative mandate.⁴² The minority view was that "the suggestion of coercion finds no support in the record or in any data showing the actual operation of the act. Threat of loss, not hope of gain is the essence of economic coercion."

While the Supreme Court in this "Hoosac Mills" case ruled that the proceeds of a processing tax could not be used as the means "for purchasing . . . submission to federal regulation," it followed the broader interpretation of the federal spending power enunciated by Hamilton and accepted by Mr. Justice Story rather than the narrower Madisonian interpretation of the Constitution. This right to spend federal monies "to provide for the general welfare" as Congress may interpret that term, encouraged the Administration to believe that an amount of "income supplement" no less than that disbursed as compliance payments under the old A.A.A. could be continued under a program less obviously directed toward production control. The shift in emphasis from acreage control to soil conservation and the change in the legal forms for disbursing income supplements so as to comply with the ruling of the Supreme Court was effected under the Soil Conservation and Domestic Allotment Act of February 29, 1936.⁴³

Soil conservation and income adjustment. Of course the general subject of soil conservation had for many years been a part of the research and teaching programs of state agricultural experiment stations and extension services as well as the federal department.⁴⁴ This work had emphasized problems arising from water erosion in the southern states but, following the great drought of 1934, wind erosion in the Western Great Plains and adjacent areas diverted attention sharply—even dramatically—to this phase of the problem also. The new act was designed to articulate the new work with the pro-

⁴² *U. S. v. William M. Butler et al.*, receivers of Hoosac Mills Corporation, 291 U. S. 1.

⁴³ 49 Stat. L. 1148. This act was in the form of an amendment to an act of Apr. 27, 1935, designed to co-ordinate the several phases of soil conservation work which previously had been scattered among various bureaus of the Department. The act of 1935 continues in force and is administered by the Soil Conservation Service of the Department of Agriculture.

⁴⁴ There had also been some soil erosion work in the Department of the Interior but this had been transferred to Agriculture about a month before the passage of this act.

duction programs of the Adjustment Administration.⁶⁶ To this end it included also certain amendments to the Adjustment Act⁶⁶ so that income supplement payments could be directed to meeting soil conservation needs.⁶⁷ For the purposes of this chapter, it is these aspects of the conservation program that concern us primarily. It is through the grant of large funds and the setting up of disbursement devices based on conservation work that the federal Department of Agriculture exercises a significant power to influence and direct the business of agriculture.

Section 7 (a) of the Soil Conservation and Domestic Allotment Act of 1936 stated the policy and purposes of the act to be:

(1) preservation and improvement of soil fertility; (2) promotion of the economic use and conservation of land; (3) diminution of exploitation and wasteful and unscientific use of national soil resources; (4) the protection of rivers and harbors against the results of soil erosion and in aid of maintaining the navigability of waters and water courses and in aid of flood control; and (5) reestablishment, at as rapid a rate as the Secretary of Agriculture determines to be practicable and in the general public interest, of the ratio between the purchasing power of the net income per person on farms and that of the income per person not on farms that prevailed during the five-year period August 1909-July 1914, inclusive, as determined from statistics available in the United States Department of Agriculture, and the maintenance of such ratio. . . . In carrying out the purposes of this section due regard shall be given to the maintenance of a continuous and stable supply of agricultural com-

⁶⁶ "Instead of terminating the farmers' efforts permanently, the decision of the Supreme Court in the Hoosac Mills case had the effect of hastening a transition which had long been planned. This was the transition from the temporary emergency phase of the adjustment programs to a long-time phase which would give a larger place to soil conservation and improved farm-management practice.

"Such a transition was originally planned by the Agricultural Adjustment Administration in late 1934 and early 1935. It was the subject of discussions with representatives of farmers, agricultural colleges, and extension workers in a series of regional conferences in 1935.

"President Roosevelt in a statement on October 25, 1935, had announced the Administration's intention to shift the program to a long-time basis. Hence the Hoosac Mills decision, when it came, precipitated as a sudden change that which had been planned as a gradual one." U. S. Department of Agriculture, *Agricultural Conservation, 1936*, p. 1.

⁶⁷ Other provisions of that act not invalidated by the Supreme Court continued to operate as before.

⁶⁸ Besides the preservation and restoration of agricultural resources, flood control and the protection of navigable streams are embraced in the stated objectives of this act.

modities adequate to meet consumer demand at prices fair to both producers and consumers.

To enable the Secretary of Agriculture to carry out these purposes, there was authorized an appropriation "for any fiscal year not exceeding 500 million dollars."⁸⁸ An elaborate system of payments was devised for the several regions, designed to induce farm operators to devote their energies to the production of certain crops rather than others and to follow cultural practices favored by the administering authority. In general the effects were to direct agriculture from more intensive to more extensive types of farming and to induce the farmer to forego volume of production in the short run in the interest of restoring and maintaining the productive capacity of his soil. Payments were made for reduction in acreage of "soil-depleting" crops and for increasing acreage of "soil-conserving" and "soil-building" crops. All the crops which had been the subject of control programs under the old action with some additions—practically all the cash crops—were placed in the "soil-depleting" category.

Under this program, the procedure for adjusting acreage and production of principal crops toward some officially predetermined level became more comprehensive and flexible, but somewhat less effective, than under the original legislation. It still involved the distribution of these adjustments among states, counties, and individual farms through a system of acreage "bases" which were intended to approximate normal production and against which performance could be measured. But these were in terms of the acreage devoted to soil-depleting uses rather than to the production of individual crops.⁸⁹ Moreover, contracts covering individual commodities were not used. Instead, there was simply an announcement of the provisions of the program, and payments were disbursed upon application by farmers when it was established that the prescribed conditions had been satisfied.

⁸⁸ Agricultural conservation payments actually made were 369.2 million dollars under the 1936 program, 460.3 million under the 1937 program, and 494.2 under the 1938 program. The latter two figures include payments under the Sugar Act of 1937, which contains certain conservation provisions.

⁸⁹ Special rates and bases of payment were provided for important individual commodities, but the participant was free to effect his adjustment among these as he chose.

Effort already begun under the original Agricultural Adjustment Act to have farmers represented as widely and actively as possible in the drafting of programs, the setting of specific objectives, and in passing on questions of compliance or accomplishment has been carried still farther under the soil conservation program from 1936 forward. The Soil Erosion Act of 1935 had contained a provision authorizing the Secretary of Agriculture to require such states as desired to participate in benefits under the act to pass suitable state laws for carrying out erosion control. This gave rise to a "standard" state law providing for conservation districts which, with minor modifications, was enacted by eighteen state legislatures in 1936-37 and subsequently by seven more. In the words of the chief of the Soil Conservation Service:

The formation of soil conservation districts opened for the first time an avenue through which the combined force of individual and governmental initiative can be exerted to the fullest in extending the principles of soil conservation to all of the country's agricultural land. Hitherto, such an avenue has been lacking; there has been no adequate link between the individual land user seeking to conserve his private resource and agencies of government engaged in the conservation of a resource vital to society and the nation as a whole. Direct contact between the two has been limited to areas selected for co-operative watershed demonstrations of erosion-control technique; the governmental approach to the whole broad problem of soil-erosion control has been based, consequently, upon the principle of education by demonstration. Now, as a result of state legislation, the soil conservation district emerges as a mechanism through which land users of any community may join with the Soil Conservation Service and other governmental agencies in the formulation and execution of conservation plans. The opportunity for co-operative action by these two conservation forces—the land user and government—thus is broadened out; for the first time it extends not merely into isolated demonstration areas, but to the whole of our farm and grazing lands.⁷⁰

Whenever 25 farmers in a given area petition to establish a conservation district, the question may be submitted to all the land occupiers within the proposed boundaries for a referendum vote. While the act itself is permissive rather than mandatory, any individual occupier is bound by the terms of the program after the

⁷⁰ *Report of the Chief of the Soil Conservation Service, 1937, p. 1.*

formation of the district is approved by a majority of the occupiers. Such district authorities have the power to purchase lands classified as submarginal and keep them in grazing or timber, or otherwise to control land use within the district under zoning regulations.

Besides these administrative districts, the device of county advisory committees has been extended and systematized.

In 1936, committees of representative farmers in 2,400 counties worked out tentative over-all goals for agriculture in their counties. They studied their individual counties from the viewpoint of conservation and other long-time objectives and accumulated information which can become the background for an approach to long-time goals for each county. When these goals are adapted to individual farms and fitted into state, regional, and national plans, the basis is established for an action program that involves local adaptation, local participation, and greater voice in development and administration by local groups within a framework of co-ordination by a national agency.¹¹

The committees' functions were somewhat enlarged under the Adjustment Act of 1938. Before examining the provisions of this act, we must trace certain of its features through their evolution from the original Adjustment Act and the programs formed under it.

Commodity loans. While the production problems of agriculture were being dealt with from the conservation approach, the type of effort undertaken by the Federal Farm Board in the direction of stabilizing market prices through government support of the market at times of acute weakness had not been abandoned. "Commodity loans" on corn and cotton were begun in 1933 and have been used intermittently ever since, the list of commodities on which loans were made having been rapidly expanded since 1937.¹² The corn loan of 1933-34 extended a loan of 45 cents a bushel to farmers who stored corn under seal on their own farms at a time when prices at country markets averaged about 35 cents. Thus encouraged, corn farmers stored some 271 million bushels. A "ceiling" was placed above this support effort by making the loans subject to call when

¹¹ U. S. Department of Agriculture, *Agricultural Conservation, 1936*, p. 13.

¹² Before this expansion of the list of commodities eligible to loans under the A.A.A. was effected, there had been some loans of essentially similar character carried by the R.F.C.

the market rose to 75 cents a bushel at Chicago. In practice, most farmers fed the corn on their own farms as need appeared during the subsequent year when feed shortage developed as the result of a severe drought, or sold it for cash and repaid their loans, mostly before the extended maturity date, October 15, 1934. Besides such advantage as farmers derived from the operation, the Commodity Credit Corporation made a net profit of nearly half a million dollars on its operations.

The first cotton loan was made on a basis of 10 cents for middling $\frac{3}{8}$ -inch cotton on the New Orleans "spot" market, with loans callable when the market reached 15 cents a pound. Some 2.3 million bales of warehoused cotton were borrowed on by farmers. Although the price rose to 12 cents within a few months, cotton farmers were less inclined to sell their product and repay the loans than were corn farmers, who in this year had the pressure of feeding needs as an inducement to liquidation. Through a succession of cotton loans, there has been apparent a tendency toward persistent speculation by farmers in a very non-perishable product which cannot be consumed on the farm, and the use of political pressure to set the loan rate above the point justified by market conditions and outlook. The result has been a continued accumulation of cotton in the government's hands.

From the start, the Adjustment Administration drew a sharp distinction between its situation and that of the Federal Farm Board on the basis that it was in a position if not of control at least of influence toward bringing subsequent production in line with the absorptive power of the market at the desired price level. To this end it was required that any farmer who received such a loan must agree as a condition thereto that he would become a participant in the control program of the following year.⁷³

⁷³ Created as an independent agency in October 1933, the Commodity Credit Corporation was transferred to the Department of Agriculture by the reorganization plan of July 1, 1939. It is authorized, with the approval of the Secretary of the Treasury, to sell bonds, notes, and debentures to the amount of 900 million dollars unconditionally guaranteed as to both principal and interest by the United States. It makes loans through agencies designated by the Reconstruction Finance Corporation. Besides loans on cotton and corn, it has extended credit on wheat, tobacco, wool and mohair, gum turpentine and gum rosin, peanuts, raisins, dates, figs, prunes, and butter.

Ever-normal granary. In fact, the Secretary of Agriculture argued that a comprehensive and continuous system of loan operations should be used to accumulate the "surplus" in years of abundant yield. These stocks were to be liquidated in short crop years and the scale of production operations meanwhile was to be adjusted with reference to the evolving supply-and-demand situation. Such is the essence of the "ever-normal granary" proposal which has been at least partially provided for in the Agricultural Adjustment Act of 1938.¹⁴

Under this law the conservation program and payments are continued, the acreage of "soil-depleting" crops which the farmer may produce (and still receive benefit payments) being an allotment of his "equitable share, as determined by the Secretary, of the normal national production . . . required for domestic consumption and export, adjusted to reflect the extent to which their utilization of crop land on the farm conforms to farming practices which the Secretary determines will best effectuate the purposes" of the act. Loans through the Commodity Credit Corporation are authorized for all farm products upon recommendation of the Secretary of Agriculture with the approval of the President. For wheat, cotton, and corn, such loans become available to participants in the conservation program when the prospect is for a "crop in excess of a normal year's domestic consumption and exports" or if the farm price on a specified date is below 52 per cent of parity for wheat and cotton or 75 per cent for corn. The amount of such loans may range from 52 to 75 per cent of the parity price. These rates apply to farmers co-operating in the conservation program. To others the rates are 60 per cent of those applicable to co-operators. These loans are expected to result in accumulation of carry-over stocks in good crop years. If the payments in connection with acreage allotments under the conservation plan fail to keep these stocks from reaching very high levels, then "marketing quotas" will be imposed, subject to a referendum vote of the farmers. If more than one-third of the farmers vote against the application of marketing quotas, they cannot be imposed, but no further commodity loans shall be made before the second succeeding marketing year for that commodity.

¹⁴ 52 Stat. L. 31.

Marketing quotas were, with the approval of the producers, imposed on cotton and two types of tobacco during the 1938 season. They were announced also for the 1939 crop and the matter submitted to a referendum vote of the growers on December 10 and 17, 1938. Cotton farmers approved the use of quotas by a majority of 84 per cent.⁷⁵ Growers of Burley tobacco returned an affirmative vote of 61.2 per cent, growers of dark types 60.5 per cent, and of flue-cured 56.9 per cent. These majorities being less than the two-thirds required under the act, all three marketing proposals were rejected. The referendum of rice growers showed a majority of 52.6 per cent against the quota. A cotton marketing quota has been approved by growers for the 1940 season.

Crop insurance. Somewhat linked to the ever-normal granary proposals has been the development of all-risk crop insurance. Commercial insurance companies had in the past made rather extensive but disastrous attempts to develop crop insurance. The Federal Crop Insurance Act of 1938⁷⁶ attempted to avoid the difficulties encountered by the commercial companies, through utilizing fully the more adequate information now available as to the production history of the different sections, by having wider geographical coverage, and by providing for payment of policy premiums and benefits "in kind."⁷⁷ For the 1939 crop, policies were written for 170,000 wheat growers, and larger participation is expected for

⁷⁵ The carry-over of this crop at the beginning of the new crop year amounted to 13,600,000 bales—600,000 above any previous peak. About three-fourths of this amount was pledged to the government as collateral under the various cotton loan operations. This figure may be compared with 3.6 million bales of cotton holdings financed by the Federal Farm Board at the peak of its holding operations through the Stabilization Corporation and co-operative associations.

⁷⁶ 52 Stat. L. 72.

⁷⁷ Thus it was argued that, when crops were abundant and prices low, a very large number of farmers would participate in the insurance scheme and that their premiums in kind would build up a substantial stock of the given commodity (in addition to those quantities stored under commodity loans). In years of short crop and high price, such stocks would automatically be paid out as insurance settlements. In so far as these were feed grains used on the farm, they would tend to hold down the farmer's cash outlays or prevent the sacrifice of stock for lack of feed. In so far as they were commodities processed off the farm, they would give him an additional volume to sell at a time when prices were relatively high. Since such stocks are released into market channels automatically through the process of settlement of insurance claims, there would not be the difficulty encountered by the Farm Board in liquidating stocks because of the probable price-depressing effect of such action.

1940. It is too soon to know whether this activity as actually administered will be self-supporting⁸ or will entail a public burden, and whether it will have the effect of strengthening the hold of farmers on inferior producing regions or will stimulate the abandonment of such regions in favor of those where the weather hazard is less. Even if it should prove that an element of subsidy is involved, it may be borne in mind that in part at least this may be the alternative for non-recoverable seed and feed loans or outright relief distribution by federal or local public agencies or by such private bodies as the Red Cross.

Surplus disposal. Another device by which government agencies have sought to carry out the general policy of supporting agricultural prices which has developed during the last decade is that known as "surplus disposal" operations. These are of two kinds: disposal within commercial channels and diversion to relief uses. Both were experimented with by the Federal Farm Board, which in turn borrowed the idea from earlier commercial experience. We referred above (p. 901) to pooling operations in the grape and rice industries of California, the latter of which was designed to effect export "dumping" and the former something which could, not inappropriately, be called "domestic dumping." As this device was used by the Farm Board, part of the grapes were held back from table use and allocated to raisin, wine, brandy, and other lower-value uses in which a given volume would have less pronounced effect on prices, a "floor" being put under the whole price structure by dumping into non-human consumption as stock feed or fertilizer or allowing a substantial part of the fruit to go unharvested. Instead of leaving each individual producer to determine where the lines of demarcation for the several uses or between use and non-use are to be drawn and to suffer the losses of his own errors in judgment or lack of information, it centralized the operation for a significantly large group of producers and gave them official support in the execution of a group strategy in the market.

⁸ The prospect of low yields of winter wheat in 1940, as a result of drought, carries a threat of heavy government loss before the agency has had time to accumulate reserves. Meanwhile, separate acts to extend the plan to cover cotton have been passed by both Senate and House and appear likely to result in a conference act which will become effective for the 1941 crop.

The Agricultural Adjustment Administration has expanded and systematized diversion operations of both commercial and charitable types. It makes payments to processors of various agricultural commodities designed to make it possible for them to take more of the various articles into by-product or other relatively low-price uses as a means of maintaining a differentially higher scale of prices in the major market use. Thus, for example, peanuts or olives have been diverted to the oil mill, dried fruits to the jam factory or distillery, and cotton to use in road building or the making of bale coverings. Nuts, dried fruits, wheat and flour, and a few other commodities have been diverted to the export market.

The illustrations just cited call attention to the fact that diversion operations are used in conjunction with marketing agreement programs for minor products as well as being a supplement to the major programs for staple commodities under soil conservation and "ever-normal" granary procedures. We have already discussed the manner in which the control committees might apportion market stocks between higher-value and lower-value uses. From the beginning, however, marketing agreements have provided that in addition to such apportionment, there might be special allotments at cut prices into "non-routine" markets for promotional purposes. They also provided that product in excess of total marketing quotas might be distributed gratis through charitable channels, protected against competition with the commercial market.

Gratuitous distribution to persons on relief, begun under the Farm Board, has been greatly expanded and institutionalized under the Agricultural Adjustment Administration. The Federal Surplus Relief Corporation, organized in October 1933, was followed by the Federal Surplus Commodities Corporation, which still continues in operation, purchasing a wide variety of agricultural products (41 commodities last year). Such products are given in addition to relief allowances, and the manner of distribution is such as to prevent these goods so far as possible from competing with commercial food supplies. Stocks purchased by the Federal Surplus Commodities Corporation are shipped direct to state relief agencies in response to their requests and are distributed by them to persons on the relief rolls or sometimes to non-relief families just on the borderline.

They are also given to nursery schools in poor neighborhoods or used to provide public school lunches. Expenditures for the fiscal year 1939 were 66.6 million dollars. Funds for this purpose were at first provided by the F.E.R.A. or drawn from general appropriations of the A.A.A., but since 1935 they have been provided by allocating to this and certain other purposes 30 per cent of the revenue derived from import duties on agricultural products under section 32 of the act of 1935 amending the Agricultural Adjustment Act.

The general purpose here has been to obviate or lessen the demand for operations designed to curtail production, by increasing consumption at those places in the system where, because of the low income of the recipients, such action would improve diet without resulting in appreciably lessened demand in the regular commercial market. The selection of commodities to be diverted to relief uses and the quantity and timing of such diversion are worked out by the Division of Marketing and Marketing Agreements of the Department of Agriculture which serves as a planning agency for the F.S.C.C. Both report to the Secretary through the same executive head.

In the spring of 1939, experiments were begun in a new method of distributing surplus foods, namely through "normal channels of trade." Recipients of relief were issued food stamps with which they could secure any of a list of officially designated surplus food commodities in any co-operating retail store, which in turn redeemed the stamps for cash from the F.S.C.C. The plan had been used successfully in more than twenty widely scattered cities and two or three county areas up to the end of 1939 and plans for extending it to include 100 cities and county areas are being actively pushed.

Export subsidy. While diversion operations through marketing agreements or "section 32 funds" have included occasional diversion to foreign markets under arrangements tantamount to an export subsidy, great reluctance has been shown about abandoning our traditional opposition to export bounties and making agriculture in any comprehensive sense an area of special treatment in this regard. But during the last few years long steps have been taken in subsidizing both wheat and cotton.

On August 29, 1938, the Department of Agriculture announced a "wheat and flour export sales policy for the 1938-39 marketing season, designed to enable United States wheat farmers to maintain their share of the world export trade." In the hope of maintaining such exports at approximately the 100-million bushel level, the Federal Surplus Commodities Corporation bought wheat in the domestic market and resold it to exporters at such lower prices as were necessary to secure its movement abroad. Losses were recouped from "section 32 funds." Since the purchase and resale method was not adapted to flour transactions, the plan was shortly modified so as to provide outright indemnities to flour exporters for losses incurred on foreign sales.⁷⁹ In August 1939, the wheat export program was extended to July 31, 1940 and indemnity for loss on export sales substituted for purchase and resale for wheat as well as flour. No flat rate of indemnity was provided, but competitive individual offers are received from exporters.

With the domestic price of cotton supported through a succession of government loans, carry-over stocks gradually rose to above 14 million bales, of which more than 11 million were in government hands. Export had declined to a point where fear was felt for our future position in the export market. Various proposals for some form of production control or the increase of domestic consumption had failed to produce results. Finally, an export subsidy of 1.5 cents per pound of lint cotton and comparable rates on cotton products was initiated on July 27, 1939. The announced purpose of this export program was "to assure the United States its fair share of the world trade in cotton and to do so by restoring the normal competitive position of American cotton in world markets . . . the United States [having] no intention of seeking more than its fair share of cotton exports as measured by the traditional position which this country has occupied in the cotton markets of the world."

The hope was expressed that this export bounty would be tem-

⁷⁹ After October 1938 costs of the flour export program were charged to the general A.A.A. appropriations rather than to section 32 funds. Up to the end of June 1939 foreign sales of American wheat and flour slightly exceeded 118 million bushels, of which 93.8 million had been assisted by subsidy payments, averaging 29 cents per bushel for wheat unground, and 22 cents per bushel for wheat in the form of flour. *A.A.A. Press Release No. 96-40*, and U. S. Department of Agriculture, *The Wheat Situation*, July 24, 1939, p. 8.

porary²⁰ and steps were taken to secure an international cotton agreement. Experience with similar efforts for an international wheat agreement, however, destroyed any great hope of securing an effective measure. Furthermore, the possibility of maintaining anything like a 9-cent domestic price level for cotton and present income supplements without perpetuating the surplus supply situation seems remote. A somewhat similar situation exists with regard to certain types of tobacco as well as wheat and lard. Proposals for export bounties on lard and tobacco have indeed been actively pressed.

Rural electrification. Since 1935, the Rural Electrification Administration had been undertaking to bring a larger proportion of the population within the area of electric service. (Compare p. 676.) To do this, it carries on research and promotional activities and allocates loan funds to public or private agencies to develop transmission or generating facilities or to prospective users of current for the purpose of wiring their premises or purchasing electric equipment. Generating plants are financed only in case no private plant is available or the rates are, in the judgment of R.E.A., higher than are compatible with necessary costs and with the possibility of remunerative sale of current if the rate structure is suitably adjusted. Allotments approved up to November 15, 1937 totaled nearly 80 million dollars, of which 76.3 million went for land and construction, 2.8 million for generating equipment, and 0.8 million for wiring and plumbing on patrons' premises. Such loans may not exceed 85 per cent of the value of the property and must provide for amortization over a period not to exceed 25 years in the case of plant and not more than 5 years in the case of domestic installation and appliances. The Electrification Administration makes no grants but only lends; its loan funds are derived from annual appropriations from Congress of 40 million dollars per year (till 1945) and credit extensions from the Reconstruction Finance Corporation up to a maximum limit of 100 million dollars subject to the approval of the President.

The general objective sought by R.E.A. is to reduce the prices of current to the farmer to levels below existing commercial rates.

²⁰ On December 6, the rate was lowered to three-quarters of a cent a pound. Export movement had strengthened and funds were shrinking rapidly.

Considerable reduction in actual cost is sought through simplification of design or other reduction of the construction cost of distribution lines. Paralleling this is the effort to intensify the demand for current to the point where this increased volume can be profitably furnished at low unit charges. This has involved not merely the installation of lighting fixtures in farm homes but more particularly the use of appliances which consume relatively large amounts of current, such as stoves, washing machines, refrigerators, food grinders, and other light farm machinery. Nearly a million and a half farm families are now being served through R.E.A.⁸¹

Considerable controversy has raged around this development. The electric utilities claim that it constitutes an invasion of their field of business. R.E.A. contends that it is simply acting as pace-maker in a field that private enterprise had served inadequately, being content simply to "skim the cream" of the business without sufficient effort to serve the needs of the community as fully as could profitably be done if vigorous promotional activity had been displayed and capital put in on the basis of prevailing low interest rates. Sufficient time has not yet elapsed to know whether the various projects will prove to be self-liquidating.

Complementary to the work of the R.E.A. have been the efforts of several state public utility commissions in stimulating and cooperating with private utility companies to extend their service in rural areas. This has involved the readjustment of rate schedules, the setting of lower minimum charges, reduction of construction costs, and public aid in financing.

Assistance for low-income farm families. Increasingly during the past few years governmental attention has been directed to the problem of rehabilitation (with or without physical resettlement) of farm families in the low income groups. From 1933 forward, the Federal Emergency Relief Administration differentiated the rural from the urban part of its problem, emphasizing the restorative

⁸¹ Certain broader ramifications of this development suggest themselves as, for instance, its possible effect in making electric current a conventional necessity for farmers' families, tending to draw them away from isolated locations up to the main highways along which electric service, no less than transportation service and postal delivery, can be most cheaply effected. See Edwin G. Nourse, "Some Economic and Social Accompaniments of the Mechanization of Agriculture," *American Economic Review (Proceedings)*, Vol. 20 (1930), pp. 114-32.

value of rehabilitation as superior to the palliative character of relief and also the economy of self-sustaining life on the land as against the high expense of direct and work relief.⁶² While F.E.R.A. was concerned in relieving the destitution of families from industrial towns or "stranded" areas, such as certain coal mining regions, it was also concerned with rehabilitation for two types of farm families proper, namely, (1) those who by guidance and some financial aid could improve their income position on the land already occupied, and (2) those who needed transfer from poor land as well as subsequent direction and financial aid.

Farm families in the first of these groups which seemed to be reasonably good risks were transferred from the relief rolls, each under an individual plan of farm and home operations by which they could progress toward becoming self-supporting. Agricultural experts gave advice and supervision on plans of diversification of production to promote a high degree of self-maintenance while specialists in home economics gave instruction in canning and preserving foods and in other matters of household economy. These adjustments often included negotiations with creditors for the scaling down and postponing of debt payments, and working capital was supplied through rehabilitation loans, often in the form of seed, livestock, or equipment.

Similar procedures were followed with reference to the second group, although the task of resettlement involved considerable additional effort on the part of the directing agency and greater strain of readjustment on the farm family. On April 30, 1935, a Resettlement Administration was established. In the strictly agricultural part of its work, this agency laid considerable emphasis on prevailing conditions of tenancy as a factor in the unsatisfactory income position of the farm families with whom they were dealing. Quite sweeping proposals were therefore made for the modification of existing institutions of land ownership. Several bills aiming at the promotion of farm ownership were introduced in Congress from 1935 to 1938. Most of these proposed simply to make loans available to farmers on more liberal terms, but other proposals included extensive acquisition of land by the government for resale to farm-

⁶² Compare p. 1171 ff.

ers, with such strict supervision of their operations and such long periods of amortization as to amount virtually to government landlordism.

In November 1936, the President appointed a special committee to make a report on a "long run program of how to alleviate the shortcomings of our farm tenancy system." Early extreme proposals were much moderated during the process of discussion by a subcommittee of economists and subsequently by the President's committee. The final recommendations were directed toward tenancy reform rather than aggressive promotion of owner-operation under government direction and financing. The final product was the Bankhead-Jones Farm Tenant Act.⁸³

This act authorizes the Secretary of Agriculture to make loans to farm tenants, share-croppers, and laborers, and to assist them in acquiring ownership of farms of "such size as the Secretary determines to be sufficient to constitute an efficient farm management unit and to enable a diligent farm family to carry on successful farming of a type which the Secretary deems can be successfully carried on in the locality in which the farm is situated." Interest is at the rate of 3 per cent, with principal to be amortized over not more than 40 years. For the year ending June 30, 1940 the sum of 40 million dollars is available. The act authorizes the Secretary of Agriculture to make rehabilitation loans to farmers for subsistence, improvements, and related purposes, and to develop a comprehensive program of land utilization. On September 1, 1937, the Farm Security Administration was set up as successor to the Resettlement Administration to carry out the purposes of the Bankhead-Jones Act and projects begun by the Resettlement Administration.

Land-use planning. Many phases of this program of rural rehabilitation, resettlement, and tenancy reform are but aspects of a larger movement for the re-examination of our national institutions of land ownership and use. Promotion of a maximum degree of freedom of individual enterprise in agriculture and of private ownership of farm land in fee simple has been relied upon for decades, back even to colonial times, as the simple and sufficient rule of agricultural prosperity. As the country passed out of the pioneer

⁸³ 50 Stat. L. 522.

stage, however, there emerged a growing realization that this situation held large possibilities of abuse, such as waste of soil resources, inefficient distribution of farmers, and commercial exploitation of settlers. As early as 1920 a Land Utilization Division was set up in the Bureau of Agricultural Economics to study problems of efficient land use, and various agricultural colleges and experiment stations also devoted special attention to this field of work. From 1907 forward, the federal government, as we have seen, had followed a more aggressive policy with reference to the segregation and management of large forest reserve areas, and several of the states, particularly in the northeast section of the country, had followed systematic forestry programs of their own.

Under the Federal Farm Board, the idea gradually took shape that an increasing amount of control over the ownership and utilization of land might be developed as a positive factor in control of agricultural production and thus of agricultural prices and farm income. The third annual report of the Board pointed out that such adjustments "involve important changes in the use of land." "Land-use programs," they said, "must provide for each tract of land that use which will enable it to yield the largest return to the labor and capital employed upon it, whether that be some form of cropping, or of pasture farming, or of forestry, or of pure recreational use, or some combination of these. Obviously, such programs must look a good way into the future, since some of the forms of land—notably the forest uses—may take several generations to mature."⁸⁴

The Board reported that it had studied the problem of land utilization "pursuant to the instructions contained in the Agricultural Marketing Act," but had not "undertaken any independent activities, preferring to assist the United States Department of Agriculture in developing a program. This has finally taken the form of setting up a national land-use planning committee, whose membership includes representatives of all federal and state interests concerned with land use, including a representative of the Farm Board. Much of the work of this committee is being done by a series of twelve technical advisory committees, on which members of the board's staff are serving. The board hopes that the national land-use

⁸⁴ *Third Annual Report of the Federal Farm Board (1932)*, p. 59.

planning committee will shortly reach the point of outlining a positive land-use program with the necessary provisions for its execution."⁸⁵

It is evident that the early A.A.A. effort to control acreages of particular crops had a certain bearing on this problem, and the subsequent shift to a soil conservation program moved still further in this direction. Long-time planning of land use was viewed as a natural outgrowth of, but quite different from, emergency adjustment efforts. The latter involved small adjustments on individual farms all over the country, whereas comprehensive long-time planning would require the removal of large areas of inferior land from crop production and the development of well-balanced, efficient systems of farming on land remaining in cultivation. To aid in the development of such a forward-looking policy of land use planning and to deal with the problem of relating future plans of the A.A.A. to such requirements, a Land Policy Section was included in the Program Planning Division established in the reorganization of the A.A.A. in December 1933.⁸⁶ This section worked in close collaboration with the Bureau of Agricultural Economics, and jointly they attempted to bring about an expansion in basic land utilization research as well as bring the results of this research to bear upon the problems encountered in the formulation of action programs.

During the summer of 1933, a seeming conflict of purposes between the A.A.A. crop reduction program and the increases in cultivatable acreage resulting from irrigation projects undertaken by the Public Works Administration was recognized. This prompted suggestions that the effects of these irrigation projects should be more or less⁸⁷ offset by the use of an equal amount of public works funds in the purchase of marginal lands and their withdrawal from cultivation. Discussion and study of these proposals contributed to

⁸⁵ The same, pp. 59-60.

⁸⁶ The task assigned to this division was stated as "to relate all programs and activities under the Agricultural Adjustment Act to a general attack on the whole front of the agricultural situation, to correlate the programs for all commodities and to shape the entire program into a more coherent whole which will constitute an advance through emergency measures to an established and lasting agricultural industry to the ultimate benefit of the whole nation." *Agricultural Adjustment, May 1933 to February 1934*, p. 15.

⁸⁷ The limitation of irrigation works to those economically justified has, of course, never been politically possible.

the adoption of a program of acquisition of low-grade lands and stimulated further interest in the general problem of land use planning.

Through the land purchase program the government undertook to acquire land which was sub-marginal for the uses to which it was being put and to divert it to more suitable uses such as recreational development, forestry, wild life preserves, or grazing.⁸⁸ After development such land was to be turned over to whatever agencies seemed to be in the best position to administer it in the new use. For example, recreational areas might be turned over to the National Park Service, grazing lands to the public domain,⁸⁹ and wild life preserves to the appropriate state agencies.

At the outset it appears that this venture was looked upon as the beginning of large-scale land purchases through which the federal government would ultimately acquire a large part of the lands classified by the agronomists and farm management specialists as unsuited to private economic use. Very soon, however, it became apparent that such an ambitious policy was not going forward at once and the purchase projects actually undertaken (approximately 9 million acres) have been viewed as demonstrations of methods for correcting social and economic maladjustments arising out of im-

⁸⁸ Responsibility for the program of land purchase was placed in the Resettlement Administration in 1935, thence transferred to the Bureau of Agricultural Economics in 1937, and to the Soil Conservation Service the following year.

⁸⁹ A significant move toward securing most efficient utilization of grazing lands, both public and private, was initiated under the Taylor Grazing Act of 1934 (amended 1936). Under this act 142 million acres of public domain, together with an approximately equal amount of state and private range lands, have been brought under the general supervision of a Director of Grazing in the Department of the Interior. Under a system of decentralized administration in 49 grazing districts, it has been sought to develop such a system of "home rule" under local advisory boards as would stop over-grazing, permit the restoration of the range, and develop a grazing code which would recognize local customs and administrative needs. Under local rules of "fair range practice" grazing permits are issued, nominal grazing fees collected, and the proceeds applied to the physical improvement of range facilities. Eventually grazing permits for a term not to exceed ten years will be allocated on the basis of prior use and the character of applicant's land holdings, the total of permitted grazing being limited to the amount which the range can carry under good management practices without further deterioration and with provision for eventual restoration to its maximum carrying capacity. Under this act responsible livestock owners and stockmen's associations have been aided in bringing order into the notoriously lawless and wasteful sheep and cattle kingdoms.

proper land utilization. Projects were established in areas which land classification studies had shown to present the most serious land use problems and were located where they were expected to have the greatest educational value as demonstrations. Local living standards, number of cases on relief, local governmental finances, and other factors were taken into account in selecting project areas.

Within little more than a year after the program was initiated, land use problem areas were investigated in 45 states, 245 projects located in 469 counties were tentatively approved, 18,868,931 acres were proposed for purchase, 14,277,729 acres were appraised and options were taken on 6,242,656. Subsequently a more moderate goal of acquiring 10 million acres was adopted and this was substantially attained by the close of the fiscal year 1936-37. By that time 206 projects were under way involving the purchase of 9,148,903 acres, of which title had been obtained to approximately 56 per cent and the remainder was under option. Succeeding activity on this program has related chiefly to the development and improvement of these areas.⁹⁰

Although a purpose of this program has been to demonstrate methods that could be employed by state and local agencies in correcting major maladjustments in land utilization, in its development the federal government followed rather than led in types of work which had already been considerably advanced under various state governments.

New York State some five decades earlier had begun a program of acquisition of sub-marginal farm lands to be devoted to forest and recreational uses, linked with the protection of urban water supplies. From 1923 forward delimitation of areas for acquisition was greatly aided by studies made by the Farm Management Department of the State Agricultural College at Cornell University. Under a reforestation amendment to the state constitution in 1930 provision was made to devote funds eventually amounting to 20 million dollars to the acquisition of sub-marginal land for public use and for

⁹⁰ Funds for purchase of land consisted of about 48 million dollars from emergency appropriations, supplemented since July 1937 by 15 million dollars appropriated under Title III of the Bankhead-Jones Farm Tenant Act. Nearly 60 million dollars of W.P.A. and P.W.A. funds have been expended in developing and improving the purchased lands for recreation, forestry, or wild life.

reforestation work. The total of state holdings now approaches 3 million acres. Pennsylvania and several New England states have followed a somewhat similar course. In the Great Lakes region Wisconsin took the lead in dealing with this problem, having taken the zoning device widely used in cities and adapted it to the rural situation. Under this plan, the state assists the people of the several counties in developing a pattern of land use designed to prevent uninformed settlers from attempting farming operations in areas where the hazards are unduly great and to save the public treasury from the expense of maintaining roads and schools for such stranded settlers. The best lands are used for settled farming communities. Summer use is made of other areas, while still others are zoned for the most extensive types of use—such as forestry, hunting, and fishing—under a license system remunerative to the state and local treasuries. Public acquisition of land is not a large factor in this program, but voluntary exchange of one type of land for another and change of location are frequent. Minnesota passed a generally similar law in 1939.

Impetus to this line of activity has also been given by the work of the National Resources Board and its Committee on National Land Problems.²¹ Established by the President on June 30, 1934 as the successor to, and upon the recommendation of, the National Planning Board of the Public Works Administration, this agency has given powerful support to the idea of land-use planning through its efforts (1) to inventory the resources of the nation, including land, research materials, and the experience of existing governmental planning agencies; (2) to encourage a great expansion of basic studies; and (3) to promote action at federal, state, and local levels through the co-ordination of existing lines of activity and the stimulation of new planning endeavors. In this connection it has fostered the establishment of planning boards in 46 states.

In order to co-ordinate the various lines of work of the Department of Agriculture which relate to land use, the Secretary in March

²¹ In the fall of 1933 during the discussions of the proposal to purchase land for retirement from farming, various interdepartmental committees were formed. One of these, appointed by Secretaries Wallace and Ickes, became permanent and was later established as the Land Section of the National Resources Board. In its work the other agencies engaged in land planning and land purchases collaborated closely.

1935 appointed a Land Policy Committee to pass on policy involved in all land projects of the Department. In 1937 this idea was carried even further in the establishment of an Office of Land Use Co-ordination. This office has the assistance of the Land Policy Committee and also of a liaison board consisting of one representative of each land use agency. Through regional offices in charge of regional co-ordinators it has also entered into the active promotion and encouragement of co-ordination and planning among states and among the various agencies within the state whose activities have a bearing upon land-use problems.

VI. EMERGING ISSUES

Despite the complexity of detail displayed in the relations which government has assumed to the agricultural industry during recent years, the main outlines of this relationship and of the policy, explicit or implicit, of which it is an expression may be sketched in a few broad strokes. Agriculture is patently an area of special treatment by state and federal government, particularly the latter. Both the willingness to accord special treatment and the character of some of the measures employed show the influence of a widespread and persistent attitude aptly described by J. S. Davis as "agricultural fundamentalism."⁹² Those who hold this philosophy maintain that agriculture is the base of the economic pyramid and upon it the strength and soundness of our entire economic system depend. Often this view as to the paramount importance of agriculture is applied not merely to the economic aspect of national well-being but also covers the physical health, the political stability, and even the moral character of our people. While such reasons for the special treatment of agriculture by government are naturally to be expected from rural leaders, their prevalence in other quarters is attested by the quotations presented earlier in this chapter (pp. 895-98) from the National Industrial Conference Board and the Business Men's Commission on Agriculture. "Farming," they said, "is more than an industry . . . it involves the national security, the racial character, the economic

⁹² On *Agricultural Policy 1926-1938*, pp. 24 ff. Some years earlier Edwin Cannan similarly deplored "the worship or undue glorification of agriculture." *Economic Journal*, Vol. 43 (1933), pp. 368 ff. On the other hand, see Black, *Agricultural Reform in the U.S.*, p. 58.

welfare, and the social progress of our people." "His is a proud heritage, last bulwark of true democracy. . . . That the farmer's problem may be approached and solved like any other business, industrial, or economic question involves a fallacy."

A second factor which has at times played a role in the adoption of measures for the special treatment of agriculture and which has exerted a continuing and powerful influence in determining their form and direction resides in the technical and economic character of the industry itself. It is one of wide geographical dispersion, with persistent adherence to a very small unit of business organization and management. In spite of the fact that, for peculiar reasons, certain large corporations grow some of their own supplies or otherwise engage in agriculture in the grand manner, the family farm still predominates overwhelmingly even in this machine age. The perfection of small units of motorized farm equipment has confirmed this character by making a high degree of mechanization possible with economy and without consolidation.

With the small-scale character of the operating unit thus confirmed and accentuated, government has gone farther and farther toward supplying larger overhead units of service, management, and economic organization. In fact, this took the form of aid in perfecting a distinctive type of private business association—the agricultural co-operative. It was designed to provide flexible association of individual enterprises for the performance of particular functions—notably marketing—without actual consolidation, while the government itself would perform various investigational and advisory functions for the whole industry. These approaches through co-operative association and educational agencies have been traced throughout the chapter. Our account of the evolution of governmental agencies for educational guidance shows that, though their origins reach back to the Civil War or beyond, they have undergone a striking change, mostly within the past decade. From 1929, forward, there has been definite acceptance of the view that government should not merely supply educational materials for the guidance of individual competitive enterprise but should afford also "action agencies" for the overhead organization of the whole industry.

The nature of this more active and comprehensive directional role must be clearly noted. Leaders in the new movement disavow either the purpose or the effect of superseding private enterprise by centralized bureaucratic regulation. Their intent has been to marshal the most adequate body of professional expert service through a decentralized system of state and federal agencies, to bring to the largest possible competent leadership group among farmers the materials upon which wise decision for the organization and operation of the industry could be based, and to provide democratic discussion and planning agencies through which these individual enterprisers and their professional counsellors can work out progressively those plans for the co-ordinated development of all branches of agriculture which would promote the largest measure of success and prosperity.⁹³ This development is described by Undersecretary

⁹³ The fact that a distinctive new relationship has been established between farmers as a group and the public agencies of agriculture was clearly recognized in connection with the administrative reorganization of the federal Department of Agriculture promulgated in October 1938. The administrative changes then inaugurated, said the Secretary, "are designed substantially to complete the task of putting the Department in the position to administer its new work [i.e., action programs] as efficiently as it has conducted research and educational activities" in the past. (U. S. Department of Agriculture, Memorandum for Chiefs of Bureau and Offices, Oct. 6, 1938, p. 12.) To this end, reorganization proceeded along four lines: (1) "streamlining" of the Agricultural Adjustment Administration for its permanent administrative task of carrying out specific agricultural programs year after year; (2) the segregation and grouping of all marketing and regulatory work under one central direction; (3) the marshalling of the resources of the whole department for planning through one centralizing agency, the Bureau of Agricultural Economics; (4) the correlation of all activities involving actual physical work on individual farms in the Soil Conservation Service.

Significant is the fact that this comprehensive reorganization is not merely a matter of departmental administration in Washington but embraces the active participation of individual farm proprietors through local, state, and federal agencies and aims to organize them into a nation-wide scheme of democratic intellectual leadership and concerted action. The redesigned Bureau of Agricultural Economics in exercising function 3 above is responsible for co-ordinating "programs and plans to guide the entire group of agricultural adjustment, conservation, and marketing services to farmers and the general public." In so doing it is to draw not merely upon the resources of the whole federal department, technical, statistical and economic, but also upon county agricultural planning groups, land-use planning committees, and state agricultural advisory councils serving "as a guide to the administration of public farm programs." The Bureau of Agricultural Economics has no operating responsibility but is designed as a great research agency intimately related to the Secretary's office on the one side, and to the actual operations of the industry on the other. It will be tied into the experiment station organization through a resident state representative and will stress empirical meth-

M. L. Wilson as "economic democracy." Starting with the single business enterprise, almost synonymous with the individual worker, this pattern of economic organization goes far beyond that which is typical of industrial, commercial, and financial institutions, to evolve a comprehensive agricultural system, nation-wide in extent. In so doing it has at two points clearly overruled the private initiative of the individual farmer or single concern by the voice of the majority.

The first of these steps was taken in the licensing provision attached to the marketing agreement section of the original Adjustment Act. While the provision was decidedly ambiguous in the original act, the amending act of 1935 made explicit the authorization of the Secretary of Agriculture (under the changed form of "Secretary's orders") to compel a minority of handlers of the produce to abide by a plan of distribution drawn up and approved by the majority or even (with the express approval of the President) without the approval of a majority of the handlers if two-thirds of the producers (three-fourths in the case of California citrus) approved the arrangement. The other type of constraint of the individual through community action occurs in the cases of the soil conservation district under the Department of Agriculture and the grazing district under the Department of the Interior.³⁴ Once a majority of the occupiers of such areas decide that community regulation of grazing or farming operations will promote their mutual advantage and draw up a code of "fair range practice" or a soil use program, the minority

ods of research. It expresses the belief that "farmers need the help that specialists can provide and specialists must draw on the experience and judgment of farmers." The new action program embodied in recent legislation is conceived as growing directly out of the traditional programs of research and education which have been developing since the Civil War.

³⁴ While there has undoubtedly been wider extension of the practice of group control of individual action in recent years, it would be a mistake to assume that the principle is really novel. From the beginning of forest reservations in 1891, grazing over increasing areas fell under governmental regulation. The controls exercised in the conservation district are less bureaucratic than those of the forest service but less democratic than those of the grazing district, which have been democratized to about the maximum practicable point. As to the local self-governing district, this is a device which has long been used under state law for the establishing of drainage districts, disease and pest control districts, and weed abatement districts. Essentially the same sort of group constraint of individual enterprise has also been developed in connection with irrigation enterprises and to a less extent for the purpose of securing uniform seed or varieties of orchard stock.

must adapt their operations to this group plan, policed by the group not the courts.

It is much too soon to appraise the significance of the changes which have taken place during the evolution of this scheme of industry-wide organization of agriculture under the leadership of governmental "action agencies." The broad issue which it raises should however, be clear. If it means not merely the largest potentiality of efficiency or collective planning but also maximum power for collective bargaining or group pressure in agriculture, we shall have a scheme of organization which, in the absence of a philosophy of moderation, might conceivably be used to the end of exploiting other industries or departments of the national economy. Naturally, every step that agriculture takes toward improving its own condition through such agencies is likely to provoke an outcry from other interests and to raise sharply the question whether the scheme of organization thus evolved for agriculture under government sponsorship advances the general interest or merely the interests of farmers as a class or of particular groups of farmers. In the latter case there is the further question whether special advantages are being conferred on farmers or whether they are simply being safeguarded against disadvantages under which they would otherwise suffer as a result of the institutional positions and prevailing policies of other interest groups.

In the last analysis, it is not possible to devise for any branch of economic life a scheme of organization which in any mere mechanical sense assures high effectiveness combined with a proper amount of restraint. Its economic and social soundness must depend on the conscious philosophy of those who are directing and participating in it. This is an obvious challenge to farmers and officials under the type of agricultural organization which government has developed or permitted to be developed for agriculture. The present Secretary of Agriculture has presented his argument for the safety and constructive values inhering in this line of institutional development in the following words:

It is necessary to obtain in legislation, not only a more effective expression of various group interests, but also more adequate recognition of the interdependence of the major economic groups. Our democratic form of

government functions most effectively when national policies reflect different group needs in due proportion, with group unity as the basis of inter-group co-operation. . . . There is no basic antagonism between town and country; there is not even true rivalry. Country and town are complementary and inter-dependent . . . have the same need for an increasing, properly balanced production and for an expanding market adequately supplied with buying power. Neither can profit by victimizing the other, or by conditions that give one or the other an undue temporary advantage. . . .

. . . True, there is less room for expansion in agricultural than in industrial production. Ultimately, the growth of population limits the need for farm commodities, whereas the only limit to the demand for many industrial products is the extent to which consumer buying power can be increased and diffused. Many consumers could use more farm products than they do today if they had more purchasing power. But an increase in the purchasing power of the urban low-consumption group can come about only through increased industrial activity and increased wage payments. . . . The farm proportion of the national income should not be too high. Above a certain level it cannot be stable. . . . Heretofore, most efforts at economic adjustment, both in agriculture and in industry, have looked toward reduction of output as a means of sustaining prices. The great problem is to discover how adjustment may promote balanced expansion, so that labor, capital, and natural resources can be employed and at the same time conserved. . . .

Our maturing economic system has brought with it new demands which cannot be met by the old self-sufficiency and the old individualism. Group interdependence has become the cornerstone of the new economy. . . . It is time lost for the farmers to try to get that which is not for the long-time welfare of the nation. Farm solidarity means united agricultural thought and action for the general welfare, rather than simply for the promotion of limited farm objectives.⁹⁵

Whether Mr. Wallace himself entertains these views as to the functional role of agriculture within the structure of the national economy with such tenacity or interprets them in such sound and realistic terms that his leadership, if fully accepted, would produce nationally and internationally optimum results is a question that will be answered only in part by the record of history. It involves a corollary question—whether any philosophy of general economic welfare can long prevail in the struggle against narrow group interest equipped with the weapons of political power.

⁹⁵ *Report of the Secretary of Agriculture, 1937*, pp. 1-2, 3, 5, 6, 8.

This issue touches particularly the problem of subsidy elements, which have become so large a factor in the several action programs. Any payment directed by government to the enhancement of the private income of farmers or rural residents beyond such income as they would derive from the ordinary operation of commercial agencies may be justified by its advocates upon sincere grounds of economic reasoning—which may or may not be sound; it may be consciously or unconsciously rationalized under the guise of economic reasoning; or it may, with complete frankness, be sought as a matter of “getting while the getting is good.” Anyone who has been closely in touch with agricultural activities since the World War must be aware that present grants in aid of agriculture fall within all three of these categories. If such payments are to be continued, or if they are to be wisely reduced and readjusted as to direction and timing, there is demand for greater understanding on the part of both rural and non-rural people as to the incidence which such manipulations of the national income have upon the functioning of the economic system.

For example, do present or proposed administered rates of interest on farm loans and the size and terms of their extension operate to promote the long-run prosperity of the agricultural industry as part of an inter-related national economy? Or do they operate to stimulate such extension of agricultural production in general or particular classes of farm products as to burden the market at the same time that its purchasing power is impaired through the tax withdrawals necessary to support the credit subsidy? From another point of view, is the direct benefit which farmers derive from an artificially lowered interest rate offset by a proportionately higher capitalization of their farm property?

Other subsidy payments go to the farmer as proprietor or to support the market in which his products are sold. In the former case the question is raised as to whether what is paid for as “conservation” has an economic value commensurate with its cost, whether its effect on the farmer is to improve his qualifications as a producer or to weaken his initiative and debauch his moral character. From another side, does it attract and hold in farming more people than the industry can efficiently employ? And does it activate the rest of

the economy by giving the farmer purchasing power in the market for other goods and services more than it retards other business by making raw materials and workers' living costs higher, taxes more burdensome, and commercial arrangements less flexible?

Subsidy payments in the marketing process⁹⁸ raise at least two significant issues. (1) Is the policy of export subsidy initiated with reference to wheat and cotton likely to be limited to these as particularly exigent cases? Or is this the thin entering wedge of a new type of commercial development which is destined to be rapidly and extensively enlarged—and with what results? (2) Is the gratuitous distribution of substantial quantities of foodstuffs a national benefit because of the social value of better nutrition of the poorer classes? Is it likely to pauperize any considerable group of the population so as to make a constantly increasing body of non-commercial demand which may serve as an excuse for the government purchase of large volumes of agricultural commodities? On the other hand, will such purchases inevitably be maintained at or expanded to such a level as to exercise a stimulative effect on the quantity of such products being produced? In terms of economic theory, are we definitely turning away from faith in the action of price changes as a regulator of production and, if so, have we substituted more useful devices for directing human and natural resources toward their most effective use?

By intervening actively as a factor in the distribution of the national income, the government has directed agricultural subsidies toward three general purposes: (1) adjustment of agricultural production and agricultural income in the area of commercial farming; (2) rehabilitation of ill-equipped, badly located, or misdirected farmers so as to become efficient, largely in terms of self-subsistence; and (3) relief.

With the pressure that the rapid succession of events has put upon

⁹⁸ An interesting question involving price control rather than market subsidies is raised by the marketing agreement device. Is the special treatment of the fluid milk problem likely to evolve into regulatory devices analogous to public utility regulation, or to be the precursor of legal price-fixing over a substantial part of the agricultural field? Comprehensive price-fixing bills have been repeatedly introduced over the past 15 or 20 years and this approach to the farm problem is still actively urged.

the thinking of administrative leaders and the pressure that interest groups have put upon their action, these issues have not been clearly differentiated.⁹⁷ However, their recognition cannot long be postponed or at least the unfortunate results of ignoring them will soon become evident. They must be considered both in terms of the economic results which flow from given acts and of the ends which we seek, as well as alternative roads by which they might be approached. The agricultural problem does not exist in isolation but as part of the functioning of the national economy. There is not even a segment of the population which can be delimited as that to which agricultural policy is limited. Both the numbers to be dealt with and the methods to be followed under the "farm security" program are intricately intertwined with those of the "social security" program being experimented with in the industrial and commercial field.

The vital issue here appears to be whether the methods of attaining these ends as laid down in present agricultural legislation and elaborated in administration can promote the desired results without unduly burdening the economy in other directions or whether some shift or sharing of this responsibility should be brought about. Proponents of present measures must face the issue of whether conditions can be made thus tolerable to the lower income groups in rural areas without retaining in this group or attracting to it such large numbers as both to increase unduly the cost of the educational and directional work and of attendant subsidy payments and likewise of producing such incidental products for commercial sale as would complicate to an impossible extent the maintenance of a satisfactory price structure for the predominantly commercial farming class.

The rural birthrate is definitely higher than that of the cities. Such surplus labor as is not drafted by urban callings remains on the land, and a substantial part of that which is turned off by industry and trade in times of depression drifts back to the country. If, under the name of agriculture, we are in fact assuming a localized responsibility for a reserve labor force whose utilization would lie outside

⁹⁷ See E. G. Nourse, Joseph S. Davis, and John D. Black, *Three Years of the Agricultural Adjustment Administration* (1937), Chap. XV.

agriculture, is the incidence of this burden falling equitably on industry and other appropriate groups under present fiscal arrangements? Would some other means of dealing with the problem spur employers to reduce the actual burden by increasing their own utilization of this labor, which is redundant so far as agricultural production is concerned? Obviously this simply ties back the problem of agriculture as a concern of government to the larger problem of how government can deal in its relationships with the several industries in such a way as to develop the highest standards of living through the fullest utilization of our total labor force with our total natural resources and accumulated capital.

CHAPTER XXIV

BITUMINOUS COAL

The public has long shown some special interest in the coal industry, as may be seen from the 19 governmental investigations of the industry between 1914 and 1937.¹ During the last quarter-century, the status of the bituminous coal industry has alternated between that of an area of special federal control, and that of a free competitive industry subject only to the police and taxing powers of the states,² and to the general federal controls set forth in Volume I.

During the war years, the mining and distribution of coal were subjected to a higher degree of control than any other large industry except the railroads and the recognized public utilities. In the years from 1919 to 1922, the bituminous coal branch of the industry was four times brought under special federal control for short periods, because of interruptions of production, shortages of supply, and high prices which resulted from labor difficulties in the mines and in transportation. In the period 1933-35 coal mining was regulated, along with other industries, under the National Industrial Recovery Act. Within a few months after the invalidation of the Recovery Act, bituminous coal mining was again made a special area of federal control by the passage of the Bituminous Coal Con-

¹ National Resources Committee, *Energy Resources and National Policy* (1939), p. 17.

² Because of the peculiar hazards of the industry, bituminous coal mining has for many years been the subject of special safety legislation in all the important coal-producing states.

The difficulties of the anthracite coal industry have so far been treated as a state rather than a federal problem, since all the important anthracite deposits are in one state (Pennsylvania). The United States Coal Commission, appointed in 1922, made a detailed study of the anthracite as well as of the bituminous coal industry, but since federal regulation—except during the war years and under the N.R.A.—has been confined to bituminous coal, this chapter will not deal with the anthracite industry. See 68 Cong. 2 sess., *Report of the United States Coal Commission*, S. doc. 195, Pts. I and III (1925). This is summarized in E. E. Hunt, F. G. Tryon, and J. H. Willits, *What the Coal Commission Found* (1925). An excellent recent study of the anthracite industry and its problems is contained in Commonwealth of Pennsylvania, *Report of the Anthracite Coal Industry Commission* (1938).

ervation Act, more commonly called the Guffey-Snyder Act.³ This act contained provisions for the regulation of coal prices and of the wages and hours of mine labor, and outlawed certain competitive trade practices as "unfair." When, within a year, this act was declared unconstitutional,⁴ the Bituminous Coal Act of 1937 (Guffey-Vinson Act) was passed. This act provides for regulation by a federal commission of prices of coal at the mines, and outlaws certain specified "unfair" competitive practices, but omits the labor clauses of the earlier act.⁵

We shall first sketch the history of the war-time and early post-war excursions of the federal government into the field of special regulation of coal production. Then, after examining the economic and political conditions which have given rise to the demand for special treatment of the industry and which have influenced the public to acquiesce in it, and after discussing briefly the regulation of the coal industry under the N.R.A., we shall describe the present act and its administration in more detail.

I. WAR-TIME REGULATION OF THE COAL INDUSTRY

The Food and Fuel Control Act of August 10, 1917 (Lever Act) provided, among other things, for control of prices, production, distribution, and storage of coal.⁶ Under this legislation, the President, on August 21, set basic tentative prices for coal at the mines, based upon cost of production figures which the Federal Trade Commission had supplied. He also set margins for jobbers. On August 23, 1917 he appointed a Fuel Administrator, who exercised control until after the Armistice. The Administrator extended control to include retail prices and the distribution of coal. Under a plan announced in October 1917, no retail dealer was allowed to charge a retail gross margin for coal or coke "in excess of the average gross margin, above his average cost, added by the same dealer during 1915, plus 30 per cent of the 1915 margin."⁷

³ 49 Stat. L. 991.

⁴ *Carter v. Carter Coal Co.*, 298 U. S. 238 (1936).

⁵ 50 Stat. L. 72. This act is to expire four years from the date of its passage. In July 1939, the functions of the Commission were taken over by a Bituminous Coal Division established in the Department of the Interior. See p. 972.

⁶ 40 Stat. L. 276.

⁷ Paul W. Garrett, *Government Control over Prices* (1920), pp. 162, 165-71,

The Fuel Administrator used the President's tentative prices as a basis for the initial fixing of wholesale prices, and for early revisions. Then, in January 1918 he appointed a committee of engineers to make a careful review of all coal-production costs in the United States, and to make recommendations concerning the continuation or revision of the prices previously fixed. This committee was to determine "a price fair to the public," and one that would "encourage legitimate production" while discouraging "inefficient and unduly costly operations." Moreover, the Lever Act required that the producers be insured "the cost of production, including the expense of operation, maintenance, depreciation and depletion, and . . . a just and reasonable profit."⁸

From the cost data which the Federal Trade Commission had collected from the coal producers of the United States, the committee prepared a control chart for each district which showed the relation between cost and tonnage. On each chart a line was placed, called the "bulk line," which showed the cost which must be allowed to assure a given high percentage of the maximum coal supply from each district, while ruling out the highest-cost producers.⁹ The bulk line ordinarily was fixed "to assure the production at a minimum of profit, of 90 per cent of the total capacity, thus cutting off the upper crust of high-cost producers." The Fuel Administrator fixed the price for each district by adding to the bulk line the profit margin which he thought necessary. Special prices for prepared sizes were often allowed.¹⁰

177-83. See also H. A. Garfield, *Final Report of the United States Fuel Administrator, 1917-1919* (1921).

⁸ United States Fuel Administration, *Report of Engineers Committee, 1918-1919* (1919), pp. 11-13.

⁹ The same, pp. 14, 16. In the excluded group were found: mines which had failed under normal competitive conditions and which were reopened under the stimulus of the prices which preceded government control; mines abandoned as exhausted but reopened for some remaining pillars; some new mines in the developmental stage; mines on very thin beds; small mines on outcrop coal; mines which had faults or in which the coal had split or where the quality had deteriorated; and mines so badly managed "as to show unwarrantable costs of operation."

¹⁰ Garrett, *Government Control over Prices*, p. 183. A study of the average costs, bulk line costs, and prices fixed for 84 per cent of the bituminous coal production in the United States for August and September 1917 shows that the margin between average costs and average prices fixed was 45.6 cents, and that the margin between average bulk line costs and the average prices fixed was 26 cents.

In addition to fixing prices, the Fuel Administration had to face the problem of efficient distribution of the coal mined, under conditions of acute railway congestion. In March 1918, therefore, there was established a system of geographical zones in which the Fuel and Railroad Administrations regulated the distribution and apportionment of coal. Producers were not allowed, without special permits, to sell coal beyond designated zones.

After the signing of the Armistice, the system of government regulation was promptly abandoned. Control of prices and distribution ended February 1, 1919, the only requirement left in force being a provision that all contracts for the sale of coal should carry provisions making them subject to any later revival of fuel control.¹¹

It may be noted in anticipation of later discussion that the basic problem with which the Fuel Administration had to deal was precisely the opposite of that which is the central point of current governmental planning for this industry. During the war the object was to prevent prices from rising to the level fixed by competition, and at the same time to encourage an increase of output, while under the present program the objective is to put prices above the competitive level. The war-time program aimed to protect the consumers, including the government, from the consequences of a sudden increase of demand; the current program aims to protect the producers and their employees from the consequences of a decline in demand.

II. EARLY POST-WAR REGULATION

From the discontinuance of the war-time system of control until 1933, the special regulation of the bituminous coal industry was in general left to the states. During the first few years of this period, however, several emergencies arose which led to the temporary re-establishment by the federal government of special controls of a character somewhat similar to those which were imposed during the war. These emergency measures were called forth by a succession of labor disturbances—some in the industry itself and others in the railroad service—which interrupted the production or distribution of coal, with resulting high prices and irregularity of supply.

¹¹ Hunt, Tryon, and Willits, *What the Coal Commission Found*, p. 81.

The first of these emergencies was a strike of the bituminous coal miners, which began on November 1, 1919 and lasted until the middle of December. On October 30 the President asked the war-time Fuel Administrator, Harry A. Garfield, to resume his duties, and Garfield put into effect an order restoring the war-time control over prices and distribution. On the same day the Director-General of the Railroads authorized the railroads, which were still under government control, to accumulate reserves of coal by purchase if possible, but, if necessary, by seizing coal in transit. However, coal destined to certain classes of consignees was excepted, in accordance with the priorities observed during the war.¹³ On December 10 the miners accepted a proposal that the President create a commission to make a report on the reasonableness of their wages, which would be used as a basis for the negotiation of a future wage agreement. Work in the mines was gradually resumed, and Garfield resigned as Fuel Administrator on December 13. On March 10, 1920, the Commission transmitted a report to the President which granted wage increases of 27 per cent, but denied the miners' request for shorter hours. The wage agreement was to take effect on April 1, 1920, and to continue until March 31, 1922. Federal control of prices also ended on April 1.¹³

In the spring of 1920, however, a strike of railway switchmen added to the shortage of coal, and together with the high prices which followed the coal strike of 1919 produced another crisis in the relations between the coal industry and the public. Under the Transportation Act of February 28, 1920,¹⁴ the Interstate Commerce Commission had been given power to prorate coal cars, and it proceeded to issue a series of orders through the summer of

¹³ *The Commercial and Financial Chronicle*, Vol. 109 (1919), p. 1658; *Majority and Minority Reports of the United States Bituminous Coal Commission*, 1920, p. 22. See also Hunt, Tryon, and Willits, *What the Coal Commission Found*, pp. 81-82.

¹³ *Majority and Minority Reports of the United States Bituminous Coal Commission*, 1920, pp. 5, 11, 24, 53; *The Commercial and Financial Chronicle*, Vol. 110 (1920), p. 1248; *Coal Age*, Vol. 16 (1919), pp. 856-57, 864, 935; Vol. 17 (1920), pp. 57, 650-52, 654, 669-70.

See also F. E. Berquist and associates, *Economic Survey of the Bituminous Coal Industry under Free Competition and Code Regulation*, N.R.A. Work Material No. 69, Vol. 1, pp. 163-67.

¹⁴ 41 Stat. L. 456, 476.

1920, which gave priority to fuel shipments consigned to public utilities and to public institutions. An attempt was made also to control the prices of coal through voluntary co-operation between the coal operators and the Department of Justice,¹⁵ and through indictments and threats of indictments under the anti-profiteering provisions of the Lever Act.¹⁶ In February 1921, however, the Supreme Court held that the relevant provisions of the Lever Act were unconstitutional.¹⁷ With the decline of industrial activity in the fall of 1920, and with improvement in the railway service, the occasion for government control came to an end.

In April 1922, the refusal of the operators to renew the 1920 agreement led to another general strike of union mine workers. The coal shortage resulting from this strike was made more acute by a strike of railway shopmen which took place in that summer. Again the federal government took steps to control distribution and prices. In May, the Secretary of Commerce, Herbert Hoover, reached an agreement with some 50 non-union mine owners on a plan for voluntary action on their part to prevent profiteering while the industry remained tied up.¹⁸ On May 31, he called a general coal-price conference at which the operators agreed to set up district and national committees and a plan for consolidation of buying. The operators also agreed that the Fuel Administration prices of October 1917 should be used as a basis for computing fair prices at the mine.

In July, the President appointed a Fuel Distribution Committee, of which Hoover was chairman, to make plans for the distribution of coal supplies. Their plans called for an administrative commission composed of representatives from the President's committee, and of the coal operators, the railroads, and the larger consumer groups. All of these agencies were to co-operate with the Interstate Com-

¹⁵ *The Commercial and Financial Chronicle*, Vol. 110 (1920), pp. 1577, 1687; Vol. 111 (1920), pp. 260, 1237, 1530, 1711, 2006, 2007. The operators pledged themselves to decline to ask or receive unreasonably high prices, and appointed fair practice committees to act with the Department of Justice in stabilizing the coal industry. See also *Coal Age*, Vol. 17 (1920), pp. 818, 823, 968, 1116; Vol. 18 (1920), pp. 83, 303, 308, 697, 919; Hunt, Tryon, and Willits, *What the Coal Commission Found*, pp. 83-85.

¹⁶ *Coal Age*, Vol. 18 (1920), pp. 308, 548; Vol. 19 (1921), p. 421.

¹⁷ *United States v. L. Cohen Grocery Co.*, 255 U. S. 81.

¹⁸ *The Commercial and Financial Chronicle*, Vol. 114 (1922), pp. 2202-03; *Coal Age*, Vol. 21 (1922), pp. 891-92, 975-76, 1057.

merce Commission in carrying out its preferential orders. Moreover, district committees were to recommend an allotment of cars only to those producers who agreed to comply with the fair prices agreed upon in conference with the presidential committee. In general, the prices agreed upon by the operators and the Secretary of Commerce, at their May 31 conference, were to be maintained.¹⁹ Apparently the only legal basis of this control was that derived from the Interstate Commerce Commission's control over the movement of coal cars.

On July 28, the appointment of a Federal Fuel Distributor was announced, and on July 29 the Fuel Distribution Committee asked each state that imported coal to create a central agency for the purchase, or the guarantee of purchase, of coal imported into the state. All such coal was to be consigned to a state agency which was to control its distribution.²⁰ The Federal Fuel Distributor undertook to see that coal would be sold to these agencies at a fair price, and stated that he would prorate the available supplies between the states on the basis of priorities declared by the Interstate Commerce Commission.²¹ The bituminous strike ended in the middle of August, and on August 28 the Fuel Distributor announced discontinuance of federal control of prices and of distribution of fuel.²²

In September 1922, Congress passed a coal distribution and anti-profiteering act (Cummins-Winslow Act), which provided for the appointment of a Federal Fuel Administrator, and which specifically authorized the Interstate Commerce Commission to prevent (by orders for priorities in car service) "the purchase or sale of coal or other fuel at prices unjustly or unreasonably high."²³ The act was to remain in force for 12 months from its passage, unless the Presi-

¹⁹ *The Commercial and Financial Chronicle*, Vol. 115 (1922), p. 500; *Coal Age*, Vol. 22 (1922), pp. 141-42.

²⁰ "By this arrangement, a great deal more mobility is given the state authorities in shifting coal to meet its local emergencies. Furthermore, this arrangement will remedy the financial impossibility of asking coal producers to ship to strange consumers whose reliability must be established." *The Commercial and Financial Chronicle*, Vol. 115 (1922), p. 605.

²¹ *Coal Age*, Vol. 22 (1922), pp. 176-78, 213-14, 217-18.

²² *The Commercial and Financial Chronicle*, Vol. 115 (1922), p. 1054; *Coal Age*, Vol. 22 (1922), pp. 257-58, 373.

²³ 42 Stat. L. 1025, 1026. *Coal Age*, Vol. 22 (1922), pp. 371-72, 421, 461, 505-06.

dent declared that the emergency was ended before that time. The new administrator appointed under this act appointed an advisory committee on transportation and on industry, composed, respectively, of railway and of business executives, to help speed up the coal traffic. He also directed (September 27) every producer of soft coal to make daily reports on the kind, amount, price, and destination of soft coal shipped. He revoked these orders on November 24, 1922.²⁴

One result of these recurring crises in the coal industry was the creation of a federal commission to examine and report upon the facts in the coal industry.²⁵ The commission, appointed by the President in October 1922, presented a five-volume report to Congress in December 1923, surveying in detail conditions in both the anthracite and bituminous coal industries.²⁶

Holding that the function of government in relation to the industry was to supervise and regulate but not to take over the mines, the commission recommended that the production of bituminous coal be regulated by the granting and withholding of transportation facilities, and by concentrating the car supply at the mines where it could be used most efficiently. It also suggested that a coal division should be set up in the Interstate Commerce Commission which should collect information concerning the quality of coal sold, the costs and profits of operators, and the earnings, living conditions, and living costs of the miners. The commission further recommended that whenever failure to renew a wage agreement threatened, the President should authorize a special compulsory investigation in order that a report of the facts should "focus upon the negotiators the irresistible moral pressure" to settle their differences and to supply the public with coal.²⁷

The settlement of the coal and railway disturbances of this early post-war period relieved the coal shortages and the high prices, and public interest in further special regulation of the industry lapsed.

²⁴ *The Commercial and Financial Chronicle*, Vol. 115 (1922), p. 1494; *Coal Age*, Vol. 22 (1922), pp. 505-06, 557-58, 599, 888.

²⁵ 42 Stat. L. 1023, 1446.

²⁶ 68 Cong. 2 sess., *Report of the United States Coal Commission*, S. doc. 195.

²⁷ The same, Part I, pp. 263-73. The commission recommended against compulsory arbitration, however (p. 158).

Moreover, both the operators and the laborers opposed special regulation of the industry.²⁸ Nothing came, therefore, of the coal commission's recommendations.

III. THE ECONOMIC CONDITIONS IN THE INDUSTRY, 1923-32

As we have seen, the earlier demands for government regulation of the industry came chiefly from the consumers of coal. The more recent demands for special governmental action, however, have come from the mine laborers, and to a less extent from producers, and have been based on the "depressed" state of the industry.

In the middle and later twenties, the history of the coal industry was an almost unique story of distress in the midst of general industrial prosperity. Thus, while it was perhaps no more affected than most other industries by the depression which began in 1929, it entered this period of general business decline already in financial difficulties. The average price of coal at the mines declined from \$3.75 in 1920 to \$3.02 in 1922, and by 1929 had fallen to \$1.78. The value at the mines of bituminous coal produced in 1923 was 1,515 million dollars; in 1928 it was 934 million, and in 1929, 953 million dollars.²⁹ The income tax returns of bituminous coal-producing companies as a whole showed substantial net deficits in 1928 and 1929.³⁰ Thousands of mines were closed during the twenties. The number of men employed in bituminous coal mines fell from 705,000 in 1923 to 503,000 in 1929, a decline of nearly 30 per cent, although in the six years between these dates the total number of man-hours worked declined by only 13 per cent. In the same six years, average annual earnings of mine workers fell from \$1,208 to \$1,169 (in spite of an increase in the average number of hours worked) and the computed total wage payments for the industry dropped from 851 million dollars in 1923 to 588 millions in 1929.³¹

²⁸ The same, Part I, p. 159; J. L. Lewis, *The Miners' Fight for American Standards* (1925), p. 17.

²⁹ Data collected by the Bureau of Mines, reprinted in U. S. Department of Commerce, *Statistical Abstract of the United States, 1932*, p. 711.

³⁰ U. S. Bureau of Internal Revenue, *Statistics of Income for 1928*, p. 334; 1929, p. 288. For earlier years, separate data for bituminous coal are not available, but in 1925 and 1927 the coal mining industry as a whole showed a deficit. The same, 1925, pp. 116-18; 1927, p. 326. No data are available for 1926.

³¹ *Carter v. Carter Coal Co.*, *Brief for Government Officers*, In the Supreme Court of the United States, October Term, 1935, pp. 57-58.

These declines took place in a period when the average of commodity prices was relatively stable, and wage rates generally were rising.

The immediate source of the difficulties of the bituminous coal industry was the existence of a productive capacity so great that it led to prices inadequate to cover total costs. This was due to three factors:²³ the great increase of investment that was stimulated by the high prices of the war and the post-war boom; the rather sudden flattening out of the growth of demand after 1920; and the rapid development during the twenties of improved mechanical methods of cutting, loading, and transporting coal in the mines.

The increase of investment under the stimulus of high prices just after the war was so great that in 1923, though the year was one of active business and the output of coal only 3 per cent below the all-time record of 1918,²⁴ the ratio of output to theoretical capacity was only 58 per cent as compared to 81 in 1918.²⁵ The expansion of investment in this particular period was not peculiar to coal, of course, but it was greater than in most industries because coal prices from 1916 to 1920 had been considerably higher, in proportion to those of the pre-war period, than were most prices, and because of the long time required to complete an investment in a new mine property and bring it into production.

In addition to the stimulating effect of the high war and post-war level of demand, a stimulus to the expansion of activity came from the transportation difficulties and labor disturbances of 1917-22. The reduction of output in important producing areas resulting from these difficulties led to a rapid expansion of capacity at points which for the time being were relatively free from these restricting forces. Moreover, all through the twenties the industry was migrating from the northern to the southern coal fields, largely because of lower wage rates in the latter areas. Since the abandonment of mines in the areas that were losing business was much less

²³ The coal industry normally operates with a considerable excess of theoretical capacity, chiefly because there are wide seasonal variations in the demand for coal. Because coal is so expensive to store, it is more economical to provide capacity sufficient to meet the peak demands.

²⁴ Data from Bureau of Mines, reprinted in *Statistical Abstract of the United States, 1932*, p. 711.

²⁵ N.R.C., *Energy Resources*, p. 72.

rapid than the expansion of capacity in the areas that were gaining, the result of this shift was greatly to increase total capacity. Finally, the mechanization of mines was adding to the capacity of mines already in existence.⁸⁵

The flattening out of the growth curve was very striking. For many years before the war, the market for coal had been expanding very rapidly. From 1900 to 1910 the increase in output amounted to 97 per cent; from 1910 to 1920, in spite of the war-time expansion and the boom conditions at the close of the decade, it was only 36 per cent. In the decade of the twenties the trend was practically horizontal.⁸⁶

The leveling off of the growth curve of the coal industry before the depression was due in part to the slower growth of population and of industry generally. More important than either of these factors, however, was the increasing competition of other sources of energy—oil, natural gas, and hydro-electric power. The Bureau of Mines has estimated that bituminous coal supplied about 70 per cent of the heat and energy generated in the United States during the first 20 years of the twentieth century. By 1923 this percentage had declined to 60.5; by 1935 to 45.1.⁸⁷ Moreover, in many fuel-consuming industries there has been a shift to lighter products or to new methods of production requiring less fuel. There has also been a substitution of scrap iron for virgin pig iron, which has lessened the production of pig iron and hence the amount of coal used in blast furnaces.

Increased efficiency in the use of coal is also frequently cited as a

⁸⁵ Output per man-hour increased nearly 15 per cent from 1921 to 1929. This increase was apparently due chiefly to mechanization and other technological improvements, though other factors entered in, such as closing of less efficient mines. From 1913 to 1929 the increase was 43 per cent. Works Progress Administration, *Mechanization, Employment and Output per Man in Bituminous Coal Mining* (1939), Vol. 2, p. 378. Compare N.R.C., *Energy Resources*, pp. 76-78.

⁸⁶ Measured by the records of peak years the trend was slightly downward. The all-time peak was in 1918, with 1920, 1923, and 1926 only slightly lower, and 1929 considerably lower than any of the four previous peaks. However, the average for the five years 1925-29 was greater than for any previous 5-year period. Data from Bureau of Mines, reprinted in *Statistical Abstract of the United States*, 1932, p. 711.

⁸⁷ J. P. Williams, "Organization of the Production, Processing and Distribution of Coal and Coal Products," *Third World Power Conference*, 1936, Vol. 3, p. 615. See also T. A. Veenstra and W. G. Fritz, "Major Economic Tendencies in the Bituminous Coal Industry," *Quarterly Journal of Economics*, Vol. 51 (1936), pp. 113-17.

further cause of the decline in the consumption of coal. And it is true that in the generation of electrical energy by steam power there was a saving of nearly 40 per cent in coal consumption per unit of output between 1923 and 1934, and a reduction of 24 per cent in coal consumption per ton-mile hauled by railway locomotives. However, while these factors within themselves might have been expected to decrease the demand for bituminous coal, it is obvious that without them bituminous coal would have lost even more of its markets to competing fuels and to water power.³⁸

Since the opening up and equipping of a mine must always be based on estimates of future demand, and since mines have a long life, a higher ratio of capacity to output was bound to appear whenever the rate of growth leveled off. The fact that the leveling off period came immediately after the 1916-20 period of high prices and expanded investment aggravated the difficulty.

Under these conditions of expanded capacity and shrinking demand, it would be expected, in any industry not controlled by monopolies, that there would be a tendency for competition to drive prices down to the level of out-of-pocket costs in establishments that were not in an unusually favorable cost position. Once the initial investment in shaft, tipple, track, and equipment is made, the direct cost of production, consisting mainly of wage payments, is all that need be covered to keep production going.³⁹

Moreover, the coal industry was especially vulnerable to the impact of the forces that tend to drive prices below the level that will yield a return on fixed capital, because of the wide dispersion of ownership and consequent difficulty of forming monopolistic combinations. Although a considerable amount of concentration of control has taken place,⁴⁰ ownership of workable coal seams is still

³⁸ Compare Williams in *Third World Power Conference*, Vol. 3, p. 615.

³⁹ It is to be noted also that much of the operating cost of a mine is virtually a fixed charge, which must be met regardless of output if the mine is not to be permanently abandoned. Such costs include a large part of those incurred for pumping water and supporting roofs. Once a mine is closed for any length of time, reopening it becomes more and more expensive. Compare Carter Coal case, *Brief for Government Officers*, p. 34. There were 1,355 idle but not abandoned mines at the end of 1930. Veenstra and Fritz in *Quarterly Journal of Economics*, Vol. 51, p. 107; N.R.C., *Energy Resources*, p. 72.

⁴⁰ In 1936, 660 bituminous coal mines, out of 6,875 mines producing 1,000 tons or more per year, produced almost 70 per cent of the bituminous coal mined that year. Each of the 660 mines had an output of 200,000 tons or more. Bureau of Mines, *Minerals Yearbook, 1938*, pp. 711-13.

A considerable number of coal mines are owned and operated by subsidiaries of

widely scattered, while reserves are owned by thousands of individuals. More than 11,500 producers, for example, had accepted the code under the act of 1937, up to November 15, 1938.⁴¹ To some extent this diversity of ownership has been due to public policies, which in the past have been designed to encourage small scale enterprise in the industry.⁴²

Taxation of coal reserves by the states, on the basis of value which reflect returns from anticipated future conditions, probably has had some tendency to stimulate the expansion of output beyond what would be most economical if taxes were levied on the basis of income or gross receipts.⁴³

The same factors which depressed rates of return to capital in

railroads, public utilities, iron and steel mills, and other large consumers. Coal owned by and supplied to a parent organization for its own use is called "captive" coal. In 1929 such captive coal constituted 17.5 per cent of the total coal production of the country. Williams, in *Third World Power Conference*, Vol. 3, p. 619.

⁴¹ N.R.C., *Energy Resources*, p. 73.

⁴² A general coal land act, passed in 1873 (17 Stat. L. 607), provided for the sale of federal coal lands at not less than \$10 an acre for lands more than 1 mile from a completed railway. Only 160 acres could be sold to an individual and 640 to an association. A large part of the coal land had passed into private hands as agricultural land before the end of the nineteenth century. In 1906 the Geological Survey started to determine the quantity, quality, and value of coal lands remaining in public domain. In 1909 a regulation based the selling price of coal lands on the tonnage and quality of the coal, some of the best lands being classified at \$300-\$400 per acre. (N.R.C., *Energy Resources*, p. 383.) It was believed that charging a relatively high price for coal lands, as compared with agricultural land, would discourage speculative purchase far in advance of the possibility of profitable development, and that the elimination of such speculative purchase would decrease the probability of the lands' ultimately falling into the hands of monopolistic combinations. In 1920 the Mineral Leasing Act was passed which authorized the Secretary of the Interior to divide any of the public coal lands into leasing tracts of 40 acres each or multiples thereof and in "such form as . . . will permit the most economical mining of the coal in such tracts," but in no case exceeding 2,560 acres in any one leasing tract, and to award leases thereof by competitive bidding "or by such other methods as he may by general regulation adopt." 41 Stat. L. 438.

⁴³ N.R.C., *Energy Resources*, p. 74; W. G. Fritz and T. A. Veenstra, *Regional Shifts in the Bituminous Coal Industry* (1935), p. 150. Information on the extent of taxes on property and equipment collected by the National Recovery Administration during 1934 showed that there is considerable variation in the effect of such taxes on costs of coal produced. Taxes in Divisions I and III comprise 1.6 per cent of the total cost, and in Division II, 0.8 per cent. Division I includes Pennsylvania, Maryland, Virginia, West Virginia, northern Tennessee, eastern Kentucky, Ohio, and Michigan. Here the tax cost was 3 cents per ton as against total production cost of \$1.90. Division II included Illinois and Indiana. Division III included Alabama, Georgia, and southern Tennessee. Williams in *Third World Power Conference*, Vol. 3, p. 655.

the coal industry, also attracted a supply of labor which the industry could not maintain under the changed conditions. There was a large influx of labor into the industry during the boom years, and a further increase resulted from the migration of the industry from north to south, because the new mining developments in the South drew in new labor largely from nearby sources, while the laborers employed in the northern fields did not withdraw from the industry with corresponding rapidity.

Although these various difficulties of the coal industry caused much complaint and discussion of possible remedies, they did not lead to any positive governmental action until the oncoming of the depression after 1929, and they did not lead to any special treatment of the bituminous coal industry till after the termination of the general controls that were established in this industry, along with others, under the National Industrial Recovery Act. The treatment of the coal industry under this act is discussed in the following section.

IV. BITUMINOUS COAL UNDER THE NATIONAL INDUSTRIAL RECOVERY ACT

Under the National Industrial Recovery Act the regulations were not imposed wholly from without the industry, as was theoretically the case with the war-time control and with most phases of the early post-war regulation. Industry groups played an important role in the framing of codes, and the consent of a majority of the industry was ordinarily required for final enactment. When approved by the President, the codes had the force of law and were binding on all operators. The code for the bituminous coal industry, which was approved September 18, 1933, declared that "minimum" prices must be maintained, and that certain "unfair trade practices" must be eliminated. It set up minimum-wage and maximum-hour provisions which operators were required to observe, and it required operators to bargain with duly elected representatives of employees and to avoid interference with the free choice of representatives by their employees. The provisions concerning price-fixing were very general and vague, and were later amended with more detailed provisions.⁴⁴

⁴⁴ N.R.C., *Energy Resources*, pp. 407-08; Berquist, *Economic Survey of the Bituminous Coal Industry*, pp. 78-134. Compare Chap. XXVII of this volume.

The code divided the bituminous coal industry into five geographical divisions, in each of which there was to be a divisional code authority to administer the code, the members of which were to be chosen by the coal producers, with the exception of one in each division who was to be appointed by the President.⁴⁶ As a result of criticism because these authorities included no representative of the miners, the code was amended in March 1935 to provide that each divisional authority should have one member to be "selected from nominations submitted by the accredited and recognized organization of employees."⁴⁶

The code declared "unfair" the selling of coal below a "fair market price." A fair market price was defined as one "necessary to carry out the purposes of the National Industrial Recovery Act, to pay the minimum rates herein established, and to furnish employment for labor." However, consideration was also required to be given to "competition with other coals, fuels, and forms of energy or heat production."⁴⁷ Fair prices were to be fixed by "representative marketing agencies," which were trade associations of coal producers. Where these did not exist, the code authorities were to fix the prices. In any event, they were subject to review by the Administrator.

The standards for price-fixing were amplified on January 25, 1935 by the requirement that consideration must also be given to "the customs, requirements and needs of the buying and consuming public for various kinds, grades and sizes of coal and the necessity for giving to consumers reasonable opportunity to buy and to producers reasonable opportunity to sell their coal in usual and normal markets." Moreover, the agency or authority was to:

. . . classify all coals, applying all factors usually considered in connection with physical structure and chemical analysis and their effect upon the salability and use value of such coals . . . and . . . so price coals as to afford producers reasonable opportunity to sell the coal in competition with other coals, fuels and forms of energy or heat production.

⁴⁶ National Recovery Administration, *Codes of Fair Competition*, Vol. 1 (1933), p. 332.

⁴⁶ The same, Vol. 22, p. 150.

⁴⁷ The same, Vol. 1, p. 329.

But it was not to make "dumping prices in any area of consumption."⁴⁸

If a producer made written complaint concerning a price set, he was to be granted a hearing. In these hearings the authority was further to consider:

. . . the market demand for the class of coal of the producer, the relative operating time at the mines of the producer, as compared with that of the mines of other producers in the same and competing districts, their past production history, as well as the quality of the coal and the comparative delivered value thereof to the consumer.⁴⁹

The code authorities for the five divisions into which the country was divided were authorized to meet and confer and "endeavor to agree upon a basis of fair competitive prices and practices . . . as between such Divisions."⁵⁰

Certain other practices, some of which had previously been declared unlawful, were declared unfair by the code. Among these were: the forwarding of coal which had not actually been sold; secret rebates, concessions, and credits; attempts to purchase business or to obtain information concerning a competitor's business through gifts or bribes; intentional misrepresentation concerning the size, quality, or origin of coal; unauthorized use of a competitor's trade-marks; attempts to bring about a breach of contract between a competitor and his customer; use of brokerage commissions or jobbing arrangements for making discounts or prices other than those determined according to the code provisions.⁵¹

The labor provisions of the code were important, both because they were again enacted in the Bituminous Coal Act of 1935, and

⁴⁸ The same, Vol. 21, pp. 170-73.

⁴⁹ The same, Vol. 21, p. 174.

⁵⁰ In addition, the marketing agencies or code authorities establishing prices were to set up permanent impartial boards of arbitration to hear the appeals of the producers from the authorities' decisions on prices. A board was to consist of not more than five members "who shall not be connected directly or indirectly with the coal industry during the time they serve as members of such Board." To settle disputes between authorities representing different divisions with respect to prices, there was set up an impartial national coal board of arbitration of five members, elected by the nine members of the National Bituminous Coal Industrial Board "designated by the Divisional Code Authorities." The same, pp. 174-76.

⁵¹ The same, Vol. 1, pp. 329-31. None of these provisions was to "prevent any American producer from creating special prices for overseas exports."

because under them the miners achieved almost complete unionization and so were able to wield much influence in shaping and promoting later legislation for the special treatment of the coal industry. The code prescribed a maximum of 8 hours of labor a day and 40 hours a week. It established, by districts, minimum rates of pay for "inside skilled labor" and "outside common labor," which in the case of skilled labor varied from \$5.63 per day in the Montana district to \$3.40 for the district which included Alabama, Georgia and certain counties of Tennessee. Minimum wages for common labor ranged from \$4.82 to \$2.40.⁵²

The first amendment to the code, adopted in March 1934, reduced the hours of work to 7 a day and 35 a week for almost all employees. It also increased the basic minimum rates of pay for day labor in certain fields, as well as for piece work.⁵³ Some reduction in minimum rates of pay were made in a second amendment in April 1934, and in a third in June 1934.⁵⁴

Article V of the code prescribed certain conditions of employment of which the most important was the following:

Employees shall have the right to organize and bargain collectively through representatives of their own choosing, and shall be free from the interference, restraint, or coercion of employers . . . in the designation of such representatives or in self-organization. . . .⁵⁵

Any controversy about hours, wages, and conditions of employment was, if possible, to be adjusted by conference and negotiation between designated representatives of employers and employees. If this procedure failed, the matter might be referred to the Bituminous Coal Labor Board of the division.⁵⁶ The decision of this board

⁵² The same, pp. 327, 336-37.

⁵³ The same, Vol. 9, pp. 666-68.

⁵⁴ The same, Vol. 10, p. 433; Vol. 11, p. 391.

⁵⁵ The miners were also given the right to have a checkweighman of their own choosing to inspect the weighing of coal, where rates of pay were based on weights. Wages were to be paid semi-monthly "in lawful money" and no employee could be required to live in a house owned by the employer, or to trade at a store owned by the employer. No person under 16 years of age could be employed in or about a mine; none under 17 inside a mine or in a hazardous occupation outside. The same, Vol. 1, pp. 328-29.

⁵⁶ These boards were to be appointed by the President. Each board was to have three members, one selected from nominations made by the organizations of employees, one from nominations made by the Divisional Code Authority, and one to be the impartial representative of the President.

was to be effective for a period of not longer than six months. A National Bituminous Coal Labor Board, composed of the members of the divisional labor boards, could be called by the Administrator, if employers and employees of more than one division were involved in a controversy, or if he thought the decision of the divisional board would involve "a policy affecting the general public, or the welfare of the industry as a whole."⁸⁷

During the time the code was in effect, there were increases in the numbers of men employed and of total days worked, in wage rates, and in prices.⁸⁸ The Schechter decision of the Supreme Court in May 1935 brought to an end the special N.R.A. controls over coal, as it did all the other N.R.A. controls. Long before this time, however, the observance of the coal code had broken down almost completely. Price-cutting below the prices fixed early became widespread, and the N.R.A. had no adequate enforcement machinery to compel obedience.⁸⁹ In these circumstances, the operators and organized labor leaders soon sought for special controls over the coal industry, designed to achieve the N.R.A. objectives, but equipped with more effective enforcement devices. The results are described in the sections to follow.

V. THE IMMEDIATE BACKGROUND OF RECENT SPECIAL TREATMENT

Beginning on February 19, 1935, congressional hearings were held to consider the enactment of a special regulatory act for the bituminous coal industry to supplant the ineffectual N.R.A. regulations.⁹⁰ In addition to the breakdown of the N.R.A. regulations, a number of other factors contributed to the demand for and acceptance of special control for coal. The general financial weakness of the industry, discussed in section III above, had grown much more acute in the course of the depression. Further, the union labor situa-

⁸⁷ The same, Vol. 1, pp. 333-34.

⁸⁸ Just how much of this was due to the code is, of course, difficult to ascertain. See Berquist, *Economic Survey of the Bituminous Coal Industry*, pp. 1-12; and W. E. Fisher, *Economic Consequences of the Seven-Hour Day and Wage Changes in the Bituminous Coal Industry* (1939), especially pp. 94-100.

⁸⁹ For a general analysis of the operation of the N.R.A., see Chap. XXVII.

⁹⁰ 74 Cong. 1 sess., *Stabilization of the Bituminous Coal Mining Industry*, Hearings before (S.) Committee on Interstate Commerce on S. 1417; and the same, Hearings before (H.) Committee on Ways and Means on H. R. 8479.

tion and the acute distress of a large proportion of mine laborers and their families, played important roles; and public acceptance of special regulation was made easier by the interest in conservation of an essential resource.

For several years after the World War, the United Mine Workers had been one of the strongest industrial unions in the country, and had exercised effective control over employer-employee relationships in a large section of the industry. In 1922, 70 per cent of the coal was produced under collective wage agreements, and at the time of the Jacksonville wage agreement of 1924 a large part of the coal in all the major producing areas was still produced in unionized mines. The flattening out of the demand for coal after 1924 brought pressure on the price of coal, and in the following years the major districts south of the Ohio River shifted to the use of non-union labor. Thus, after 1924 the organized areas lost ground to the unorganized areas, in which operating costs, especially wages, were considerably lower. In the northern coal fields, which had lost tonnage to the southern non-union fields, many mines closed down and some of them opened later on a non-union basis. Mechanization of the industry at the same time was leading to a decrease in direct employment, particularly in the northern districts where the high union wages prevailed.⁶¹

The United Mine Workers thus rapidly lost strength after the expiration of the Jacksonville agreement in 1927, and with the onset of the depression. It is estimated that by the end of 1932 the total tonnage produced under union contracts was no more than 15 per cent of the total for the United States.⁶² Under the National Recovery Act, however, with its provisions favoring collective bargaining, union activity revived, membership of the United Mine Workers increased to 87 per cent of the total employment in the industry in 1934, and it became again an important factor in collective bargaining.⁶³ After the invalidation of the National Industrial Recovery Act, leaders of the United Mine Workers looked to

⁶¹ Berquist, *Economic Survey of the Bituminous Coal Industry*, pp. 174-86.

⁶² The same, pp. 6, 187.

⁶³ N.R.C., *Energy Resources*, p. 75; see also National Labor Relations Board *The Effect of Labor Relations in the Bituminous Coal Industry upon Interstate Commerce* (1938), pp. 39-42.

special legislation for help in retaining the position which the N.R.A. had enabled them to attain. Under the National Labor Relations Act enacted in 1935 they regained their right to bargain collectively, but they favored price-fixing of coal as providing them a stronger basis for bargaining for higher wages. Many of the producers supported—some of them even initiated—the demand for price control.

Secondly, special treatment of the bituminous coal industry was suggested by the fact that the distress which characterized the condition of labor throughout the country during the early thirties, because of the high degree of unemployment, was apparently more severe in coal mining than in most industries. This may be shown by a comparison of the relief load in coal-producing counties and in other counties. Out of 88 counties engaged chiefly in bituminous coal mining, there were 22 in which over 24 per cent of the population was on relief. On the other hand, out of 163 of the leading manufacturing counties in the United States, there was only one with 24 per cent or more of the population on relief, and of 41 other important urban counties, there was only one with this proportion on relief.⁶⁴ Since local relief in these areas was soon exhausted, distress became so severe that in 1931, two years before relief in general was undertaken by the federal government, President Hoover asked the American Friends Service Committee to undertake child feeding in the coal fields.

Third, some public support for the special treatment of coal was probably gained by the argument that coal is a non-renewable natural resource which is the source of much of our energy, and that in the absence of public regulation this resource is likely to be "wasted."⁶⁵ It is argued that competition in the mining of coal leads

⁶⁴ Carter Goodrich and others, *Migration and Economic Opportunity* (1936), pp. 47, 98, 101; Veenstra and Fritz, "Major Economic Tendencies in the Bituminous Coal Industry," *Quarterly Journal of Economics*, Vol. 51, p. 126; Carter Coal case, *Brief for Government Officers*, p. 85.

⁶⁵ N.R.C., *Energy Resources*, pp. 42, 49-50, 61-64, 114. This report, while stressing the serious consequences which would result from a scarcity of coal, points out that there are over 3 trillion tons of coal reserves, and that estimates of the future life of these reserves vary from 365 to 2,250 years. The lower figures were obtained by projecting forward rates of increase of consumption derived from experience prior to the downward turn of coal consumption discussed above. A similar projection forward of rates of decline since 1923 would forecast the

to mining the best and most accessible coal and abandoning the rest which process "leaves large quantities of coal irrecoverable, or recoverable only at high cost."⁶⁶ Therefore, it is urged, "the first in dispensable step in reducing the wastes of mining is to aid the industry to establish itself on a stable and profitable basis."⁶⁷

There may appear to be little relationship between the difficulties of the industry, as described above, and the structure of regulation which was established in 1935 and 1937, to be described below. But, regardless of the appropriateness of the remedies provided by these acts, it is clear that their proponents believed that the unsatisfactory conditions in the industry could be remedied by federal regulation of prices and of competitive practices. Senator Guffey's speech at the opening of the Senate hearings on his proposed bill on February 19, 1935, illustrates this point of view. He said:

I . . . have personally seen the struggles of the miners to obtain some semblance of steady employment at wages which might permit them to live in accordance with those American standards of living to which all of our people aspire. The operators have been faced with overproduction and its resulting cutthroat competition, which, in turn, has brought ruin to them and their associate investors. The workmen and their families have suffered and starved. The desolation of their homes has all too often been most pitiable.

In my judgment this legislation will eliminate these conditions in that it will enable the owners of and the investors in bituminous mines to obtain a fair return on their investments; it will benefit those who labor in and about the mines through the payment of fair wages and the granting of improved working conditions. In addition, it will protect the consumers against unreasonable prices and assure them of an ample supply of coal at all times. It will also result in the conservation of bituminous-coal resources for the use of future generations and the Nation itself in time of need.⁶⁸

practical elimination of demand in the course of a few generations! Compare below, pp. 984-85. See G. S. Rice, A. C. Fieldner, and F. G. Tryon, "Conservation of Coal Resources," *Third World Power Conference, 1936*, Vol. 6, p. 676

⁶⁶ Fritz and Veenstra, *Regional Shifts in the Bituminous Coal Industry*, p. 150

⁶⁷ Rice, Fieldner, and Tryon, in *Third World Power Conference*, Vol. 6, p. 701. The authors state that "the problem of conservation . . . is not one of absolute exhaustion centuries hence but of increasing cost at a relatively early date. . . . It is to maintain the life of the good beds as long as reasonably possible by prevention of needless waste . . ." (p. 682).

⁶⁸ 74 Cong. 1 sess., *Stabilization of the Bituminous Coal Mining Industry*, Hearings on S. 1417, p. 10.

A quotation from the testimony of John L. Lewis, the president of the United Mine Workers, illustrates the similar point of view of that organization concerning the bill:

The mine workers for years and years have learned that if the operators cannot sell their coal for a price that will give them a return, they cannot pay a wage scale, and wages comprise at least 65 per cent of the total cost of producing coal. Wages is the only item of cost in which there is any flexibility. If an operator has to reduce his cost, he thinks only in terms of reducing the wage cost or the labor price.⁶⁹

VI. THE BITUMINOUS COAL CONSERVATION ACT OF 1935

As an outcome of the hearings which began in February 1935, a bill to provide special regulation of the coal industry was introduced into Congress.⁷⁰ This bill provided for a plan of production control in which output quotas for districts and for mines would be established by national and district boards of operators. The sponsors of this provision contended that control of output would bring about the desired results of increased wage rates and increased prices more easily and effectively than would minimum price control, which under both the Lever Act and the N.I.R.A. had been difficult to administer and comparatively easy to evade. However, the bill also contained provisions for the establishment of minimum prices in each price area based on the cost of production, for the purchase of coal deposits by the federal government "in order to conserve the Nation's bituminous-coal resources" and to check "the evil of excessive and wasteful production"; and for the "stabilization" or elevation of the existing wage structure through provisions for collective bargaining. This bill was sponsored, and in part drafted, by the United Mine Workers. A large number of operators, especially owners of captive mines, objected to government control of the industry, but other operators supported the bill with some modifications. As finally passed, the provisions for control of production and for federal purchase of coal deposits were deleted.⁷¹

⁶⁹ The same, p. 546. For a similar statement by Philip Murray, the vice-president of the United Mine Workers, see the same, p. 148 ff.

⁷⁰ 74 Cong. 1 sess., S. 1417.

⁷¹ N.R.C., *Energy Resources*, pp. 408-09; 74 Cong. 1 sess., S. 1417, Title II, sec. 1; 74 Cong. 1 sess., *Stabilization of the Bituminous Coal Mining Industry*, Hearings on S. 1417; and the same, Hearings on H. R. 8479.

The Bituminous Coal Conservation Act of 1935¹² created a National Bituminous Coal Commission of five members in the Department of the Interior. Experience with the difficulties of enforcing compliance with the N.R.A. code led to a clause in this act which levied, on all coal produced, a tax of 15 per cent of the sale price of coal at the mine—or, in the case of captive coal, of the “fair market value” of such coal at the mine—but which provided that 90 per cent of the tax should be refunded to operators who complied with the terms of the act.

Twenty-three production districts were established, which were arranged in nine minimum price areas. Each district was to have a board of from three to seventeen members to be elected by the coal producers of the district, except for one member who was to be selected by the organized employees. Each district board was to establish minimum prices for its district “so as to yield a return per net ton for each district . . . equal as nearly as may be to the weighted average of the total costs . . . of the tonnage of such minimum price area.” These prices were subject to the veto of the Coal Commission, but were to become effective unless specifically disapproved. The Commission could also set maximum prices if it thought this necessary to protect the public interest. The interests of consumers were to be represented by a Consumers’ Counsel who could require the Commission to supply information and to conduct investigations when he thought them necessary. Provisions were made for the collection of reports and information by the Commission and for the holding of hearings upon complaint. Certain trade practices (for example the granting of secret rebates, or otherwise discriminating in price) were declared to be unfair.¹³

Provisions concerning labor constituted an important part of the 1935 act. Collective bargaining by representatives of the miners of their own choice was specifically protected. An agreement concerning minimum wages and maximum hours of work negotiated in a district by producers of two-thirds of the tonnage and by representatives of a majority of the workers was to be binding on all producers in that district. Employees were to be permitted to select their own checkweighmen and were not to be required to live in houses, or to

¹² 49 Stat. L. 991.

¹³ The same, pp. 993-95.

trade at stores, owned by the employer. A Bituminous Coal Labor Board of three members, of whom one was to be a representative of the organized employees, one a representative of the employers, and one a person with no financial interest in the industry and with no connection with the miners' union, was given power to adjudicate disputes between operators and miners and to hold elections to determine the choice of representatives among the employees.⁷⁴

In May 1936, less than a year after its passage, the 1935 act was declared unconstitutional by the Supreme Court,⁷⁵ primarily on the ground that the labor provisions of the act were beyond the power of Congress. The act had declared that regulation of coal production by the federal government was necessary because interstate commerce was directly affected by the condition of the industry. But the Court held that the "incidents leading up to and culminating in the mining of coal do not constitute" such commerce, which is "a thing apart from the relation of employer and employee."⁷⁶ It held further that the price-fixing provisions of the act were so related to the labor provisions that they could not stand independently. The whole act was therefore invalidated without a ruling as to whether the price-fixing clauses would have been constitutional if they had stood alone.⁷⁷

The life of the 1935 act was so brief that experience under it can hardly be evaluated. While producers of about 70 per cent of the total tonnage of coal subscribed to the provisions of the act, prices were fixed for only four western districts, covering less than 3 per cent of the total annual production of the United States.⁷⁸ Moreover, since non-subscribing producers were reducing their prices, and since the act was under immediate attack in the courts, many subscribing producers doubted the wisdom of using the price-fixing powers granted by the act.

⁷⁴ The same, p. 1001.

⁷⁵ *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936).

⁷⁶ The same, p. 303.

⁷⁷ The same, p. 316. The Court also held (p. 289) that the tax provision of the law was really a penalty and not a tax, so that the act could not be held valid as an exercise of the taxing power of Congress.

⁷⁸ *Annual Report of the Department of the Interior, 1936*, pp. 41-44; Orders issued in Docket No. 9 of the National Bituminous Coal Commission, November and December 1935.

VII. THE BITUMINOUS COAL ACT OF 1937

A new act, the Bituminous Coal Act of 1937, also called the Guffey-Vinson Act,⁷⁹ was passed in April 1937, which re-enacted many of the provisions of the act of 1935. The provisions for the regulation of labor of the earlier act were, of course, omitted, but employees of coal producers were assured the right to organize and bargain collectively concerning their hours of labor, wages, and working conditions; and it was expressly stated that the provisions of the National Labor Relations Act of 1935 were to apply to employees of coal producers.⁸⁰

The earlier law had been criticized because it granted so much control over prices to the district boards, which were elected largely by the mine operators.⁸¹ In the act of 1937 the powers of the district boards are limited to the proposal of prices, the final decision on prices being made by a National Bituminous Coal Commissioner (later changed to a division in the Department of the Interior). The tax drawback agreement of the earlier law is omitted in the act of 1937, and, instead, a tax of 19½ per cent of the sale price of coal at the mine, or of the "fair market value" of captive coal is imposed on all producers who do not accept or are denied membership in the coal code.⁸² Transactions in intrastate commerce are not subject to the act, unless they can be shown to affect interstate commerce directly. Compliance with the act is not to constitute a violation of the anti-trust laws.⁸³

The act established a National Bituminous Coal Commission of seven members, of whom two had to be experienced coal mine workers, and two had to have previous experience as producers. On July 1, 1939 the Commission was abolished and its functions were transferred to the Secretary of the Interior, who organized a Bituminous Coal Division under a director to administer the act.⁸⁴

The most important duty of the Division is the fixing of minimum

⁷⁹ 50 Stat. L. 72. This act is to expire after four years, in 1941.

⁸⁰ The same, sec. 9.

⁸¹ N.R.C., *Energy Resources*, p. 410.

⁸² 50 Stat. L. 72, sec. 3.

⁸³ The same, secs. 1, 4-A, and 4, Pt. I (d).

⁸⁴ Reorganization Plan No. II, *Federal Register*, 1939, pp. 2731-32; 76 Cong 1 sess., Pub. res. No. 20; U. S. Dept. of the Interior, *Third Annual Report under the Bituminous Coal Act of 1937, 1938-39*, p. 3.

prices for coal. Prices are first proposed by each of the 23 district boards.⁶⁶ The Division may approve, disapprove, or modify these prices. After this, the district boards are supposed to "co-ordinate" the prices "in common consuming markets," but if they are unable to do this within an allotted time, the Division is to perform this function. Then the Division is to establish, as effective, the prices so fixed.

The prices proposed by the district boards are "to yield a return per net ton for each district in a minimum price area,⁶⁶ . . . equal as nearly as may be to the weighted average of the total costs, per net ton, . . . of the tonnage of such minimum price area."⁶⁷ A number of other matters are also to be considered in the setting of prices. The boards must propose prices for "kinds, qualities and sizes of coal . . . and classification of coal and price variations as to mines, consuming market areas, values as to uses and seasonal demand." The prices must also reflect "the relative market value of the various kinds, qualities, and sizes of coal," must be "just and equitable as between producers within the district," and must have "due regard to the interests of the consuming public."⁶⁸

After the Coal Division has approved, disapproved, or modified such proposed prices, the district boards are required to "co-ordinate in common consuming market areas upon a fair competitive basis the minimum prices" and to re-submit them to the Division. And it is required that all minimum prices proposed for coal for shipment into any common consuming market area:

⁶⁶ Each district board is composed of from three to seventeen members, all of whom must be code members except one, who is selected by that employees' organization which has the greatest number of employees in the industry in that district. One-half of the producer members of the board are elected by majority vote of the code members. The other half are elected by votes cast in proportion to the annual output of the code members in the district. 50 Stat. L. 72, sec. 4, Pt. I (a).

⁶⁷ There are ten minimum price areas. The same, sec. 4, Pt. II (a).

⁶⁸ The costs shall include: "the cost of labor, supplies, power, taxes, insurance, workmen's compensation, royalties, depreciation and depletion (as determined by the Bureau of Internal Revenue in the computation of the Federal income tax) and all other direct expenses of production, coal operators' association dues, district board assessments for Board operating expenses only levied under the code, and reasonable costs of selling and the cost of administration." The same, sec. 4, Pt. II (a).

⁶⁹ The same.

. . . shall be just and equitable, and not unduly prejudicial or preferential, as between and among districts; shall reflect, as nearly as possible, the relative market values, at points of delivery in each common consuming market area, of the various kinds, qualities, and sizes of coal produced in the various districts, taking into account values as to uses, seasonal demand, transportation methods and charges and their effect upon a reasonable opportunity to compete on a fair basis and the competitive relationships between coal and other forms of fuel and energy; and shall preserve as nearly as may be existing fair competitive opportunities.

These co-ordinated prices must not reduce or increase the minimum prices more than is necessary for co-ordination, "to the end that the return per net ton upon the entire tonnage of the minimum price area shall approximate the weighted average of the total cost per net ton of the tonnage of such minimum price area." After the co-ordinated prices are submitted to the Division, it is required to establish minimum prices and marketing rules and regulations.⁸⁹ It may review and revise these from time to time.

In order to protect the consumer against "unreasonably high prices" for coal, the Division may also establish maximum prices for coal in any district. These must be at a uniform margin above the minimum prices, so that "in the aggregate the maximum prices shall yield a reasonable return above the weighted average total cost of the district: *Provided*, That no maximum price shall be established for any mine which shall not yield a fair return on the fair value of the property."⁹⁰

The sale of coal below the minimum or above the maximum prices set constitutes a violation of the code. The act also lists a series of "unfair methods of competition" which are to be considered violations. The most important of these is price discrimination, whether achieved by the paying of rebates in any form, by the adjustment of claims or the prepayment of freight charges, by the use of brokerage commissions or sales agencies, or by extending to some purchasers services or privileges not extended to all.⁹¹

⁸⁹ The same, sec. 4, Pt. II (b). Between 150 and 175 common consuming market areas have been tentatively established.

⁹⁰ The same, sec. 4, Pt. II (c).

⁹¹ It is, however, permissible to sell to or through any legitimate farmers' co-operative organization whether or not it grants rebates or other benefits to its members. Other unfair methods of competition are: attempting to get business or obtain

The interest of the consuming public is to be represented through the office of the Consumers' Counsel. This office was under the Commission until the reorganization of July 1939, when a separate Consumers' Counsel Division was set up in the Interior Department. The Counsel may appear in any proceeding before the Division and may conduct such independent investigations of the coal industry or of the administration of the act as he may think necessary.⁹³

All rules of district boards may be reviewed by the Division. Further, if a code member, a district board member, or the Consumers' Counsel, is dissatisfied, or if any state or political subdivision of a state is dissatisfied with the co-ordination of or the failure to co-ordinate prices, with any regulations, or with any price established, they may complain to the Division by petition, and the Division, after holding a public hearing, may issue a supplementary order.⁹⁴ Furthermore, any of these persons may obtain a review of the Division's order in the appropriate federal court. The Division may not make any rule or regulation which has the force of law without having given notice of a hearing and afforded interested parties a chance to be heard, and without making findings of fact. These findings "if supported by substantial evidence shall be conclusive upon review thereof by any court of the United States."⁹⁵

The Division has a number of duties concerning the collection and reporting of information,⁹⁶ and may require producers to main-

information concerning a competitor's business by concessions, gifts, or bribes; intentionally making false statements concerning the coal bought or sold; unauthorized use of a competitor's trade-marks or advertising; inducing or trying to induce breach of contract between a competitor and his customer; and employing a sales agent at a salary above the ordinary value of services rendered in order to secure preferment with purchasers. The same, sec. 4, Pt. II (i).

⁹³ The same, sec. 2 (b); U. S. Dept. of the Interior, Press Release No. P.N. 68583, July 12, 1939. Either the Commission or the Consumers' Counsel may complain to the Interstate Commerce Commission about rates and practices in the transportation of coal. The I.C.C. must notify the Commission and permit it or the Counsel to be heard before disposing of any complaint concerning coal. 50 Stat. L. 72, sec. 16.

⁹⁴ 50 Stat. L. 72, sec. 4, Pt. II (d); sec. 6 (b).

⁹⁵ The same, sec. 2 (a).

⁹⁶ Each district has a statistical bureau established originally by the Commission to which code members must report all spot orders, and with which they must file copies of all contracts for the sale of coal, invoices, credit memoranda, and such other information as the Division may require. The same, sec. 4, Pt. II (a).

tain a uniform system of accounting. The expense of administering the code by the district boards is borne by the code members in the respective districts, each paying his proportionate share computed on a tonnage basis. Although expenses of the Division are met by congressional appropriations, an excise tax of one cent per ton is imposed upon the sale or other disposal of all bituminous coal produced in the United States.⁹⁶

The act was approved by the President on April 26, 1937, and the Commission was organized on May 17 of that year. The taxes imposed under the act became effective on June 21. The producers enrolled in the code by November 1938 had produced 415,300,000 tons of bituminous coal in 1936, which was about 95 per cent of the total output for that year. Since most of the remaining 5 per cent is produced by operators who claim exemption on the ground that their coal does not move in commercial markets, the present code membership covers almost all of the commercial production of bituminous coal.⁹⁷

Almost immediately after its establishment the Commission began the task of setting prices in accordance with the procedure outlined above. It ran into difficulties, however, when the district boards attempted to co-ordinate prices in common consuming markets. Although many of the boards performed this task, in certain of the eastern districts they failed to do so and the Commission, under the authority given it in section 6, took over the task of co-ordination. On November 30, 1937, it issued orders establishing minimum prices and marketing rules and regulations which became effective for the eastern districts on December 16, and for the western districts early in January.⁹⁸

Although the Commission had held many informatory hearings, it held no final hearings before establishing prices. Because of this, it received many complaints that the procedure did not meet the requirements of due process of law, since the act required reasonable public notice and the holding of a hearing before the issuance of any regulation having the force of law. The Commission held

⁹⁶ The same, sec. 4, Pt. I (b), sec. 3 (a). N.R.C., *Energy Resources*, p. 410.

⁹⁷ *Second Annual Report of the National Bituminous Coal Commission, 1937-38*, pp. 1-2.

⁹⁸ The same, pp. 4-5.

hearings on these petitions, and in a number of cases changed the prices. Meanwhile a number of petitions were filed, pleading for court review of the original price orders on the ground that the procedure followed denied due process of law. Some temporary restraining orders were granted by the courts.⁹⁹ The effect of these orders was to permit producers in many areas to sell coal at unregulated prices. Thus the price structure created by the Commission broke down, and on February 25, 1938 the Commission revoked all the prices and marketing rules and regulations which it had established.¹⁰⁰

After the revocation of its price orders, the Commission prepared a new procedural program to carry out its work and began again the task of fixing prices. Under this new procedure more elaborate provision was made for public hearings. A review of this procedure will help to make clear the enormous complexities which are involved in fixing prices under the current special regulation of the bituminous coal industry.

Hearings on the weighted average costs for each minimum price area computed by the Commission were held in June and July 1938. The record contained 1,300 pages of testimony and 488 exhibits. After the hearings, in July and August 1938, the Commission issued findings of fact, conclusions, and appropriate orders concerning weighted average costs by minimum price areas.¹⁰¹

⁹⁹ The same, pp. 5-6; see *Saxton Coal Mining Co. v. National Bituminous Coal Commission*, 96 Fed. (2d) 517 (1938).

¹⁰⁰ *Second Annual Report of the N.B.C.C., 1937-38*, pp. 6-7. For a discussion of the problem of administrative law involved in the judicial review of the original price orders, see *Mallory Coal Co. v. National Bituminous Coal Commission*, 99 Fed. (2d) 399 (1938).

¹⁰¹ The findings contained 412 pages. *Third Annual Report under the Bituminous Coal Act of 1937, 1938-39*, p. 10.

Before the hearings, the Commission had announced that it would open the individual cost returns to parties who could show a proper interest, but it was enjoined from so doing by a temporary restraining order obtained by certain producers. In the meantime, however, it opened all of the original cost records to the office of the Consumers' Counsel. Each item questioned by this office was taken up by the statistical bureau with the reporting producer and corrected if found to be in error. All replies to these questions were discussed by the Commission's accountants with the Consumers' Counsel, and items found not to be a proper charge against cost as defined in the act were recommended for disallowance during the hearing. *Second Annual Report of the N.B.C.C., 1937-38*, p. 10.

On January 30, 1939 the United States Supreme Court sustained the right of

The district boards next filed with the Commission proposed minimum prices for the various kinds, qualities, and sizes of coal produced in their respective districts. The Commission, after publishing these proposals, conducted public hearings on them, in September, October, and November 1938. The record of testimony at these hearings contains 7,995 pages and 575 exhibits.¹⁰⁹ The preparation and analysis of the evidence involved a vast amount of statistical work on the part of the Commission. For example, to review the classifications proposed by district boards for the coals of their code members, and to check the price differentials for the various kinds, qualities, and sizes produced, the Commission collected reports from 7,000 code members on "the qualities and sizes obtained at each mine, the seam operated, and available chemical analyses."¹¹⁰

The next step in the procedure for fixing prices and rules and regulations is for the district boards to co-ordinate the prices of the coals from the various producing districts for common consuming market areas. As this work requires a detailed knowledge of freight rates, and as no existing analysis of rates was adequate, the traffic section of the Commission had compiled the freight rates for coal "moving from every origin rate group to all destinations served by rail in the United States or in the Canadian Provinces served by American coal." These files contain more than 1 million rates classified and indexed for immediate reference, and are constantly being revised. The Commission has also undertaken to compile data on the tonnage of each grade and size of coal which moves into each market. For this purpose, every producer shipping by rail or water has been required to show the number of tons of each kind, quality, and size of coal shipped to each destination. Truck mines have been called on for similar reports in simpler form. The reports received up to November 15, 1938 covered the distribution of 428 million

the Commission to disclose the original cost data to interested parties, whereupon the Commission reopened the cost hearings. *Utah Fuel Co. v. National Bituminous Coal Commission*, 306 U.S. 56 (1939). See also *Second Annual Report of the N.B.C.C., 1937-38*, pp. 11-12.

¹⁰⁹ *Third Annual Report under the Bituminous Coal Act, 1938-39*, p. 12.

¹¹⁰ *Second Annual Report of the N.B.C.C., 1937-38*, p. 13.

tons in the year 1937.¹⁰⁴ This compilation of data shows "the movement of coal from each rail-shipping mine to city of destination, by class and size of coal, by consumer use, by freight-origin groups, and by market area."¹⁰⁵

The district boards were asked to complete the co-ordination of prices by March 15, 1939, but since most of them failed to do so, the Commission completed the co-ordination. It then published schedules of proposed co-ordinated minimum prices for all districts, so that each code member was given a proposed minimum price for each kind, quality, and size of coal produced by him for shipment into every market area into which he shipped coal. Final hearings on these proposed co-ordinated prices were held from May 1939 until January 1940. These hearings concerned coals produced at the mines of more than 12,000 code members, shipping annually about 400 million tons of bituminous coal from more than 30 states. Nearly 1,000 hours were spent in the hearings, and approximately 26,000 pages of testimony and 1,800 exhibits were put into the record.

The next step was the publication in April 1940 of the final price schedules which the Division trial examiners recommended. The hearing of exceptions to the examiners' findings by the director of the Division, and of appeals to the Secretary of the Interior, will complete the process for the final establishment of prices.¹⁰⁶

In order to secure compliance with the act, the Division, as we have seen, may issue a cease and desist order enforceable in certain

¹⁰⁴ The same, p. 14, and information obtained from the Bituminous Coal Division.

¹⁰⁵ N.R.C., *Energy Resources*, p. 413.

¹⁰⁶ *Third Annual Report under the Bituminous Coal Act, 1938-39*, pp. 15-18; U. S. Dept. of the Interior, Bituminous Coal Division, Press Release No. C.D. 47, Jan. 20, 1940; No. P. N. 9809, April 16, 1940.

The Director of the Coal Division has announced that in order to eliminate possible legal controversy, although the Director and the Secretary of the Interior believe review by the Secretary to be unnecessary as a matter of law, parties who desire to do so may file with the Secretary of the Interior exceptions to the orders establishing prices. Such exceptions may be filed, together with supporting briefs, within ten days of the date of the Director's order. This procedure does not contemplate oral argument before the Secretary, nor will it ordinarily delay the effective date of minimum prices, since the Secretary of the Interior will consider these exceptions during the interim period which is to elapse between the issuance of the prices and their effective date. U. S. Dept. of the Interior, Bituminous Coal Division, Press Release No. C.D. 41, Dec. 14, 1939.

courts, or it may revoke code membership and thus subject the producer to the 19½ per cent tax. The most important means of locating violations is through the filing of invoices, contracts, and spot orders with the Division. Producers have been required to file records of all contracts and spot orders since June 1937, and of all invoices and credit memoranda since January 1, 1938. Wholesalers who apply for registration as distributors are also required to file copies of their invoices. The number of copies of documents of sale received runs between four and five million a year.¹⁰⁷

In addition to the hearings held at the three stages of determining costs, proposing prices, and co-ordinating prices, the Commission held hearings to determine what transactions in intrastate commerce in bituminous coal affect interstate commerce and thus come under the provisions of the act.¹⁰⁸ It also held hearings in order that it might prescribe reasonable maximum discounts and price allowances to distributors.¹⁰⁹

Finally, it held hearings on applications for the approval of marketing agencies. Section 12 of the act exempts from the provisions of the anti-trust laws any agreement creating a marketing agency for the co-operative marketing of coal by producers of coal who are code members, provided that the agreement has received the approval of the Division. Moreover, the Division may establish reasonable regulations concerning the operations of marketing agencies. Any such agreements must not "unreasonably restrict the supply of coal in interstate commerce," must not "prevent the public from receiving coal at fair and reasonable prices," and must not "operate against the public interest." Since April 1937, when the act went into effect, 16 marketing groups have applied for approval, and 11 have received it. Some of these agencies have never engaged in the marketing or sale of coal, and only three have been in operation since 1937. These three showed a considerable decline in membership between 1937 and 1939. The producers who were members of approved agencies in October 1939, however, pro-

¹⁰⁷ *Second Annual Report of the N.B.C.C., 1937-38*, p. 15. The average invoice received covers 94 tons of coal.

¹⁰⁸ For a brief summary of these proceedings, see the same, pp. 16-17.

¹⁰⁹ The same, pp. 17-19.

duced more than 20 per cent of the total national output, though they numbered only 184 out of 12,622 code members.¹¹⁰

It is easy to see from the foregoing description of the work of the Commission and its successor, the Division, that the administrative task involved in this regulation of the bituminous coal industry by the government is very extensive and very complicated. The great care which must be taken in the procedure of the Division in order to maintain the legal rights of the persons involved requires so much time and so much detailed work that continuous flexibility in the pricing of various classes of coal—even in terms limited to the criteria set forth in the act—may be impossible.

VIII. APPRAISAL

The principal objective of price control of bituminous coal under the acts of 1935 and 1937 is to protect the operators and workers from the results of market competition.¹¹¹ This is to be done by keeping prices up to a minimum level determined by average production costs in a given area, excluding a return on investment.¹¹² Somewhat similar purposes motivate the special controls imposed over industries affected by foreign competition, agriculture, and petroleum, although the method used in these cases has been control of supply or the grant of subsidies, not direct price regulation. In contrast is the regulation of the rates charged by so-called public utilities, where the purpose is almost entirely the protection of the consumer from monopolistic price control, though some other phases of public utility regulation are designed to protect and effectuate the monopoly itself. Special regulation in the field of transportation combines both sets of objectives. The rates fixed by the I.C.C. are both maximum and minimum, to protect the consumer from exploitation in those cases where there is a substantial monopoly, and to protect the members of the industry from the full force of com-

¹¹⁰ *Third Annual Report under the Bituminous Coal Act, 1938-39*, pp. 24-26.

¹¹¹ Earlier special federal regulation of this industry, as we have seen, was designed to protect consumers against the working of these same competitive forces.

¹¹² As is pointed out above, the Bituminous Coal Division does have power also to fix maximum prices if the public interest requires it, but this contingency is deemed to be remote, and there have been no investigations or discussions looking to the use of this power.

petition. Similar objectives govern the controls over abandonment, maintenance, and extension of service by railways.

The full effects of special regulation in the field of bituminous coal cannot yet be judged, in view of the fact that minimum prices are just being established as this volume goes to press. Certain features of the act, when appraised in terms of its presumed objectives, point, however, to difficulties and problems which may be expected to arise. First, one may note what appears to be a number of ambiguities or conflicts of objectives. It is implicit in the scheme that prices are to be kept above the competitive level so long as competitive prices are below costs, yet "existing fair competitive opportunities" are to be preserved, and there must be "due regard to the interests of the consuming public." In co-ordinating prices for common consuming markets, it is necessary that the prices fixed for like kinds, qualities, and sizes of coal be uniform at points of delivery, despite the fact that there are wide variations as between mines and between competing districts, both in costs of mining and of transportation. Yet the Division is called upon to see that these prices not only cover the average cost of production in each minimum-price area, but that they be "just and equitable" both as between producers and between districts, and at the same time preserve "existing fair competitive opportunities." Secondly, there are very serious administrative difficulties. Even if the various criteria mentioned in this paragraph prove to be more consistent than they appear, their practical application in fixing some 400,000 prices is clearly an overwhelming task.

Of greater significance is the question whether the controls provided in the present special treatment of bituminous coal are reasonably adapted to the objectives of the regulation. These must be considered separately from the respective standpoints of mine operators, mine laborers, and the public.

While the criteria which are to govern price-fixing do not explicitly require that prices be raised, it is clear that the act would have no meaning under the conditions which now prevail in this industry and have prevailed for several years, if prices were to be fixed at or below their present level. Apart from the gains which may come to certain operators because prices are fixed so as to give

them an advantage over their competitors, coal operators in general stand to gain at least temporarily from an increase in prices. A rise in coal prices of the magnitude which may be expected from the present regulation, while it will probably cause some loss of business to competing sources of energy, is not likely to have any important immediate effect on the total volume of coal consumption. The explanation for this lies in the fact that the mine price of coal is only a small part of the cost to the consumer,¹¹⁸ and that the other costs are not affected by the regulation. Moreover, in by far the largest proportion of its uses, coal costs are only a minor fraction of the total costs of production, while a change to another type of fuel would in most cases involve expensive changes in equipment. Although in the long run these factors are unlikely to be controlling, because of the many effective possibilities of substitution, they do provide short-run opportunities for increasing profits.

An equally important objective of the act is the maintenance of current wage contracts, with the hope of raising wage levels. It was expected that an increase in prices would enable the union at least to maintain wages at the existing level, and perhaps to secure increased wages for its members. If the consumption of coal is not affected materially by the price increase which accompanies an increase in wages, it is probable that such wage increases will not result in a significant immediate diminution in employment. It is, moreover, presumed that increases in wage costs will be reflected in revised schedules of minimum prices, so that producer resistance to increased wages will be minimized.

In the long run, the prospects of gain from the current regulation, either to operators or to workers, are much less than in the short run. As existing coal-burning equipment wears out, opportunities will arise for shifting to other fuels without adding unduly to investment. The pressure of substitute fuels, which are already making steady inroads into the coal market, will be increased in proportion as coal prices are pushed upward. Higher wages will give a further stimulus to mechanization of the industry, and thus to a

¹¹⁸ In the case of domestic coal consumption, mine cost is much less than freight and distribution. In the case of railroad fuel, it is a very high proportion, while the industrial uses are intermediate.

further diminution of direct employment.¹¹⁴ In times of cyclical recessions in general business activity, the fixation of wages and of coal prices may bring about even more serious curtailments in consumption than took place in the recent depression.

That portion of the price increase which is not passed on to laborers in increased wages may be dissipated in large part by the diversion of the competitive effort of the operators into such channels as increased sales efforts and indirect price cutting.¹¹⁵ It is tactics such as these which, once prices are pegged, provide the most promising outlets for the strong competitive forces which exist in this industry.

From the standpoint of the public, a serious difficulty may arise because of the existence of a great multiplicity of kinds, sizes, and uses for coal, and because of the possibility of substituting one type of coal for another in any single use. The price differentials that are established for the various types of coal have an important effect on their sales. When the margins between the prices of different types of coal are fixed, the substitution of one type of coal for another, and the selection of the type which from a social standpoint is most economical for a particular purpose, may be made more difficult.¹¹⁶ The extreme complexity of determining the relative merits of the enormous variety of coal types and sizes in the absence of freely moving prices, the frequent shifts of production between areas, the changes in the varieties of coal produced and in their relative costs and demands, make this difficulty a very significant one.

A separate set of issues is raised by the question whether the controls imposed under the act have any real value in promoting the stated objectives of conservation. Some proponents of price control argue that if the rate of return to capital in the industry can be raised above the level set by competition, producers will

¹¹⁴ For a recent study of the increase in the mechanization of the mines, see W.P.A., National Research Project, *Mechanization, Employment, and Output per Man in Bituminous Coal Mining*, 2 vols. (1939).

¹¹⁵ The act provides some control over indirect price cutting, but it is not clear that all methods which may be conceived have been covered.

¹¹⁶ National Bureau of Economic Research, *Report of the Committee on Prices in the Bituminous Coal Industry* (1938); J. P. Miller, "The Pricing of Bituminous Coal," in *Public Policy*, edited by C. J. Friedrich and E. S. Mason (1940), pp. 144-75.

be likely to follow a socially more satisfactory rate of exploitation, and to modify to social advantage their tendency to mine the best veins of coal first. It is obvious, however, that the rate of exploitation of a natural resource attained under competition, if all factors of cost and gains are considered by the operators (including the interest cost of deferred recovery, and considerations of present as against future worth), is also the rate at which the resource yields the greatest total benefit to the public, as measured by pecuniary standards. There is, moreover, no reason to believe that a rise in coal prices will have any effect on the advantages of mining the best veins first. The choice of veins to be mined is a matter of the alternative prospects of gain in the use of capital within the coal industry, and this is not affected by the absolute level of coal prices.¹¹⁷

In any case, the conservation argument for special regulation of bituminous coal at this time appears to be of dubious merit. As was noted above, the known reserves have an estimated life of a minimum of hundreds of years, even if the upward trend of consumption is resumed. In these circumstances, there appears little justification for requiring methods of recovery more expensive than those which are dictated by the self-interest of owners. The case for restricting the output of coal appears all the weaker when it is realized that this is likely to increase the consumption of other fuels (particularly oil), the known supplies of which are far more limited.

It might appear that, having pressed successfully for government control in the early twenties, when coal operators were enjoying the benefits of high prices, coal consumers are in a weakened position to complain if they are denied some of the benefit of competitive prices that reflect a condition in which demand is not sufficient to justify economically the volume of investment that has been

¹¹⁷ If the purpose of regulation is merely to reduce consumption, and thereby to lengthen the life of our coal reserves, it is obvious that price-raising measures will tend to accomplish this purpose. They will also provide a slightly greater incentive to the use of methods which will achieve an eventually increased total recovery, at a higher cost.

The special conditions surrounding the production of petroleum and natural gas, which make that industry somewhat different from bituminous coal, are discussed in Chap. XXV.

made in the coal industry. The two situations are not, however, directly comparable. The high prices of the early post-war period resulted from obstructions to the production and free movement of coal which cannot be considered to be part of a properly functioning system of private enterprise, whereas the current depressed prices have arisen from changes in the demand for coal.

The question whether the government should undertake to protect the members of an industry against the effects of a decline in the demand for its products is a fundamental one. In contrast with the policy which has generally been pursued outside the areas of special treatment, regulation of the character now being applied to the bituminous coal industry will soften the penalties of any failure of mine owners and mine laborers to allocate the resources which they control in response to market demands, and consequently will diminish the incentive to the making of such an allocation. It is likely to create an obstacle to the movement of labor to better uses, and perhaps a barrier to the development of mines competitively more efficient than those already in operation. If this regulation is effective, there will be at least a temporary increase of operator and worker incomes in the industry and perhaps a permanent increase in prices, at the expense of coal consumers. This is a significant departure from our traditional reliance on the free discretion of the individual in bringing about the allocation of resources to the satisfaction of consumer demand. If this idea is to be more broadly applied as similar situations arise in other industries, it may eventually necessitate detailed regulation of prices and production, with controls over the flow of capital and output in industry generally. The more widely such a policy is followed, the less is the net benefit to the members of the regulated industries, and the larger is the cost to the community as a whole.

It must be concluded that it is highly improbable that the fixing of prices can be made effective in so inherently competitive an industry as coal, without the imposition of governmental controls over output. Moreover, even if coal prices are successfully raised, it is improbable that they will yield permanent gains either to the operators or laborers, or bring about a socially more advantageous rate and technique of exploitation. It seems clear, there-

fore, that the present arrangement is a makeshift which cannot long be deemed satisfactory. The direction of change—whether abandonment or fortification of current regulation—will depend upon the strength of the conflicting forces both within and without the industry.

CHAPTER XXV

PETROLEUM AND NATURAL GAS

Governmental activity with respect to the production and distribution of oil and gas affords a good illustration of several striking tendencies in the present trend of the relations of government and business in the United States, including the trend toward the exercise by government of increasing managerial controls over the operations of private business, the tendency of the federal government to assume an increasing degree of responsibility for the performance of functions formerly left to the states, the increasing interest in conservation of natural resources, and the tendency toward the protection of industry from the adverse effects of competition, if necessary, at the expense of the consumer.

I. THE BACKGROUND OF REGULATION

In the case of oil, the special governmental controls relate almost entirely to the production and the marketing of the basic raw material, crude oil. In the case of natural gas, there are two distinct systems of control, one relating to production and the other to distribution and marketing. The latter system is discussed in the chapter on public utilities along with the control of the manufactured gas industry, to which it is closely related. In this chapter we are concerned only with governmental control over the drilling of oil and gas wells and their operation. As this is entirely an intrastate activity, governmental control naturally first developed as a state function. The federal government has been drawn into the field chiefly because of the competitive difficulties of state control over a product which is sold in a national market; partly because of stakes of the federal government, as proprietor of the public domain, in the exploitation of oil and gas resources; and perhaps partly also because of the fact that oil and gas are occasionally found in large pools which are crossed by state lines, and because there are certain national considerations which may be ignored by state governments.

Although in many cases oil is recovered from wells which do

not produce gas, and gas from wells which do not produce oil, as a general rule they occur together. The structure of control correspondingly includes some legislation and administration which relates only to one or the other, and some which relates to both. It will be most convenient to discuss the two together.

Public interest in special control of oil and natural gas production stems from four sources:

1. Conservation of exhaustible and highly essential natural resources.
2. Conservation of other resources through the prevention of unnecessary costs in the development of oil and gas resources.
3. Protection of the rights of individual owners of portions of underground stocks of oil and gas which can be drawn off by any one of them.
4. Price "stabilization"; that is, the maintenance of higher prices than the public would have to pay, at least temporarily, in the absence of special regulation.

In principle, the first of these issues is the same in the oil and gas industries as in other industries which exploit exhaustible and irreplaceable natural resources; and the fourth issue has arisen with regard to several other industries, as is pointed out in the chapters on foreign commerce, agriculture, and bituminous coal. But the forms in which the issues arise, and the types of regulation that have been applied to the petroleum and natural gas industry are entirely different from those which characterize any other industry. The unique character of the problems of the industry and of the types of regulation that have been developed are due chiefly to three factors: first, the mobility of these fluid minerals, which makes their extraction unusually easy once they are located and creates the problem of drainage of oil across ownership boundaries; second, the legal "rule of capture" which bases ownership not on title to the surface soil, as is the case with non-fluid minerals, but on reduction to possession; and third, the diversity of ownership within single oil pools, which springs in part from a desire to spread the risks of exploration and development.

A standard argument for the application of special public rules to the oil and natural gas industries is derived from the public

interest in the conservation of irreplaceable and highly important wasting assets. In this respect, the argument for special control parallels that which is urged in the case of the coal industry, discussed in Chapter XXIV. The difference is that the prospective exhaustion of the known oil supply is figured in decades, while that of coal is figured in centuries.¹ This factor, taken in conjunction with the importance of oil in the industrial system and in the contemporary mode of life, is widely accepted as a justification for public rules designed to lengthen the period of utilization of existing supplies, even though this involves an increase of prices for the immediate future.

It is unnecessary to discuss in detail the essential role of petroleum and natural gas in modern society, which arises primarily from the dependence of both urban and rural communities upon gasoline as fuel for automotive transport,² and, hardly less important, from the dependence of industry upon mineral oils for the lubrication of machinery.

The key position of the oil and natural gas industries in our national economy may be better appraised if we recall the history of their rise to prominence. The first oil well was drilled in 1859.³ Forty years later there were produced annually in the United States 60 million barrels of oil and 100 billion cubic feet of gas, and in the next 40 years, output of both was increased over 20-fold. The present annual rates of production are approximately 1,300 million barrels of oil and 2,300 billion cubic feet of marketed gas.⁴ The phenomenal growth of these industries may also be shown by the increase of the proportion of total energy for which they account. In the present century the proportion has increased from 7 per cent to 43 per cent.⁵ The proven reserves of crude oil in the

¹ It should be noted, however, that despite its enormously extended use, because of the continuous discovery of new supplies, the known reserves of oil and gas, when measured in terms of years' supply, have not changed greatly over a period of many years—varying during the past five years around a 14-year supply.

² Petroleum and natural gas are not the only known sources of motor fuel, but known substitutes are much more costly.

³ For a concise and readable history of the oil industry, see John Ise, *The United States Oil Policy* (1926).

⁴ The output data are taken from *Minerals Yearbook*, 1938, pp. 818, 907, published by the U. S. Bureau of Mines, and earlier volumes in the same series.

⁵ See *Minerals Yearbook*, 1937, p. 807, and 1938, pp. 701-05. The years for which the textual figures are given are 1899 and 1937. It should be noted that this

United States were estimated at approximately 18½ billion barrels, as of January 1, 1940.⁶ At the current rate of consumption this means a supply for approximately 14 years. However, all such estimates are subject to very significant qualifications, which are well summarized in the following quotation:

The proven reserve is quite a different matter from the volume of oil yet to be produced, for the former represents only the apparent volume of blocked out oil, whereas the latter includes oil yet to be discovered as well as additional oil to be recovered from known deposits by improved methods. In fact, one of the prime causes of the recent increases in the indicated reserve is the revision brought about by the increased efficiencies of improved technique and delayed production. The size of the proven reserve gives no clue to, and logically cannot be expected to reveal, the imminence or remoteness of scarcity.⁷

A closely allied reason for special public interest in the oil industry is found in the importance of petroleum in the national defense. This is due not only to the growth of the air force and the increasing use of oil products by the army in consequence of mechanization, but also to the increasing dependence of modern warfare on the heavy industries which in turn are dependent on oil products.

Another reason for specialized treatment of the oil and gas industries is found in the fact that the form and incidence of private ownership, as the industry has traditionally been organized, in combination with the peculiar set of technological conditions encountered in the extraction of oil and gas, make it almost impossible for private enterprises, in the absence of special regulation, to utilize the most efficient and economical methods of operation, without impairing individual claims to an equitable share in the value of the common pool. An understanding of this phase of the problem requires some discussion of the legal prescriptions and technological conditions under which the industry operates.

computation is made by converting all fuels into their respective B.T.U. contents. This basis of calculation fails by a fairly wide margin to accord adequate credit to oil as a source of energy, since in the case of gasoline, and to a less extent kerosene and fuel oil, the heating value represents only a minor factor in the total energy generated therefrom. This is not true of coal and wood. Compare Myron W. Watkins, *Oil: Stabilization or Conservation?* (1937), p. 3.

⁶ American Petroleum Institute, Press Release of Mar. 25, 1940.

⁷ Joseph E. Pogue, *Economics of the Petroleum Industry*, p. 15.

Legal background of special regulation. The legal structure of the oil industry was formulated at a time when there was no previous experience in dealing with any closely analogous situation, and when there was little knowledge of the physical conditions underlying the exploitation of gas and oil resources. From the beginning, the law made oil and gas, like other minerals, the property of the owner of the overlying surface,⁸ but only if they were reduced to possession, following the analogy of the case of wild animals.⁹ This is the so-called "rule of capture" which is now considered to be an obstacle in the way of a satisfactory exploitation of oil and gas resources.

The effect of the "rule of capture" is to make it imperative for any owner or lessee of a tract of land known to overlie an oil or gas deposit to drill numerous wells as rapidly as possible and to extract as much of the deposit as he can before it is drained off through neighboring wells. So obvious is this necessity that the law has incorporated, as an implied term in every lease of oil land on a royalty basis, a covenant obliging the lessee diligently to develop the tract in the event of discovery being made there or in close proximity thereto.¹⁰ The obligation to drill and operate offset wells to prevent loss by draining has been especially emphasized. Hence each successive discovery of oil has immediately precipitated an offset drilling campaign and a race in production.

The offset pattern of drilling dictated by sound strategy under

⁸ For detailed accounts of the development of oil and gas law, consult: W. W. Thornton, *Law of Oil and Gas*, rev. ed., 6 vols. (1932); and W. L. Summers *Law of Oil and Gas*, permanent edition, 6 vols. (1938). For briefer treatments, see W. L. Summers, "Property in Oil and Gas," *Yale Law Journal*, Vol. 29 (1919) p. 174; J. A. Veasey, "The Law of Oil and Gas," *Michigan Law Review*, Vol. 18 (1920), p. 445; and N. L. Meyers and J. H. Marshall, "Legal Planning of Petroleum Production," *Yale Law Journal*, Vol. 41 (1932), p. 33.

⁹ The first reference to the analogy of wild animals was made in *Westmoreland Gas Co. v. DeWitt*, 130 Pa. 235 (1889), but the rule of capture had been authoritatively announced and applied as early as 1875 in *Brown v. Vandergrift*, 80 Pa. 142 (1875). It was confirmed by the U. S. Supreme Court in *Brown v. Spilman* 155 U.S. 665 (1895). Compare R. E. Hardwicke, "The Rule of Capture and Its Implications as Applied to Oil and Gas," *Texas Law Review*, Vol. 13 (1935), p. 391.

¹⁰ See for example *Parish Fork Oil Co. v. Bridgewater Gas Co.*, 51 W.Va. 583 (1902). For a collection of numerous cases upon this point consult, in addition to the general works cited above, N. Ely, *Oil Conservation through Interstate Agreement* (1933), p. 10 ff.

the rule of capture remains to the present day the settled rule in oil and gas field development. Characteristically the number, arrangement, and spacing of wells are not determined primarily by the geologic and engineering factors determining recovery efficiency, but rather by the pattern of ownership and leasing of the surface.

Technological background of regulation. From the standpoint of orderly production, the migratory characteristics of oil and gas distinguish them from other minerals. These fluid minerals do not "stay put" in the geologic structure in which they occur in nature. As soon as a drill penetrates the overlying stratum which confines them, they find an outlet from the high pressure under which they have been held. The reservoir pressure is neither of the same degree nor a resultant of the same combination of forces in every pool, but in some proportion hydrostatic pressure, the expansive power of the gas, and the force of gravity always combine to create a reservoir pressure which is in excess of the atmospheric pressure. Hence the oil and gas tend to move through any aperture made in the strata which confine them. It is this rush to escape from nature's storehouse which renders oil and gas production so little amenable to control by ordinary economic considerations.

With ownership diversified, these technical characteristics of oil and gas deposits, when combined with the legal rule of capture, have led to a larger investment and to a more costly and less complete exhaustion of supply than would be expected if ownership were unified.

There is no disagreement upon the proposition that native reservoir energy affords the most efficient and economical source of propulsion of oil and gas from the formation.¹¹ The problem is simply how and to what degree this energy should be preserved, and made to do useful work in lifting these raw materials to the surface. Though there was formerly some dispute upon the point,

¹¹ See Federal Oil Conservation Board, Report V, October 1932, Appendix VI; H. C. Miller and B. E. Lindsly, "Report on Petroleum Production and Development," in *Petroleum Investigation*, Hearings before (H.) Committee on Interstate and Foreign Commerce on H. Res. 441, 73 Cong., Pt. 2, pp. 1087-1306; American Petroleum Institute, *Drilling and Production Practice* (1934); and N. Ely, "The Conservation of Oil," *Harvard Law Review*, Vol. 51 (1938), p. 1209.

petroleum geologists and engineers are now generally agreed that for the purpose of maximizing output, the major desideratum in every type of field is the preservation, so far as may be, of the equilibrium of forces in the reservoir during the process of production.¹² This can only be achieved by holding back the natural rate of flow so as to retard the decline of reservoir pressure. Why this is essential and how it relates to the development of special regulation, require a brief explanation.

With every withdrawal of a given volume of oil or gas, a certain displacement occurs within the formation. If the oil and gas are allowed to flow freely, the gas that is dissolved in oil tends to escape from solution, while the "free" gas, being more fluid, tends to "by-pass" the oil on the way toward the well. Likewise water, being less viscous than oil, tends to be propelled more readily towards the low-pressure point. The rapid withdrawal of either oil or gas, because it does not allow sufficient time for natural forces to restore equality of pressure throughout the formation, disturbs the relative positions of the three fluid elements within the reservoir as they exist under conditions of natural equilibrium: the water beneath the oil and the oil beneath the "free" gas (if any). "Pockets" of viscous oil, "channels" or "cones" of water, and gas "caps" appear. The resultant irregular distribution of the fluid elements in the structure dissipates the native reservoir energy and causes a diminished recovery before pumping becomes necessary. Moreover, since the well cannot be shifted about like the nozzle of a vacuum cleaner, even under artificial lift large volumes of the scattered oil are wholly unrecoverable. If, in accordance with the recognized principles of efficient production technique, the rate of withdrawal is held below the open-flow rate, recovery can be materially increased.

However, if an individual operator attempts to use this technique independently of others, the oil and gas thus conserved will migrate within the structure towards other wells. Unless every well penetrating to the producing horizon is operated under a check suffi-

¹² See, for example, C. H. Lieb, "Economics of Oil-Producing Practice," *Mining and Metallurgy*, Vol. 17, June 1936, pp. 291-95; V. H. Wilhelm, "Petroleum Development and Production in the Future," the same, July 1936, pp. 343-35; and the same, pp. 345-47.

cient to maintain reservoir pressure substantially uniform throughout the formation, the proportionate recovery of different wells will be changed, to the disadvantage of those where production is checked most.¹³ Consequently, in the absence of a concerted production program, voluntary or constrained, no producer can afford to hold down his rate of output in order to conserve the pressure. Moreover, even apart from the question of drainage, it may be the most business-like course for an operator to allow gas to blow to the air as a means of drawing oil towards the well. This is likely to be true if the drill happens to penetrate the structure at a point where only "dry" gas flows, and if, because of the location of the field relative to markets, this gas has little or no immediate value. Whether such a policy is expedient will depend, of course, upon factors other than merely the marketability of the gas.¹⁴

Under these circumstances, the individual operator of one or more oil or gas wells in a pool, the surface ownership of which is subdivided, cannot afford to restrict his current production in accordance with the dictates of efficient utilization of reservoir energy for the pool as a whole. His adjustment of current production to current and prospective prices, and to current and prospective costs during the life of the well, is affected by the constraint to "capture" these fugacious materials as rapidly as possible, in order to avoid sacrifice of his (unknown) "share" in the common pool to his neighbors.

The hazardous and uncertain character of discovery and development of oil and gas resources is also sometimes said to necessitate special consideration of the industry. The location of gas and oil under the earth's surface can be definitely determined only by a costly exploratory operation, and the extent of a deposit re-

¹³ While the statement in the text requires, strictly, no qualification, it should be added, perhaps, that the susceptibility of oil and gas to drainage depends greatly upon conditions in each particular pool. Vital factors include: the pressure differentials in the reservoir, the porosity or permeability of the sands, and the composition of the oil.

¹⁴ It will depend among other things, for example, upon the estimated cost of "plugging off" the gas-bearing sand and drilling deeper, account being taken of the chances of tapping an oil-bearing stratum at a lower level. Other important factors will be the estimated lateral extension of the field and thickness of the petroliferous strata, and particularly the relative extent of the operator's leases within the area.

mains indeterminate until it is exhausted. Estimates of the extent of the recoverable oil and gas in a well-defined pool are subject to a wide margin of error, owing, among other things, to the impossibility of foreseeing such contingencies as the "channeling" or "coning" of the petroliferous strata by encroaching water which may cut off large bodies of oil and gas from movement towards the well.

However, the mere speculative character of enterprise in the discovery of oil does not by itself offer any presumption in favor of special public regulation of either discovery or operation. This is especially true since, although single pools are commonly small in relation to the total output and are quickly exhausted, so that there is a necessity for continual exploration and discovery if the supply is to be forthcoming, nowhere is there any suggestion that the amount of investment going into discovery, or the rate of discovery, is "lagging" behind some appropriate standard. In fact, it is frequently asserted that, in view of the rate of return, the amount of investment which goes into discovery is in excess of what is appropriate from a pecuniary point of view. Nor is the "wasteful" utilization of resources in the search for profitable undertakings generally considered as adequate justification for special public rules, unless the undertaking is characterized by fraud.

II. STATE CONTROL

Early legislation. Until about 1915 the special legislation for the oil industry did not involve the regulation of output. This is not surprising. From the producer's point of view, the rapid rate of growth in demand resulted in "satisfactory" prices, even in the face of "flush," or unregulated production. And the public interest in conservation was not then as great as it has since become. The technical connection between the rate of output and productive efficiency was not definitely known, and the use of petroleum had not grown so great or so widespread as to create a general concern over the preservation of supply.¹⁵

¹⁵ See 76 Cong., *Petroleum Investigation*, Hearings before (H.) Committee on Interstate and Foreign Commerce on H. Res. 290 and H.R. 7372 (1939-40), Pt. 1, pp. 515-29.

The first state legislation for the oil industry involved prevention of obvious "waste" of gas and oil resources. An example is the Pennsylvania act of 1878 which required the plugging of wells upon abandonment so as to exclude the infiltration of surface water.¹⁶ A second type of "waste," again of the "obvious" type, dealt with by early state legislation, was the attempt to deal with gas blown into the air or burned needlessly in the field. The use of natural gas for illuminating purposes in flambeau lights was forbidden as "a wasteful and extravagant use thereof" by an Indiana act of 1891.¹⁷ Two years later Indiana enacted legislation which provided that neither oil nor gas should be permitted to flow or escape into the air for a period longer than two days.¹⁸ While this statute may be said to have involved limitation of output, it did not expressly assert a public interest in the conservation of the natural resources of the state. In fact, it would appear that the primary objective of this waste-prevention measure was to protect the correlative rights of owners in common, though it contained no express stipulation of ratable taking, much less provision for an administrative determination of the respective shares of the several owners. It was largely on the ground that the police power of the state extended to such protection of the rights of common owners that the Supreme Court upheld the statute.¹⁹

In the decade following the passage of the Indiana law a number of other states adopted similar waste-prevention measures.²⁰

¹⁶ National Resources Committee, *Energy Resources and National Policy* (1939), p. 197. An additional effort to deal with the same type of "waste" is to be found in the Ohio act of 1883, requiring the casing of wells so as to prevent fresh water from penetrating the oil sand.

¹⁷ See Burns' Annotated Indiana Statutes, 1926, secs. 3016 and 4805.

¹⁸ Laws of Indiana, 1893, c. 36; Burns' Annotated Indiana Statutes, 1926, sec. 4802. This statute was upheld in *State v. Ohio Oil Co.*, 150 Ind. 21 (1897), 50 N.E. 1125 (1899).

¹⁹ *Ohio Oil Co. v. Indiana*, 177 U.S. 190 (1900).

"... the use by one of his power . . . to convert a part of the common fund to actual possession may result in an *undue proportion* being attributed to one of the possessors of the right, to the detriment of the others, or by *waste* by one or more, to the annihilation of the rights of the remainder. Hence it is that the legislative power . . . can be manifested for the purpose of protecting all the collective owners, by securing a *just distribution* . . . and to reach the like end by preventing *waste*." 177 U.S., at 210. Italics supplied.

²⁰ See J. A. Austin, "Compilation and Digest of Federal and State Statutes Relating to Attempts to Conserve Natural Gas," published as Appendix L-1 to

Some of these statutes were but indifferently enforced, and even when enforced they had in some instances little if any effect on the oil branch of the industry. Those who produced oil and had little interest in gas were able under some state laws to ignore regulations relating to their gas operations. For example, the West Virginia law of 1897 and the Texas law of 1899²¹ provided that the section designed to prevent the escape of gas from any well producing gas should not apply to any well producing both oil and gas from the same well, or to any well while it was being operated as an oil well.²²

Oklahoma. For over a decade after the early legislation just cited, there was very little public interest in the problems of the oil industry. In 1915, however, Oklahoma passed two separate laws, one prohibiting the wasteful production of oil, and the other prohibiting the wasteful production of natural gas.²³ This legislation may be said to mark the beginning of the present system of oil regulation, particularly with respect to the control of the rate of output, or proration.²⁴ This Oklahoma legislation of 1915 did not, however, lead to any practical results. It is important mainly because it was imitated by other states and because the

Utility Corporations, Report of Federal Trade Commission pursuant to S. res. 83, 70 Cong. 1 sess., Pt. 84-B (1936). A description of early legislation of this type in Texas, beginning with the act of 1899, may be found in R. E. Hardwicke, "Legal History of Proration of Oil Production in Texas," *Texas Law Review*, October 1937, Proceedings of the 56th Annual Meeting, Texas Bar Assn., p. 99.

²¹ Laws of West Virginia, 1897, c. 58, sec. 3; General Laws of Texas, 1899, c. 49, sec. 3.

²² The first limitation on gas when produced with oil was provided by an Oklahoma law of 1905 which permitted the wastage of gas produced with oil only when the oil produced had a greater field value than that of the gas "wasted." The Louisiana law of 1910 embodied the same limitation. The form of the regulation, however, made it unenforceable. Oklahoma Session Laws, 1905, c. 26, sec. 5; Acts of Louisiana, 1910, Act No. 190.

²³ Oklahoma Session Laws, 1915, c. 25, Act of Feb. 11, 1915; the same, c. 197, Act of Mar. 30, 1915.

²⁴ An earlier proration statute was passed in Oklahoma in 1913 (Oklahoma Session Laws, 1913, c. 99). But it was applicable only to natural gas production, prohibiting operations of gas wells in excess of 25 per cent of their potential open-flow capacity. There is no evidence that it was enforced, and it appears to have been superseded by the legislation of 1915. An even earlier Oklahoma statute (of Mar. 27, 1909) under which some price-fixing orders were issued should also be cited. Oklahoma Session Laws, 1909, c. 26.

standards and procedures it set up have remained substantially unaltered for a quarter of a century.

The natural gas law required that gas should be produced and utilized without waste, waste being defined in physical terms, but it also forbade gas well owners to take from a common source of supply more than their ratable shares whenever the aggregate market demand was less than the potential output, thus making marketability the test in applying proration.²⁵ The Oklahoma Corporation Commission, as the administrative agency, having been left little latitude, adopted as the criterion for the necessity of prorating natural gas, a supply in excess of the physical capacity of pipeline facilities.²⁶ On the other hand, the oil legislation of the same year went beyond the simple physical test of waste and included in the scope of regulation the elimination of "economic waste," defining the latter as "waste incident to the production . . . in excess of . . . reasonable market demands."²⁷

One section of this act illustrates clearly the importance of price as a criterion of production curtailment. It prohibited the taking of oil from the sands at any time when there is not a market demand therefor at the well at a price equivalent to the actual value of such oil. Actual value was defined as the average value in the United States at retail of the by-products of crude oil, when refined, less the cost and "a reasonable profit in the business of transporting, refining, and marketing the same." The Corporation Commission was authorized to determine this actual value.²⁸

The law also authorized the Corporation Commission, whenever "full production . . . can only be obtained under conditions constituting waste," to prorate allowable production among the several

²⁵ Oklahoma Session Laws, 1915, c. 197; compiled Statutes of Oklahoma, 1921, sec. 7924; Oklahoma Statutes, Annotated (perm. ed., 1937), Title 52, c. 3.

²⁶ See its Order No. 1299, July 16, 1917, Rule 5; and *Oklahoma Natural Gas Corp. v. State*, 161 Oklahoma 104 (1932).

²⁷ Oklahoma Session Laws, 1915, c. 25, sec. 3.

²⁸ Oklahoma Session Laws, 1915, c. 25 at p. 29. While this section remains on the Oklahoma statute books (Oklahoma Statutes, Annotated (perm. ed., 1937), Title 52, c. 3, sec. 272) the Commission never undertook to fix prices as a basis for curtailing production. In its order of Feb. 18, 1916 it specifically refused to fix the price of oil as provided in sec. 2, giving as its reason that it was impossible and impractical to do so.

well-owners entitled to produce from a common source of supply, in proportion to the potential productive capacity of their several wells. "Potential capacity" was not defined, although it seems clear that it was contemplated that quota distribution should be strictly upon the basis of producing-well capacity. This has remained the basis of proration. Attempts to employ other criteria in whole or in part, such as acreage-content, have been held invalid, although this may be attributed to the character of the Oklahoma statute.²⁹

The primary significance of the Oklahoma legislation has been in the fact that it opened the way to curtailment of production as a means of "stabilizing" the market for oil; in other words, maintaining prices at a level higher than would prevail in the absence of regulation. In fact, while the early legislation is cited as a step in the development of regulation to "conserve" oil resources, any such influence was wholly incidental.

This is clear for several reasons. In the first place, the curtailment of production as a means of more economical recovery of oil resources was then largely unknown. Secondly, the immediate occasion for the Oklahoma legislation was the increased output and decline of price which followed the flush production in the Healdton and Cushing pools. Although the obvious waste which attended attempted storage of crude oil in the presence of inadequate transport facilities was urged as justifying the legislation,³⁰ the guiding principle was the maintenance of conditions affording profitable opportunities in oil production.³¹ It is also known that the chief

²⁹ In *H. F. Wilcox Oil & Gas Co. v. State*, 162 Okla. 89 (1933) the Supreme Court of Oklahoma declared: "Under the statutes of Oklahoma, proration must be on a per well basis among the wells producing oil from a common source of supply, without regard to the identity of the producer or to the number of wells being produced by him. A proration order on any other basis is void."

³⁰ Oklahoma Session Laws, 1915, c. 197; Oklahoma Statutes, Annotated (perm. ed. 1937), Title 52, c. 3, sec. 272-74.

³¹ Compare J. E. Pogue, "Collective Planning in the Petroleum Industry," *Petroleum Development and Technology* (1935), p. 235; Watkins, *Oil: Stabilization or Conservation?* especially Chaps. IV, IX, and XIV.

A more recent statement of this point of view can be found in the Report of the National Resources Committee: "Although State oil laws have been passed and sustained as conservation measures, their primary purpose, by and large, seems to have been stabilization of the industry." (N.R.C., *Energy Resources*, p. 201.) For the role of this factor in the more recent conservation movement, compare the same, pp. 199-200.

protagonists of the Oklahoma legislation were the independent producers who wished to protect themselves against discrimination by the large-company buyers of oil. Further, it is significant that in the brief early period of restriction of production under the Oklahoma statute, the Corporation Commission based the allowable production solely upon "the amount of oil necessary to meet the daily market demands."²² In ascertaining the amount to which output should be restricted, an agent of the Commission was notified as to the quantity each purchaser would run through his pipe lines during the succeeding day. Quotas in this field were then allocated to the several operators upon the basis of their respective well-potentials. Finally, it may be noted that when restriction was later resumed, the Commission followed closely the suggestions of the industry, even to the extent of allowing individuals selected by the operators to become the agents for fixing potentials, ascertaining demand, and allocating quotas.²³

Texas. It is of further interest to trace briefly the history of regulation by Texas, both because of the importance of the state as a source of supply (furnishing, currently, over 40 per cent of the nation's requirements), and because in this state the legislative powers and administrative processes have been the subject of experimentation and the object of judicial definition to a degree not elsewhere approached.

In 1919 Texas followed Oklahoma in adopting a comprehensive

²² Oklahoma Corporation Commission, Order No. 920, issued June 5, 1915. This order was applicable to the Healdton field. It is true, however, that in support of its order it emphasized the current "practice . . . of placing . . . crude oil in earthen reservoirs." Further, the Commission supported its choice of market demand rather than capacity of transport facilities as designed to avoid "any controversy pertinent to the legal status of common carrier and common purchaser."

²³ See, for example, Oklahoma Corporation Commission, Order No. 3944, issued Aug. 9, 1927. This order was issued upon an application of one Ray Collins to curtail production in the Greater Seminole District. The order set forth a contract (Exhibit A) "between the operators and producers in said field" (the proportion of total number not stated), whereby Collins was made an "umpire" for fixing potentials, allotting quotas, and so forth. By a provision of the order, Collins was also made an "agent" of the Corporation Commission, though his entire salary was paid by the producers co-operating. This practice seems not to have been unusual. See comments upon it in *Champlin Refining Co. v. Corporation Commission*, 51 Fed. (2d) 823 (1931), and the same, 216 U.S. 210 at pp. 230-31 (1932). For evidence of a similar practice in New Mexico, see 76 Cong. 3 sess., *Petroleum Investigation*, Hearings . . . , Pt. 3, p. 1276 ff.

oil and gas conservation law.³⁴ This basic statute provided for curtailment of output whenever the aggregate potential production from any common source of supply could be produced only with "waste." The latter was defined in terms which specified numerous varieties of physical waste, and omitted any reference to market demand.³⁵ The Railroad Commission of the state was made the administrative agency responsible for the prevention of waste. Under the authority of this statute, general rules were promulgated governing methods of drilling, reports of well-logs, and similar matters; a noteworthy gesture was made towards the regulation of well-spacing, which encountered numerous judicial obstacles but before 1928 no effort was made to curtail production and establish proration.³⁶ Beginning with the opening of the Hendrick pool in that year, re-enforced by the flush production of the Powell field and numerous other fields in Central and West Texas and by the discovery of the prolific East Texas pool in 1930, Texas crude production rose enormously. This increase coincided with the expansion of output in Oklahoma from the Greater Seminole and Oklahoma City fields. The conjuncture of this expansion with a declining total demand³⁷ for oil products made restriction of production imperative if the bottom were not to drop out of the price structure of the industry, and if state revenues were not to be seriously impaired.

Under these circumstances, the proration expedient, which had been almost forgotten for ten years, was "brought out of the closet" and applied first to the Hendricks pool, then to other flush production fields, and finally, in August 1930, put into operation on a state-wide basis.³⁸ But having had the benefit neither of prior ex-

³⁴ General Laws of Texas, 1919, c. 155.

³⁵ Ten years later the legislative intent was put beyond question by an explicit exclusion of "economic waste" from the elements to be considered in determining whether a given rate of output was wasteful. Texas Laws, 1929, c. 313.

³⁶ See Hardwicke, *Texas Law Review*, October 1937, p. 99, for an excellent account of the development of proration in this state. Same, revised, *Legal History of Conservation of Oil and Gas*, Section of Mineral Law, American Bar Assn. December 1938, pp. 214-68.

³⁷ Compare Watkins, *Oil: Stabilization or Conservation?* Chap. V.

³⁸ See Hardwicke, *Texas Law Review*, October 1937, p. 106, and articles by Donoghue and Hardison on proration in Texas, *Petroleum Development and Technology* (1931), p. 67 and p. 74, respectively.

perience nor of guiding adjudication, the standards and procedures adopted by the Railroad Commission were of an exploratory stop-gap character, insufficiently adapted to the exigencies of widely varying conditions in different fields scattered from the Panhandle to the Gulf Coast. There was not sufficient co-ordination to assure equity or to appease local interests fearful of discrimination. Resistance to the proration orders was widespread and opposition vehement. The flood of litigation which ensued was hardly less unsettling and vexatious than the flood of oil the Commission was endeavoring to stem.³⁹ Finally, in 1931, martial law was declared in the East Texas field, where resistance to curtailment was most determined and resourceful, and continued to be applied for some months until the United States Supreme Court held this resort to armed force to be in violation of the Constitution.⁴⁰

The physical-waste standard of curtailment set by the 1919 statute was held in 1931 and 1932 not to be satisfied by restrictions adjusted to market demand.⁴¹ Thereupon the legislature and the governor withdrew their opposition to the use of market stabilization as a standard of curtailment, and since 1932 Texas has followed other states, at least formally, in limiting production to estimated market requirements.⁴² Quotas were at first distributed upon a flat per-well basis, later upon static bottom-hole pressure

³⁹ For a compilation of the cases, see Hardwicke, *Texas Law Review*, October 1937, pp. 107-17; N. L. Meyers and J. H. Marshall, "Legal Planning of Petroleum Production: Two Years of Proration," *Yale Law Journal*, Vol. 42 (1933), p. 702; and "Notes," 86 *American Law Reports* 418, 431 (1933), 99 *American Law Reports* 1119 (1935).

⁴⁰ *Sterling v. Constantin*, 287 U.S. 378 (1932).

⁴¹ See, for example, *MacMillan v. Railroad Commission*, 51 Fed. (2d) 400 (1931); and *People's Petroleum Producers v. Smith*, 1 Fed. Supp. 361 (1932).

⁴² Act of Nov. 12, 1932, sec. 4, amending Title 102, Article 6014 (j), Vernon's Texas Statutes. For court decisions interpreting this statute see *Danciger v. Smith*, 4 Fed. Supp. 236 (1933); *Amazon Petroleum Corp. v. Railroad Commission*, 5 Fed. Supp. 633 (1934); and *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935). See also act cited above, Art. 6049a, sec. 8a, applying the same standard to natural gas proration; and amendments of Apr. 13, 1935 and May 1, 1935, Texas Laws, 1935, c. 76 and c. 120. The latter was declared unconstitutional, in so far as it purported to authorize gas proration without regard either to waste or to drainage in *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937). A new statute regulating withdrawals of natural gas by the several owners from a common source of supply was passed on May 19, 1937. Texas Laws, 1937, c. 367.

differentials, still later upon key well-potentials, and since 1933 in some fields upon well-potentials modified by an acreage factor.⁴¹ The prorated allowables are in all cases subject to a minimum allowable per well, which varies with the well-depth.⁴² None of these bases satisfies technical engineering standards for the conservation of reservoir energy and the maximization of ultimate recovery. The Railroad Commission, however, has made a determined effort to promote conservation, so far as may be within these statutory limits on its powers.⁴³

Other states. The spread of legislation beyond the two pioneering states may be briefly summarized. During the twenties the enactment of waste-prevention statutes applicable to oil and gas resources was quite general. Typically, these statutes prohibited allowing gas to blow to the air, and required the plugging off of water-bearing strata and the plugging of abandoned wells. Frequently there were prohibitions on drilling within a certain distance of a boundary.⁴⁶

⁴¹ Compare Hardwicke, *Texas Law Review*, October 1937, p. 106 ff.

⁴² See Vernon's Texas Statutes, 1936, Article 6049b, par. 1.

⁴³ This may be illustrated by its orders curtailing the production of East Texas to a rate (of about 450,000 barrels daily) which seems to be the maximum at which it can be produced without undue disturbance of reservoir equilibrium. See R. J. Schilthuis and W. Hurst, "Variations in Reservoir Pressure in the East Texas Field," *Petroleum Development and Technology* (1935), p. 164. Despite the fact that an excessive well density, resulting from a virtually unregulated drilling campaign in that field, has brought the field allowable above 500,000 barrel daily (under the minimum allowable-per-well, or marginal-well, statute), the Commission has kept down the production rate to approximately the optimum figure (as indicated by experience), by ordering shutdowns. Originally, these shutdowns were confined to East Texas and were for only one or two days per week. They have since been extended to the whole of Texas, and the duration of the shutdowns has been increased. These orders are upon an emergency basis and having been continued for over two years, may be subject to successful challenge. But through the co-operation of the industry they have thus far been reasonably effective. See *Oil and Gas Journal*, Dec. 15, 1938, p. 15; and L. L. Foley "Spacing of Oil Wells," *Petroleum Development and Technology* (1938), pp. 15, 19.

⁴⁴ Statutes of the type indicated are listed below:

- (a) Acts of Arkansas (General), 1923, Act 664, p. 555;
- (b) Colorado, Compiled Laws, 1921, c. 55; and Session Laws, 1927, c. 13; and c. 139;
- (c) Revised Statutes of Kansas, Annotated, 1923, c. 55;
- (d) Laws of Montana, 1925, c. 56;
- (e) Laws of New Mexico, 1925, c. 121;

Until 1931 there was no legislation designed to control petroleum output more directly, except as already noted in Oklahoma and Texas. In the case of natural gas wells, such control was included in the Arkansas Conservation Act of 1923, cited above, in Michigan legislation of 1929,⁴⁷ and in Louisiana legislation.⁴⁸ But no serious effort appears to have been made to give such measures practical application outside of Oklahoma, Texas, and Louisiana.

Kansas and California in 1931, Mississippi in 1932, New Mexico in 1935, and Arkansas and Michigan in 1939, were added to the states which sanction administrative control of oil production.⁴⁹ The

(f) Compiled Statutes of Wyoming, 1920, c. 274; and Session Laws, 1921, c. 157.

Substantially similar provisions were adopted in all the states passing proration legislation, cited above and below. Compare *The Oil and Gas Conservation Statutes*, compiled by N. Ely for the Federal Oil Conservation Board, 1933.

⁴⁷ Public Acts of Michigan, 1929, Act 9, Act 15, and Act 174. (The gas section is Act 9, sec. 8.)

⁴⁸ The Louisiana oil and gas conservation laws provided for gas proration as early as 1918. See Acts of Louisiana, 1918, Act 268 and Act 270. Oil proration in certain contingencies was authorized in 1920, though the measure was given no effective implementation. See Acts of Louisiana 1920, Act 73 and Act 250. More stringent restrictions were at least formally adopted in 1924 and again in 1926, at the time of the prodigious waste of gas in the Cotton Valley field. See Acts of Louisiana, 1924, Act 252 and Act 253; and the same, 1926, Act 123. But "the law on the books" appears to have influenced production practice but slightly. See *McCoy v. Arkansas National Gas Co.*, 175 La. 487 (1932), where it was held that defendant's allowing a well to blow to the air "on an average 40,000,000 cubic feet of gas daily" (according to plaintiff) for 1,165 days, a substantial part of this period in open violation of a restriction order of the State Conservation Department, was *damnum absque injuria*, so far as adjoining land owners were concerned! (The apparent reason of the defendant for letting the gas escape was the hope that thereby oil might be sucked into the well-bore.) See also *Higgins Oil and Fuel Co. v. Guaranty Oil Co.* 145 La. 233 (1919); and *State v. Thrift Oil and Gas Co.*, 162 La. 165 (1926); and compare Federal Oil Conservation Board Report V, 1932, p. 52. It was not until 1936 that effective oil proration was established in Louisiana. By Act No. 225, Acts of Louisiana, reg. sess., 1936, in addition to the provision of new and more definite substantive rules, the office of the Commissioner of Conservation was created, with adequate authority to enforce them. See G. A. Wilson, "Recent Developments in Louisiana Oil and Gas Laws," *Tulane Law Review*, Vol. 11 (1937), p. 553.

⁴⁹ Kansas R. S. Supp. Laws of 1931, c. 226; Statutes of California, 1931, c. 585 (see Deering, General Laws of California, Vol. 2 (1931), Act 4916, p. 2398); General Laws of Mississippi, 1932, c. 118 (Mississippi has only an insignificant output of oil and does not rank high even in gas production, and the measure may be considered either anticipatory in character or imitative of neighboring states); Laws of New Mexico, 1935, c. 72; Acts of Arkansas, 1939, Act 105; Public Acts of Michigan, 1939, Act No. 61.

California law was repealed in 1932, but some regulation of production has been continued under an earlier gas-oil ratio law.⁵⁰

California is of particular interest because of the control of production through voluntary arrangements. The procedure followed is much the same as that established by law in Oklahoma, Kansas, and Texas, except that the "machinery" is provided by a private organization, the Central Committee of California Oil Producers. This committee selects an Oil Umpire, who with his staff sets the state allowable, distributes quotas therein among the several fields, and supervises the allotment of participations in the field quotas among the operators. The sanctions relied upon to secure adherence to the program and compliance with orders are numerous and devious. While the application of the gas-oil ratio law is not rigorous, it appears to serve as a buttress to the proration program. Other factors are the control of important pipe lines and auxiliary plants, such as facilities for the extraction of gasoline from natural gas by the major integrated companies, and the close relations maintained by members of the cartel with pipe-line companies, marine shipping concerns, and other outside interests. Perhaps the most potent sanction of all is the fear of a general abandonment of concerted curtailment (which need not be put forward in the form of a threat, of course). Occasionally the "voluntary" restriction program has broken down, but it has invariably been resumed within a short period.⁵¹

Another example of voluntary control existed temporarily in Arkansas, where in March 1938 a voluntary proration program was inaugurated under the aegis of the State Board of Conservation.⁵²

⁵⁰ Act of May 28, 1929, Statutes of California, 1929, c. 535, known as the Lyon Gas Conservation Act. See also Statutes of California, 1931, c. 791, sec. 8 (d). This gas-oil ratio law was upheld in *Bandini v. Superior Court*, 284 U.S. 8 (1931).

California in 1939 re-enacted an oil production law, but it was repealed on referendum the same year.

⁵¹ For a fuller discussion of the repeal of the Sharkey (proration) Act and of the development of voluntary proration in its stead, see: Watkins, *Oil: Stabilization or Conservation?* Chap. XIII. Compare testimony of E. W. Pauley at Hearings (House) on H.R. 9676, 73 Cong. 2 sess., May 30-June 7, 1934, *Oil and Oil Pipe Lines*, p. 108 ff.; and testimony of J. R. Pemberton in 76 Cong. 3 sess. *Petroleum Investigation*, Hearings . . . , Pt. 2, p. 732 ff.

⁵² See Arkansas Board of Conservation, *Petroleum Development in Arkansas 1937-38*; and O. C. Bailey, "Conservation of the Oil and Gas Resources of the

Though, in the absence of a specific enabling act,⁵³ the Board could not compel adherence to its (proration) orders, such orders were nevertheless issued, and through agreements with leading operators, and the passive co-operation of others, they proved reasonably effective in several fields. The standards adopted apparently represented a closer approach to those indicated by current technical knowledge of "reservoir behavior" than those in force elsewhere.⁵⁴ As we have noted, this legislation was succeeded in 1939 by a statute imposing compulsory standards.

Trends. On the whole, there has been discernible, particularly within the past three or four years, an increasing emphasis on the conservation aspects of proration and waste prevention. The engineering factors governing efficient recovery practice have received greater attention in comparison with the stabilization of markets. Restriction of production is still based generally and primarily upon estimates of market demand, but within the limits thus ascertained, there has been increasing effort to distribute quotas so as to maximize ultimate recovery. The significance of pressure differentials in the reservoir has become more widely recognized, and here and there efforts have been made to construct proration formulas which will take account of this factor.⁵⁵ Perhaps the most significant de-

State of Arkansas," *Southern Conservationist*, October 1938. The author is chairman of the Arkansas Board of Conservation.

⁵³ Act No. 234, approved Mar. 28, 1933, specifically authorized gas proration, but not oil proration. See Pope's Digest of the Statutes of Arkansas, 1937, Vol. 2, sec. 10468. (The whole conservation act is found in sec. 10461-10492.) An indirect basis for the Board's initiation of proration machinery may possibly be found in sec. 10471, which authorizes the Board, in general terms, "to stop and prevent waste of oil and gas."

⁵⁴ The description of the proration formula given by Bailey in "Oil and Gas Resources of Arkansas," *Southern Conservationist*, is: ". . . since observed reservoir pressure is the best index of reservoir energy available, production is controlled on the basis of a fifty per cent acreage and a fifty per cent pressure formula with gas-oil ratio as a compensating factor." What this signifies is that the Board endeavored, by the inclusion of the acreage factor, to minimize the stimulus, which the usual form of proration initiates, to excessive drilling. By a combination of the factors of observed pressure decline, and pressure differentials and of gas-oil ratio trends, a rate of withdrawal that approached maximum utilization of reservoir energy was determined. The performance of each reservoir on which operations were proceeding was recorded on a control chart, and tendencies towards waste were readily apparent.

⁵⁵ See L. L. Foley, "Proration of Allowable Oil Production," A.P.I., *Drilling and Production Practice*, 1937, p. 427. It is in the comparatively newer oil-

velopments in this direction have been in administrative rules and regulations, but statutory standards have also undergone changes, providing the necessary sanctions.⁵⁶

III. FEDERAL REGULATION

The special activity of the federal government with respect to the oil industry began during the World War. The chief reason for the control which was attempted during the war was the need to speed up production and distribution of oil to meet war demands. This was accomplished, first through a committee of the Council of National Defense, and then by the Oil Division of the United States Fuel Administration, with the assistance of a National Petroleum War Service Committee composed chiefly of producers, but including representatives of other interested groups. In view of the possible conflict with the anti-trust laws, an agreement was reached between the Federal Trade Commission and the Fuel Administration, whereby the latter became the controlling authority in the oil industry for the duration of the war.

Since 1920, federal laws have been enacted regulating the search

producing states, and still minor contributors to the national supply, however, such as New Mexico, Arkansas, and Louisiana, that these tendencies have been most marked. But progress in this direction in Texas has also been noteworthy. Compare N. Ely, "The Conservation of Oil," *Harvard Law Review*, Vol. 51 (1938), pp. 1233, 1237; and J. E. Pogue, "An Equilibrium Theory of Proration," *Petroleum Development and Technology* (1938), p. 274; also J. E. Pogue and A. Sachs, "Internal Problems of Proration in Oil Conservation," Transcript of Proceedings of Interstate Oil Compact Commission, Colorado Springs, July 29, 1938.

⁵⁶ Thus, the general revision of the Oklahoma proration laws in 1935 pointed towards the objective of conservation in two ways. In the first place, it changed the title of the law from Proration Law to Conservation Law, and made a similar change in the titles of all administrative agencies and officers (excepting the Corporation Commission). Secondly, it added to the definition of wastes prohibited "the use of reservoir energy for oil producing purposes by means or methods that unreasonably interfere with obtaining from the common source of supply the largest ultimate recovery of oil." See Oklahoma Session Laws, 1935, p. 232.

Texas also, by an amendment to its conservation statutes passed in 1935, emphasized a similar aim. It prohibited "physical waste or loss incident to . . . so drilling . . . or operating . . . wells as to reduce . . . the total ultimate recovery of crude petroleum or natural gas from any pool," and "waste . . . incident to . . . the unnecessary, inefficient, excessive or improper use of the reservoir energy . . . in any well or pool." See Vernon's Texas Statutes, 1936, Art. 6014 (f) and (g).

Similar provisions are to be found in the Arkansas and Michigan Laws of 1939.

for oil and gas on public lands, and providing for the supervision of production so that it will conform to the best practice and result in maximum total recovery with minimum waste.⁸⁷ The oil reserves owned by the federal government are small, probably under 5 per cent of the total, and output on such public lands forms an even smaller fraction of the total.⁸⁸ Such lands are important nevertheless as providing a field for the application of the best technical knowledge, and the development of standards of operation which may serve as an example for other operators.

The next stage in federal regulation of the oil industry came in 1924 when President Coolidge created the Federal Oil Conservation Board, with the Secretary of the Interior as Chairman. Both the fear of future shortage and the current decline of oil prices were given as explanations for the President's action. When hearings were first held by the Board in 1926, prices were again rising and interest in restriction of production had declined. Then followed a period of rapid discovery, increased output, and declining prices. It was perhaps in response to these conditions that the Board proposed an interstate compact under which output could be restricted. In 1929, the Chairman of the Board called a conference of the governors of the oil producing states, in the hope of reaching a joint agreement on measures to restrict output, but nothing came of it. In 1930 the Board recommended a conservation measure, including voluntary co-operation for unit operation of single oil pools, and exemption of such action from the provisions of the anti-trust acts. The Board's continued interest in voluntary interstate agreements probably contributed to the mid-continent Governors' Conference of 1931, out of which grew a production agreement for the mid-continent area that lasted to the end of 1932. The agreement was modelled after that recommended by the Board and was formally considered by it in April 1931.⁸⁹

With the enactment of the National Industrial Recovery Act, the federal government embarked on an extensive program of regulation of the oil industry. This regulation was only in part in-

⁸⁷ N.R.C., *Energy Resources*, p. 211.

⁸⁸ The same, pp. 131-33.

⁸⁹ The same, pp. 197-98, 211-12.

fluenced by the N.R.A.'s general objective of stimulating recovery from depression; in part it was related to earlier special controls over the oil industry exercised by both the federal and the state governments. The state proration measures proved inadequate to maintain prices in the face of the declining demand that came with the collapse of economic activity after 1929. There was some recovery of prices in 1931-32, but a new period of decline began in January 1933. In response to these conditions, the Secretary of the Interior called a conference of governors of oil-producing states for March 27, 1933. While there was no agreement on measures to be taken, one group of the conferees recommended federal legislation to enforce state laws and regulations. In the face of a further increase of production in East Texas, bills were introduced in the Congress, embodying this recommendation. The National Industrial Recovery Act was being considered at the same time, however, and at the suggestion of the President, oil regulation was made a part of this general measure,⁶⁰ which became law in June 1933.

Under section 9(c) of the Recovery Act, the President was authorized to prohibit the movement in interstate and foreign commerce of petroleum or its products, if produced in violation of the various state laws and regulations. This authority the President subsequently delegated to the Secretary of the Interior, who appears to have exercised it chiefly in the case of the East Texas output, first through a system of affidavits, and subsequently through the Federal Tender Board. In January 1935 the Supreme Court invalidated section 9(c) of the Recovery Act, as an improper delegation of authority, and the Tender Board ceased to function.⁶¹

Regulation was also attempted under the N.R.A., in this as in other industries, through a code of fair competition. The code for the petroleum industry was approved on August 19, 1933 and became effective on September 2, with the Secretary of the Interior as administrator. Wages and hours in the industry were covered, as they were in all the N.R.A. codes. There were also provisions for price-fixing, for the approval of plans for developing new oil pools, for the limitation of imports and of withdrawals from stor-

⁶⁰ The same, pp. 391-93.

⁶¹ *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935).

age, and for a possible substitute system of production control to replace that which section 9(c) of the Recovery Act was designed to make effective. The code provided further for estimates of production required to meet market demands, and for the allocation of the estimated total among the producing states.⁶² Along with the other N.R.A. codes, this form of federal regulation ended with the invalidation of the N.I.R.A. in May 1935.

After the invalidation of section 9(c), Congress, on February 22, 1935, enacted the Connally Act, prohibiting interstate and foreign commerce in contraband, or "hot," oil, thus re-establishing the utilization of federal authority to make state laws more effective.⁶³ With the Secretary of the Interior as administrator of the Connally Act, a new Federal Tender Board was established for the East Texas area on March 1, 1935. To this was added a Federal Petroleum Agency to investigate and administer applications for approved tenders filed with the Board.⁶⁴ To assist in the administration of the act a Petroleum Conservation Division was set up in the Department of the Interior. The proscriptions of the act, it should be emphasized, relate only to oil produced in violation of quantitative restrictions set by state laws on oil production, and not to oil produced in violation of the technical methods of production which are prescribed by the states.

While the role of the federal government is thus principally that of making more effective the output restrictions of the various states, estimates or forecasts of demand are made by the United States Bureau of Mines, and these influence the authorized quotas of production set by the various states.⁶⁵

Intermediate between the several states and the federal government, there now exists an Interstate Oil Compact Commission, to which the states of Texas, Oklahoma, Kansas, New Mexico, and Colorado adhere.⁶⁶ Aside from acting as a clearing house for in-

⁶² Compare Watkins, *Oil: Stabilization or Conservation?* pp. 53-71.

⁶³ Though first enacted for a period of approximately two years, it was subsequently extended for two more years and then for an additional three years (to 1943).

⁶⁴ Less formal methods are used in areas other than East Texas.

⁶⁵ See N.R.C., *Energy Resources*, pp. 213, 401-04; and discussion below, p. 1013.

⁶⁶ Illinois adhered to the compact until Sept. 1, 1939, but, although the governor is authorized to continue adherence, he has not at this writing done so.

formation, its activity has been confined chiefly to promoting the acceptance as a basis of production control of the "market forecasts" made by the United States Bureau of Mines.⁶⁷

The present Interstate Oil Compact is an outgrowth of several earlier attempts to effect co-operation between the states. We have already noted the initiative of the Secretary of the Interior in calling conferences in 1929 and 1933. On December 3, 1934 another attempt was made to establish a compact at a conference of governors. At this conference proposals were made that federal legislation be recommended, designed to establish output quotas for the various states, to restrict international imports, and to prevent the movement of oil produced in violation of state laws; and it was proposed that an interstate compact be formed to co-operate with the proposed federal agency and to foster conservation measures. Although favored by some states, the proposed action was not acceptable to Arkansas, Louisiana, and Texas. Apparently the chief ground of opposition of the Texas representative was unwillingness to take away from the state government control over production.⁶⁸ An agreement along somewhat different lines was effected at a third meeting on February 15 and 16, 1935, and was subsequently ratified by New Mexico, Kansas, Oklahoma, Illinois, Colorado, and Texas. Two of the states which were opposed to the earlier and stricter agreement—Arkansas and Louisiana—were not parties to this compact, while California, which favored the stricter agreement was also outside.⁶⁹

The stated purpose of the existing compact is "conservation" of

⁶⁷ N.R.C., *Energy Resources*, p. 213.

⁶⁸ The same, p. 397.

⁶⁹ The compact was submitted to Congress in April 1935 and ratified on Aug. 27, 1935, 74 Cong. 1 sess., Pub. res. No. 64. (The same, p. 398.) It is perhaps worth noting that the bill involved originally contained a provision for a federal agency to determine the reasonable market demand for oil, from time to time, and the amount to be produced by each state. Only the compact portion of the bill was adopted, however.

Originally adopted for two years, the compact was subsequently ratified by the various state legislatures and Congress for another two years, to Sept. 1, 1939, after which it was once more extended for two years (without Illinois as a member, however, as noted above).

Congressional hearings to consider further regulation of the oil industry were held in 1939 and 1940 (76 Cong., *Petroleum Investigation*).

gas and oil. For this purpose each state agrees, among other things, to enact and administer laws designed to prevent inefficient gas-oil ratios, the improper use of reservoir energy, and the location and operation of wells which result in "physical waste" or "loss in the ultimate recovery" of gas and oil. They agree also to deny access to commerce to oil produced in violation of state conservation laws. While the agreement specifically disclaims as an objective the joint limitation of "production of oil or gas for the purpose of stabilizing or fixing the price thereof," the states can of course effect the same result by action ostensibly taken on conservation grounds. Under the interstate compact, a commission was established to investigate methods of conservation, and to make recommendations for carrying these into effect.⁷⁰

As was noted above, estimates of oil "requirements" are now made by the United States Bureau of Mines. These estimates are made for the country as a whole, and by producing states, and are said to be "of value to the Interstate Oil Compact Commission and the individual state agencies in establishing their conservation programs."⁷¹ Since the estimates are based exclusively on market conditions (that is, the amount that will be absorbed without breaking the price), it is obvious that to the extent that the states regulate production with a view to making actual marketings conform to the forecasts, the ostensible conservation program becomes one of market stabilization. To what extent the state regulatory bodies consider themselves bound, under the interstate compact, to use the Bureau of Mines estimates as the basis of quotas is not definitely known.⁷² It is possible, however, to compare the state allowables and actual production in the various states with the Bureau of Mines estimates. This is done in the accompanying table for the years

⁷⁰ At this writing, no recommendations have been advanced by the committee. See 76 Cong. 3 sess., *Petroleum Investigation*, Hearings . . . , Pt. 3, p. 988 ff.

⁷¹ N.R.C., *Energy Resources* (section written by Alfred G. White, Chief Economist, Petroleum Economics Division of the Bureau of Mines), p. 402. Compare *Annual Report of the Department of the Interior*, 1939, p. 251.

⁷² It is not without interest in this connection that the Texas State Senate on May 7, 1937 authorized the governor to cancel that state's membership in the compact whenever Texas was "not allotted its reasonable and proportionate share of the production of oil." N.R.C., *Energy Resources*, pp. 398, 400.

1935 to 1939 (average of daily averages, by months, in thousands of barrels).⁷³

	1935 ⁷⁴	1936 ⁷⁴	1937 ⁷⁴	1938 ⁷⁵	1939 ⁷⁵
Bureau of Mines estimate	2,352	2,588	3,086	3,108	3,032
State allowables (total)	2,414	2,697	3,188	2,979	2,955
Actual production	2,492	2,771	3,227	3,037	2,966

It will be seen from this table that there has been a close conformance of both the state allowables and actual production to the Bureau of Mines estimates of demand.

There has been considerable concern in the past three years, in the states which regulate oil production, over the phenomenal increase of output in the state of Illinois, which does not impose such regulations. In 1936, the monthly average of crude petroleum production in Illinois was under 400 thousand barrels. By February 1940, Illinois production had grown to over 11 million barrels a month, a figure in excess of 10 per cent of the total output for the United States.⁷⁶ Illinois is the only major producing state which does not impose special regulations over the production of crude petroleum, and there is fear that the failure to restrict output there may lead to the curtailment or abandonment of regulation in other states.

IV. APPRAISAL

As was noted above, the legislation described in sections II and III, as well as the advocacy of further legislation and administrative regulation, stems from several distinct forces. In so far as it aims merely to assure a more equitable distribution of the content of oil or gas deposits among the owners of the surface and their lessees, it raises no fundamental issue of public policy. It is analogous to limitations on the permissible catch of fish and game, and, more closely, to restrictions on the use of running water (for instance for irrigation purposes) to the detriment of owners of property located further down the stream. The range of appropriate public action depends on what is technically and administratively feasible, rather

⁷³ Data for 1935 and 1936 from *Minerals Yearbook, 1937*, p. 981; for 1937, from the same, 1938, p. 819; for 1938, from the same, 1939, p. 934. Data for 1939 secured from the Bureau of Mines.

⁷⁴ Includes the states of Tex., Okla., Calif., Kan., La., and N.Mex.

⁷⁵ Includes the states listed above and Ark.

⁷⁶ Information from the Bureau of Mines.

than on any unsettled issues, either of equity or of the economic consequences of such action. The rule of capture is not an immutable law of nature. Of more importance, and of more general interest, are the assumptions of regulation with regard to "conservation" and "stabilization."

A few remarks on the nature of conservation will be of assistance in evaluating these phases of the special regulation of the oil industry, and more particularly the extent to which further federal participation is appropriate. Two distinct though interrelated aspects of conservation must be noted—the elimination of waste and the postponement of use.

The elimination of waste. In one sense, conservation means the elimination of waste, that is, the prevention of loss at a cost less than the loss would involve. With reference to the oil and gas industries the wastes can be classified as follows:

1. First, there is the waste, not of the oil and gas resources themselves, but of other resources used in these industries. In the oil industry, multiple ownership and the rule of capture are responsible for a greater amount of investment than would be undertaken by a single owner of an entire pool. If voluntary agreements between owners could be effected, or if a satisfactory substitute for the rule of capture could be elaborated, this type of waste might be eliminated without any direct regulation of the rate of output. Unit operation of oil pools is intended to accomplish this result.

On the other hand, mere restriction of output, where quotas are allotted on a per-well or well-capacity basis without restriction on drilling, may actually lead to a greater investment than under unregulated conditions, since each owner can increase his share by drilling additional wells. The results are precisely those which obtain under cartel arrangements when the price is increased, but entry, with reallocation of quotas, is left open. The price will be kept high, but as new investments are made, idle capacity will increase, and the rate of return will be driven down toward the competitive level.

2. The most important type of waste is that which renders a certain amount of oil deposits irrecoverable, or recoverable only at a greater cost, because of failure to make the best use of the reser-

voir energy as a means of bringing oil to the surface. In the absence of regulation, the owner or lessee of an entire oil pool would have two alternatives. By letting the oil flow freely he could recover a certain amount of the reserve. Then, when it became necessary to resort to secondary recovery methods (such as gas lift, water flooding, compressed air, gas repressuring, or ordinary pumping) he would continue to recover oil as long as it was profitable to do so. When this was no longer the case, he would abandon operations. This would leave a certain amount of oil—large or small—still under ground. Alternatively, he could regulate the rate of flow to conserve reservoir energy, as a result of which a larger quantity could be brought to the surface with natural energy, thus delaying the secondary recovery stage, after which production would continue as above. It is certain that the second method—the more careful use of reservoir energy—leads in the long run to lower costs per unit of output and thus eliminates the waste of other resources, and also leads to a substantially larger ultimate recovery of the oil reserve.

If single ownership of the rights in an oil pool were the characteristic pattern of the industry, individuals might be expected to follow the method of recovery which would yield the greatest output at the least cost, with due consideration for the risks of future changes in the value of oil and for the costs of delaying recovery. In fact, however, for reasons set forth in section 1, unified ownership or control of an entire oil pool is seldom encountered. Under the rule of capture, with control divided among a large number of holders of contiguous areas in the pool, it is unprofitable for any one owner to attempt to increase ultimate output by holding back the flow of oil so as to maintain the optimum rate of pressure decline. Some form of co-operation is essential, and it is usually impossible to secure this by voluntary action, since any one owner will gain a great advantage by refusing to co-operate if the rest of the owners follow a plan designed to secure maximum ultimate recovery. But, if by the use of governmental authority all owners are required to hold back the flow of oil to the rate which is technologically most efficient, both the operators and the consuming public are benefited.

3. The third and least important type of waste results from the non-use of some of the resources brought to the surface. However important this may have been in the past, it has now been practically eliminated, so far as oil is concerned, chiefly through the controls which have been imposed over production, the advance in knowledge of how to drill safely and how to store cheaply, efficiently, and safely, combined with a steady expansion and improvement of facilities for transporting and storing oil.⁷⁷

It is in respect to loss of natural gas by its being allowed to blow to the air that the most spectacular so-called wastes have occurred in oil and gas production. It is to be noted that a large, perhaps the major, part of these natural gas losses is chargeable directly to oil production, rather than to operations concerned primarily with natural gas recovery.⁷⁸ The urge to secure early access to, and as large a proportion as possible of, the oil in a common source of supply has frequently led operators, under the competitive pressure of the rule of capture, and in the absence of an immediately available market, to release the full natural flow of gas from their wells.⁷⁹ The waste-prevention legislation noted above, particularly as represented by the gas-oil ratio laws of several of the oil-producing states, and the proration of oil output, have had a marked influence in bringing about a substantial curtailment of above-ground losses of natural gas. It is conservation of oil rather than gas which is the purpose of this legislation, but an incidental effect is a slower withdrawal of gas, and more of it may consequently

⁷⁷ See H. C. Miller and B. E. Lindsly, "Report on Petroleum Production and Development," in 73 Cong., *Petroleum Investigation*, Hearings . . . , Pt. II, pp. 1247-48, 1226-49.

⁷⁸ See Scott Turner, "Conservation of Natural Gas in Relation to Some Recent Developments," U. S. Bureau of Mines Information Circular 6392 (1930) (estimates 60-70 per cent produced in conjunction with oil). Later estimates by the Bureau place the figure at about 55 per cent. See report on "Conservation of Petroleum and of Natural Gas," prepared by U. S. Bureau of Mines, *Third World Power Conference* (1936), Vol. VI, sec. IV, p. 774.

⁷⁹ See J. S. Ross, *Engineering Report of Cotton Valley Field*, Technical Paper 504, U. S. Bureau of Mines (1931); and, on gas waste in Oklahoma City, H. B. Hill and E. L. Rawlins, *Estimate of the Gas Reserves of the Oklahoma City Oil Field*, Report of Investigations No. 3217, U. S. Bureau of Mines (1933), p. 51. In the Cotton Valley field the gas was frequently allowed to blow simply in the hope thereby of bringing oil to the well. In the Oklahoma City field, on the other hand, the waste arose chiefly from an excessive gas-oil ratio.

find a market. In addition, as we have noted, there has been legislation dealing directly with the conservation of gas.

Postponement of use of oil and gas. The term "conservation" is also used to connote a mere spreading of the use of mineral resources over a longer period, without reference to a possible increase of ultimate recoveries.⁸⁰ It is apparent that conservation in the sense in which it is used in the preceding section—waste elimination—also requires lengthening the period of production and slowing down the rate of recovery in the first part of the period. To clarify the problem, however, it is best to assume that everything is already being done which can be done to operate individual pools in the most economical manner, and consider as a separate problem the further reduction of output with a view to lengthening the life of reserves. Specifically, a proposal for conservation in this sense implies (in so far as it is not merely a cover for price maintenance in the interest of operators) that, because of the importance of oil in our economic life and the limited supply, it is in the social interest to restrict current output beyond the point to which the owner of an oil pool would restrict it in the light of his costs of doing so and of current and prospective prices. The validity of this implication is very dubious in view of the continuous discovery of new supplies.⁸¹

Market stabilization. "Conservation" in either sense, it should be noted, is very closely related to the pressure for "stabilization" of the industry, which is concerned primarily with increasing the profits of producers. For it is impossible to restrict production, in the interest either of increasing total output or of lengthening the life of the supply, without raising the price, at least in the beginning, and the one purpose can readily be used as a cloak for the other. The issues involved in so protecting the members of an industry are similar to those discussed above in connection with the special treatment of the coal industry.⁸²

⁸⁰ "The general goal of all federal-state legislation affecting oil and natural gas should be to eliminate waste of these resources and to stretch the life of underground reserves over as long a period as possible without unduly restricting the more important uses of the products." N.R.C., *Energy Resources*, p. 2. Italics supplied.

⁸¹ Compare p. 990n.

⁸² Compare p. 986.

The role of the federal government. To further conservation (in both senses), it is urged that the federal government must play a larger part than it has in the past. This is urged on the grounds that the various states are not likely to show the necessary interest in conservation problems, and that interstate competition will prevent those which do have a proper appreciation of the problem from going as far as is essential. The major current proposal provides for added controls over physical waste to be imposed by the federal government.³³ It suggests restrictions over the use of reservoir energy, and over well spacing, drilling practices, well casing, well completions, oil-gas ratios, the rate and manner of water encroachment, the escape of gas, and the above-ground disposal of crude oil.

Is federal action necessary to effect such controls? There is some doubt as to whether individual states are likely to enact legislation of this character. Producers are often opposed to such requirements, unless they are also to be imposed in other states, on the ground that there would result a restriction in output which would advantage producers in the states which do not impose such restrictions;³⁴ and they often oppose the restriction of output independently of the action taken in other states, because of the risk of a future decline in the price of oil. Moreover, the state administration may be more interested in current tax revenues from oil than in a long-run program of conservation.

It is even more clear that the states are not appropriate units for output restriction to raise prices. It is to the advantage of producers in any state which does not impose such controls to increase their output, thus nullifying any tendency toward a price increase.

³³ 76 Cong. 1 sess., H.R. 7372; and 76 Cong. *Petroleum Investigation*, Hearings . . . , 3 parts.

³⁴ It is to be emphasized that the technical advantages of restricting output to increase ultimate recovery exist independently of whether other states impose similar controls over other pools. Indeed, the ultimate gains in one pool may be increased from spreading a larger output over a longer period, since flush production in other pools tends to make prices lower in the present and higher in the future. The concern of operators over the relative present and future worth of oil, and the pecuniary interest of producers in seeing restrictions placed on other producers, merely illustrate the way in which considerations of efficient technique are intertwined with the purpose of price control.

Voluntary co-operation between the states is subject to the same tendency to break down as cartel arrangements in industry and similar restrictions on agricultural production. New discoveries within a state will necessitate reallocation of quotas, and each state will always try to get as large a quota as possible for its own producers.

If controls either to avoid physical waste, or to restrict output for the sake of higher prices, are desired, it may therefore be necessary that the federal government exercise final control over the amount of oil to be produced nationally and over its proration among the states. It seems clear, moreover, that to be fully effective the control must sooner or later be extended to exploration and discovery. In so far as these are related to the profitableness of current operations, higher prices will result in bringing in additional new supplies. Leaving such operations unchecked, and reallocating the permitted output among old and new producers, will certainly result in wasteful employment of resources in general, and may result in waste of oil resources.

It is beyond the scope of this volume to undertake an appraisal of the controversial and highly technical questions of the extent to which the special regulations that have been imposed on the oil and gas industries have in fact resulted in the prevention of unnecessary losses (either of the mineral resources themselves or of the resources used in the process of production) or of the further question of the cost which the program has imposed on the public. It seems clear that these regulations do tend to bring about a material increase in the recovery of oil, and some saving of pumping costs. The effect on other costs, particularly on the costs of well-drilling, has not been subjected to sufficient study to warrant conclusive comments.

Of the various phases of regulation, the only one which raises any serious question of public policy is the restriction of output. Other parts of the program, such as requiring the plugging of abandoned wells to keep water out of the productive sands, restrictions on freedom to let gas blow to the air, and fire prevention measures, if technically in accord with engineering knowledge, are clearly in

the public interest. The reasons for restriction of output, however, are worthy of brief recapitulation and comment.

As has been noted, restriction of production has been motivated by three purposes: first, to increase ultimate output and reduce the cost of production per unit of product; second, to hold up prices for the benefit of the industry itself; and, third, to shift consumption of gas and oil in part to a future date when they may be needed more than they are now. With regard to the first objective the interests of the industry and of the public are generally in harmony. With respect to the second they are in conflict. With regard to the third, the situation is not so clear, but we believe no clear case has been made for the necessity of public action to lengthen the life of reserves, except as that is involved in increasing ultimate recoveries.

To a considerable extent all three purposes are served by the same measures. Up to a certain point, the restriction of output is an appropriate means to accomplish all three purposes, but beyond that point it serves only the second and third.⁸⁵ Public support for restriction of production has been won on the ground of its effect in conserving these resources. It is safe to say, however, that the motives of the most active proponents of the legislation, and of many administrators, have been more closely related to the second objective than to the first or third, as is evidenced by the attention paid to the price situation in regulating the rate of output. We express no judgment as to whether the amount of restriction actually carried out is materially greater than that necessary to accomplish the genuine purpose of a desirable type of conservation.⁸⁶ Certainly, however, there can be no presumption that the two standards of conservation and of stabilization will coincide.

⁸⁵ If the purpose were really to conserve supplies for the future rather than to increase producers' revenues, it would seem appropriate to tax away the excess profits resulting from the higher prices that accompany the curtailment of supply. If that is legislatively and administratively impracticable, the purpose might be accomplished by a heavy tax on production or on selected non-essential uses of the product.

⁸⁶ The following opinion on this point has been expressed by J. E. Pogue: ". . . judging from preliminary studies, the difference between the aggregate optimum production rate of our oil fields and market demand is not substantial. . . ." *Economics of the Petroleum Industry* (1939), p. 23.

CHAPTER XXVI

FOODS AND DRUGS

A final group of industries which has been subjected to governmental controls of a character that justify its inclusion in the special areas of regulation consists of foods and drugs. Certain of the regulations in the field of foods and drugs were discussed in Chapters IX and XI of Volume 1. The regulations there discussed are not special to foods and drugs, however. They are but a counterpart of similar regulations more widely applied. In this chapter we shall deal with those governmental controls over foods and drugs which place these industries in a special area of regulation. As in our other specially treated areas, the basis of distinction is the degree of specific choice of final ends made by government, and the extent and character of the limitations consequently placed on the free discretion of individuals.

The distinctive regulations undertaken in the field of foods and drugs have been in the form of positive controls over and even prohibitions of import, production, and sale, and special taxation designed to restrict consumption. Primarily, this special treatment has rested on the importance of foods and drugs to public health and morals, and the fear that individual judgments cannot be relied upon to achieve social ends to the degree that has been true in most branches of industry. Conceptually, these regulations are related somewhat closely to the efforts to prevent the deception of consumers through the proscription of misrepresentation and the provision of knowledge, discussed in Volume 1. In contrast with the controls there described, however, the assumptions here have been either (1) that the deception of buyers cannot be prevented merely by prohibiting misrepresentation and providing knowledge, or (2) that these means of preventing deception are so unreliable that they should not be trusted in view of the serious dangers attendant on consumer misunderstanding. There has also been a lack of confidence that individuals, even if fully informed concerning the merits of these products, could be relied upon to recog-

nize or heed social considerations, or always to evaluate properly the meaning of information in terms of their own personal interests.

In addition to the preservation of health and morals, the significant purposes of the special regulation in the field of foods and drugs have been the protection of private groups against the competition of substitute products, and the facilitation of foreign sale. The detailed analysis which would be necessary to a full presentation of the different objectives of these regulations is impossible here. Suffice it to say that, neither from the declarations of legislative intent, nor from other sources, is it always possible to determine clearly the full range of purposes or the degree of importance which each purpose has had in the public mind; and the significance of each of these purposes has, moreover, varied from time to time, even with reference to the same product.

I. THE PROTECTION OF HEALTH AND MORALS

In many instances it is the direct danger of physical injury to consumers which is primarily guarded against in food and drug regulation. This is true, for example, of the laws controlling the sale of poisonous or diseased animals, and unsound or unclean animal or vegetable foods. In most of these cases the consumer has no desire to rely on his own experience in making purchases, and there is little likelihood that the articles would be demanded were their nature fully understood. In other types of food and drug regulation, however, the effect is clearly sumptuary, in the sense that consumption is restricted which might have existed were the consumer allowed a free choice and regulation confined to the provision of knowledge and the proscription of misrepresentation.

Special regulation in the field of foods and drugs to preserve the public health began as early as 1848 when a prohibition was placed on the importation of adulterated and spurious drugs and medicines.¹ In 1890 more extensive controls over importation were undertaken. It was made unlawful to import adulterated or unwholesome foods or drugs, and vinous, spirituous, or malt liquors which had been adulterated or mixed with any poisonous or noxious chemical, drug, or other ingredient injurious to health.² And

¹ 9 Stat. L. 237.

² 26 Stat. L. 414.

in 1902 proscriptions were placed on both the import and the interstate sale of any virus, therapeutic serum, toxin, antitoxin, or analogous product applicable to the diseases of man, until they had passed inspection for purity and quality and been licensed by the Secretary of Agriculture.³ Twenty-five years later (in 1927) the import of milk from unhealthy cows was prohibited, as was that from cows not tuberculin tested, from unsanitary farms or plants, and where the milk failed to meet certain bacteria tests.⁴

Control over the interstate sale of foods was first undertaken in 1884 with the enactment of a prohibition against the interstate transportation of diseased livestock and live poultry.⁵ The disclosure of extensive frauds upon the government itself in the purchase of food supplies for the army during the Spanish-American War, and revelations sometime thereafter of the widespread distribution of meats, especially canned meat-compounds, unfit for human consumption, led in 1907 to the passage of a comprehensive Meat Inspection Act.⁶ Under it, prohibitions were placed on the interstate sale of meat and meat products which were unsound, unhealthful, unwholesome, or otherwise unfit for human food; and a system of inspection was established for animals before slaughter, for the meat and meat products after slaughter, and for the slaughtering and packing establishments themselves.⁷

In 1906 our first general Food and Drugs Act was passed.⁸ It prohibited the interstate sale of confectionery containing certain enumerated mineral substances, poisonous colors or flavors, vinous, malt, or spirituous liquor, narcotic drugs, or other ingredients deleterious to health. Similar prohibitions were placed on the sale

³ U. S. Code, Title 42, secs. 141-48.

⁴ U. S. Code, Title 21, secs. 141-49.

⁵ U. S. Code, Title 21, sec. 115.

⁶ See Harvey W. Wiley, *An Autobiography* (1930); "Meat Packing," *Encyclopedia of the Social Sciences*, Vol. 10, pp. 242-62; T. A. Bailey, "Congressional Opposition to Pure Food Legislation 1879-1906," *American Journal of Sociology*, Vol. 36 (1930); and C. C. Regier, "The Struggle for Federal Food and Drug Legislation," *Law and Contemporary Problems*, Vol. 1 (1933), pp. 3-15.

⁷ U. S. Code, Title 21, secs. 71-96. In addition there should be mentioned the power of the Department of Agriculture to inspect cattle for the presence of tuberculosis, and to require the disposal of those which react positively, and the compulsory pasteurization laws which have been enacted in many states.

⁸ U. S. Code, Title 21, secs. 8, 10, 15. For additional discussion of food and drug legislation, see Vol. 1, Chaps. IX and XI.

of foods, if they contained any added poisonous or other added deleterious ingredient which might render them injurious to health; or if they were composed in any part of a filthy, decomposed, or putrid animal or vegetable substance, or of a diseased animal, or one that had died otherwise than by slaughter. Articles whose sale in interstate commerce was prohibited were also forbidden to be imported; and, in addition, a proscription against import was applied to foods and drugs "otherwise dangerous to the health of the people of the United States."

In 1938^a these prohibitions were considerably expanded. The interstate sale of foods is now prohibited if they contain *any* poisonous or deleterious substances which might render them injurious to health; if they are prepared, packed, or held under insanitary conditions which might cause them to become contaminated with filth, or rendered injurious to health; or if their containers are composed of any poisonous or deleterious substance which might render the contents injurious to health. In the regulation of confectionery there was added a proscription of alcoholic or non-nutritive substances, the latter being designed primarily to outlaw the inclusion of metallic trinkets, often swallowed unknowingly by children. The Secretary of Agriculture is also given power to list and certify harmless coal-tar products suitable for use in foods, and the use of uncertified substances is prohibited as "adulteration." Also provided was a system of emergency permits, whereby the Secretary of Agriculture may require the procurement of a license for the sale of foods when there exist dangers of contamination injurious to public health which cannot adequately be determined after the articles enter interstate commerce, and permitting him to set as conditions for the grant of such a license, requirements concerning the manufacture, processing, and packing of the foods involved.

The 1938 act added to the regulation of foods and drugs, rules concerning "devices" (defined as instruments used in the cure of disease, or which affect the bodily functions) and cosmetics. Rules similar to those applied to foods were made applicable to drugs, devices, and cosmetics. In addition, there were provided impor-

^a 52 Stat. L. 1040.

tant controls over the introduction of new drugs. Before a new drug may now be introduced into interstate commerce, there must be on file with the Secretary of Agriculture an approved application. He may refuse such an application, if the drug has not been adequately tested for safety in use, if tests show it to be unsafe, or if the contemplated methods of manufacture, processing, and packaging appear inadequate to preserve identity, strength, quality, or purity. The 1938 act included also a provision prohibiting the import of these various proscribed commodities, as well as those forbidden or restricted in sale in the country of production or export.

There is a second group of controls over foods and drugs which while concerned partly with the preservation of health, are related more or less inseparably to questions of morals. Most extensive among the regulations having these objectives have been those in the field of alcoholic beverages and narcotics. The habit-forming characteristics of these products have unquestionably influenced the special controls over their use, as has the fact that beyond a certain point their consumption renders the individual less capable than otherwise, or even entirely incapable, of recognizing social considerations or exercising judgment concerning his own personal interest.

State and local governments have long regulated in detail the manufacture and sale of alcoholic beverages, and in many states there have been (and in some three states continue to be) absolute prohibitions. For a period of time, following the passage of the Eighteenth Amendment, the interstate sale and transportation of alcoholic beverages was (with certain exceptions) prohibited by federal law. At the present time, under the Federal Alcohol Administration Act of 1935, permits are required for the manufacture or sale of distilled spirits, wines, or malt beverages. Such permits are withheld from those convicted of felony or misdemeanor (within a certain prior period), and those who, because of lack of business experience, financial standing, or trade connections, are deemed unlikely to commence operations within a reasonable period, or to maintain their operations within the law.¹⁰

Somewhat similar in the degree of federal control has been the

¹⁰ U. S. Code, Title 27, secs. 203-04.

regulation of narcotics. Under an act of 1909 positive prohibitions were placed upon the import of narcotic drugs, except those necessary for "medical and legitimate uses";¹¹ and under an act of 1914 all those who import, manufacture, sell, or dispense narcotics are required to register and pay certain fees.¹² These have been supplemented by other similar laws since, most notably by the Marihuana Act of 1937, which not only levies a heavy tax and requires the registration of importers, manufacturers, and distributors, but also prescribes written order forms for all buyers, to be preserved by the seller for government inspection.¹³ In addition, many states impose detailed controls over the sale and use of narcotics.

Thirdly, combined considerations of health and morals have prompted various regulations of the sale of tobacco products, snuff, cigars, and cigarettes. In certain states the sale of some of these products was at one time completely outlawed; in others there have been (and continue to be) prohibitions on sale to minors. In the federal sphere, they have been subjected to especially heavy taxation, designed partly for revenue purposes, but partly also (on grounds of health and morals) to limit consumption. Similar taxes have been applied to liquor and narcotics.

II. GROUP PROTECTION

A second category of regulations of foods and drugs is distinguished by its purpose primarily to provide protection for certain types of manufacture against the competition of substitute products.

One example of regulation in which it seems reasonably clear this purpose has been important is the Filled Milk Act of 1923.¹⁴ This law prohibits the interstate sale of filled milk, as an "adulterated" article of food, "injurious to the public health and . . . a fraud upon the public." Filled milk is defined as milk, cream, or skimmed milk, to which has been added any fat or oil other than milk fat, so that the resulting product is an imitation or semblance of milk, cream, or skimmed milk. In the enactment of this legislation em-

¹¹ U. S. Code, Title 21, secs. 171-85.

¹² U. S. Code, Title 26, secs. 1383-88.

¹³ U. S. Code, Title 26, secs. 1399-99Q.

¹⁴ U. S. Code, Title 21, secs. 61-63.

phasis was placed on the avoidance of deception and the possible injury to public health. It appears, however, that the protection of milk producers was a far more important purpose. There is nothing physically harmful in filled milk, as such. Its consumption on the assumption that it contains all the elements of milk may result in a deficiency of certain nutritive elements. The risk in its sale in these circumstances lies in the possibility that individuals may be deceived as to its nutritive value. But there is (except under certain specified circumstances) no provision in the act for sale even if true contents are revealed. It would seem that regulations requiring full disclosure of the content of filled milk and perhaps of the manner in which it differs from milk might be a more appropriate form of control. Certainly it would allow a wider range of individual choice in income expenditure. However, if it be presumed that filled milk cannot be advertised or sold without deception as to its nutritive value, and that this deception is significantly dangerous, prohibition of sale may be thought of as having some basis in the preservation of public health. This may be true in view of the importance of milk in children's diets.¹⁵

The protection of private groups has been a significant purpose also of certain special taxes on oleomargarine, adulterated, processed, and renovated oils and butter, filled cheese, and mixed flour.¹⁶

¹⁵ A federal district court held this law unconstitutional in *U.S. v. Carolene Products Company*, 7 Fed. (Supp.) 500 (1934). The Supreme Court, however, reversed this decision and upheld the constitutionality of the act in 1938 (304 U.S. 144). There is current report to the effect that the issue may come anew before the courts on the ground that vitamin elements formerly absent are now being incorporated in filled milk.

¹⁶ Especially to be noted is the almost prohibitive federal tax which has been imposed on oleomargarine if it is yellow in color. This tax is to apply even if the product is clearly sold as oleomargarine (U. S. Code, Title 26, sec. 971). In some instances, state governments have, for the purpose of protecting industries within the state, placed absolute prohibitions on the sale or import of certain commodities. This has been particularly true in the case of oleomargarine. To facilitate state regulation of this character, there was enacted on May 9, 1902 a federal law withdrawing the protection of the "original package doctrine" from interstate traffic in butter and cheese substitutes, by making all sales of such articles in each state fully subject to local regulations (U. S. Code, Title 21, sec. 25). The passage of this law was prompted by a Supreme Court decision declaring unconstitutional a Pennsylvania statute prohibiting the sale of oleomargarine, in so far as it was sought to prevent thereunder the importation of a wholesome butter substitute from another state and its sale in unbroken, original packages. *Schollenberger v. Pennsylvania*, 171 U. S. 1 (1898).

For a review of special oleomargarine controls, and other similar legislation,

This legislation has often been regarded as having a revenue rather than a regulatory purpose. Revenue, however, does not appear to have been the sole objective, and it is possible to legislate an article out of existence by selective taxation as effectively as through the prohibition of its manufacture or sale. While the complete elimination of these products from consumers' choices has evidently not been the purpose of this taxation, the effect has been to reduce the consumption of these products, and with no apparent basis in the preservation of public health or morals.¹⁷

Somewhat similar have been the controls imposed on imports of tea. While, like the other regulations designed to provide group protection, these laws have controlled the sale of an article on bases not definitely related to public health or morals, it is less clear that they are primarily designed for group protection, inasmuch as tea is not grown in the United States and the producers of competing beverages seem not to have been influential in bringing about the regulation. Important among the purposes of these regulations appears to be the strictly sumptuary objective of limiting consumer choices.

The controls over importation of tea had their origin in the inflow of inferior grades. Distributors of tea fought actively for regulations to limit imports to the better grades, on the ground that this would bring about greater confidence in the product and a resultant increase in sales and profits. In 1883¹⁸ and 1897¹⁹ laws were enacted prohibiting the importation of tea which is inferior in purity, quality, and fitness for consumption to standards established by a Board of Experts constituted under the act. No evidence exists that these rules are designed to protect the public health. The restrictions apply to all shipments, whether or not they are contaminated to a degree that would make them deleterious to health; nor

see U. S. Dept. of Agriculture, *Barriers to Internal Trade in Farm Products*, (1939).

¹⁷ There should perhaps be mentioned at this point a number of other commodities besides foods and drugs which have been subjected to special taxation, partly as a revenue measure and partly as a means of health or morals regulation, though apparently not as a device to favor special groups. Illustrative are the special taxes levied on playing cards, amusements, narcotics, white phosphorus matches, and firearms.

¹⁸ 22 Stat. L. 451.

¹⁹ U. S. Code, Title 21, sec. 41.

are they relaxed if true contents are revealed. The predominant tests of admissibility have been qualities which are essentially questions of taste, and the choice of taste has not been left to the individual consumer. While the purpose of this legislation was perhaps in part the protection of a private group, this protection was accomplished not, as in the other cases discussed above, through the imposition of penalties on competing products, but rather through a selective restriction of the supply of the protected commodity.

III. THE FACILITATION OF FOREIGN SALE

A third type of special regulation of foods and drugs is an outgrowth of the difficulties sometimes experienced in their foreign sale. There is universally a special concern with the quality of foods and drugs, so that any lack of knowledge in this regard constitutes an important impediment to their trade. In an effort to overcome this barrier, rules have been enacted prohibiting the shipment abroad of certain types of foods and drugs, unless they have been inspected and graded by government officials according to certain commonly accepted standards. Because the standards by which these products are judged are relatively uniform as among nations, the information provided by such grading, as well as the assurances which have come from the withholding of certain unwanted supplies, have been effective in promoting foreign sale.

Regulations designed to facilitate foreign sale began with an act of 1884 under which live poultry and livestock had to pass inspection for the presence of contagious, infectious, or communicable disease before they could be cleared for export.²⁰ The Meat Inspection Act of 1907 extended these controls, withholding clearance for cattle, sheep, swine, and goats, or the carcasses of these animals, unless they had passed inspection for disease.²¹ In 1908 these proscriptions were further extended to dairy products, unless inspected and certified as to purity, quality, and grade.²² An act of 1933 designed for a similar purpose prohibits the export of pears and apples not graded according to standards established by the

²⁰ U. S. Code, Title 21, secs. 112, 113.

²¹ U. S. Code, Title 21, secs. 80-85.

²² U. S. Code, Title 21, sec. 94a.

Secretary of Agriculture.²² Several regulations of like character were embodied in the Food and Drugs Act of 1938. Foods, drugs, devices, and cosmetics intended for export are declared to be not "adulterated" or "misbranded," and hence excepted from certain restrictions on their production and sale, if they are prepared according to specifications by the purchaser, and are not in conflict with the laws of the country to which they are intended for export.

This brief statement of special regulation of the manufacture and sale of food and drug products is obviously limited, and intentionally so, to a mere sketch of the legislation in this area, and its objectives. The purpose has been to set forth the general nature of the controls which have been provided, and to emphasize the types of public ends which have been sought in enacting this legislation. The history of the administration of these controls is an interesting chapter in the development of public policy in America, but such a record of even one of the major laws would be a considerable volume in itself.

²² U. S. Code, Title 7, secs. 581-89.

B. OCCASIONS

CHAPTER XXVII

THE NATIONAL RECOVERY ADMINISTRATION

On June 16, 1933, and continuing until May 27, 1935, a large part of the economic life of America came under a régime so different from that discussed in the preceding sections of this study, and indeed so different from that existing in any other period of our history, that it cannot satisfactorily be described in the categories applicable to other periods. A special analysis is therefore required. This unique period of almost two years, which constitutes one of two general types of occasions on which special controls were applied broadly to a wide range of industry, was legally initiated by the passage of the National Industrial Recovery Act; it ended with the Schechter decision¹ of the United States Supreme Court which, by a unanimous vote of the judges, declared the act unconstitutional.

An appreciation of the special relationships of government to industry which developed under the National Industrial Recovery Act and its administration requires consideration of some four matters: (1) the forces and influences which lay behind the law, and the declared purposes under which it was enacted and administered; (2) the new procedural methods involved; (3) the substantive changes introduced in the relation of government to industry; and (4) some of the lessons of and survivals from the National Recovery Administration experience.

I. FORCES AND PURPOSES

The National Industrial Recovery Act reflected a view, widely held at the time, that business activity could be more rapidly brought out of its depressed state and restored to a satisfactory level through greatly extended activities of the federal government in relation to economic affairs. Its primary concern with recovery from depression caused the act to be called "an emergency measure" and

¹ 295 U.S. 495 (1935).

"a temporary experiment." But the influences from which it sprang were not all those of the moment, nor were its objectives only those of recovery. The prevailing forces which were born of the times were interlocked with others which had been significant for years, and in the operation of the N.R.A., emergency measures were intermingled with rules designed as permanent measures of reform.

The emergency aspect of the law sprang from the fact that in the spring of 1933 the United States was experiencing the most serious economic depression of its history. While the theory by which recovery was to be induced under the National Industrial Recovery Act was never clearly stated by those who sponsored the measure, its advocacy typically included the assumption that raising wage rates would increase wage payments, which would in turn expand purchasing power with a resultant increased demand which would not only diminish so-called overproduction, but increase productive activity. It was further thought that by "putting a bottom under prices" so-called "cut-throat" or "destructive" competition would be eliminated and wage reductions checked, thus providing an environment which would be conducive to recovery. In addition there was the hope of creating employment by "spreading work." Of these three the first, embodying the so-called "purchasing power" theory, was the one most frequently stressed.²

The effort to spur a revival of general business activity under the N.R.A. was but part of a larger recovery program undertaken by the government, embracing measures designed to check the course of liquidation and to encourage new enterprise. This program included: easier access to loan funds; a vast program of public spending for relief and public works; and a series of monetary and credit measures, comprising currency devaluation, silver purchases, and credit control. The objective was to stimulate production and employment by raising prices and adding to mass consumer purchasing power.³

² For a further discussion of the theories of recovery underlying the Recovery Act and its administration, and of the actual relationships of these to recovery, see Leverett S. Lyon and others, *The National Recovery Administration, An Analysis and Appraisal* (1935), Pt. 6.

³ In part these measures had their origin in the Hoover administration, and were elaborated or extended under the Roosevelt administration. For a general survey of New Deal policies, see Paul T. Homan, "The Pattern of the New Deal," *Political Science Quarterly*, Vol. 51 (1936), pp. 161-84. For further discussion

The longer-term objectives of the law were perhaps most optimistically stated by the President who, when signing the law, declared: "It [the law] represents a supreme effort to stabilize for all time the many factors which make for the prosperity of the nation and the preservation of American standards." More specifically, it was declared that the law would relieve unemployment, eliminate or minimize child labor and "sweated" industries, ameliorate the conflicts of employer and employee, and "civilize" competition.⁴

It is with reference to these farther-reaching objectives that ideas of longer standing were most influential in the passage of the law and in its administration. Important were: (1) the idea of minimizing technological unemployment, which goes back at least to the industrial revolution, but which as a result of the rapid technological advance of the twentieth century particularly impressed current observers; (2) the notion that it is desirable to strengthen the organization of labor to "equalize its bargaining position"; (3) the idea that much competition is "predatory" or "unfair"; (4) the conceptions, then widely discussed, of "economic planning," phrased in such terms as "balancing production and consumption." Important and not unrelated was the concept of "self-government in business," which to some meant merely the fact that business men best knew the nature of competitive problems, to others that business men within an industry should determine, or at least initiate suggestions for, the control of competition (including its abatement), and that the will of the majority in an industry should be imposed upon the minority, with "policing" activities carried on in greater or less degree by industry itself. Re-enforcing these influences were old doubts, greatly strengthened by the depression, concerning the general efficacy of private enterprise. These ideas made contact with the theories of "purchasing power" and "overproduction" already mentioned in connection with the recovery aspect of the program.

II. PROCEDURAL CHANGES

The procedures for determining the relationship between government and industry provided in the National Industrial Recovery

of specific phases of these policies, see Vol. 1 of this study, Chaps. V and VII, and in this volume, Chaps. XXIII, XXIX, and XXX.

⁴Lyon and others, *The N.R.A.*, p. 3.

Act and established under its authority differed in five important respects from the procedures which had earlier been characteristic. General regulations applicable alike to all industry, such, for example, as the anti-trust laws, were not employed; on the contrary the act provided for the creation of separate codes to govern individual industries. Regulations of this character had already, as we have seen, been provided in what we have designated as "special areas." The National Industrial Recovery Act made this type of legislation broadly applicable to the whole field of privately organized industry.

A second important innovation under the National Industrial Recovery Act was the delegation to an administrative agency of broad discretionary powers. General objectives were set forth, but they rarely proved a barrier to a contemplated program, and they were of little assistance in determining the precise lines of action to be undertaken in the enormously wide range of individual industry situations to which the act was applicable. In section 1 of the act it was declared

. . . to be the policy of Congress to remove obstructions to the free flow of interstate and foreign commerce which tend to diminish the amount thereof; and to provide for the general welfare by promoting the organization of industry for the purpose of co-operative action among trade groups, to induce and maintain united action of labor and management under adequate governmental sanctions and supervision, to eliminate unfair competitive practices, to promote the fullest possible utilization of the present productive capacity of industries, to avoid undue restriction of production (except as may be temporarily required), to increase the consumption of industrial and agricultural products by increasing purchasing power, to reduce and relieve unemployment, to improve standards of labor, and otherwise to rehabilitate industry and to conserve natural resources.⁵

The specific problems to be attacked and the merits of various means of meeting those problems had never been carefully surveyed. The N.R.A. was in effect, therefore, left with virtually unlimited authority and few definite guides or restrictions.⁶

⁵ 48 Stat. L. 195 (1933).

⁶ The following comments were submitted to the President by a special reviewing committee appointed by him after the close of the experiment: "The NRA received no initial unambiguous guide from Congress, and itself changed its policy with the passage of time. . . . The NRA started out, therefore, with no clear pro-

A third significant difference between the procedures established under the National Industrial Recovery Act and the earlier procedures was a reliance on industry groups for the initiation of regulatory proposals, and the practice of submitting proposals to industry, labor, and consumer groups for approval before their promulgation by the President.¹ The act itself authorized the President either to prescribe "such rules and regulations as may be necessary," or to approve such proposals as were made "upon the application to the President by one or more trade or industrial associations or groups." Only the latter of these two procedures was employed. Exclusive reliance for the initiation of code proposals was placed in industrial groups.

Several factors account for the reliance on this procedure. In the absence of definite guides or criteria in the act, or any adequate studies of industrial practices and policies, those most familiar with the conditions of industry and most prolific of suggestions for their modification were sought after for proposals of change. Much more important was the fact that the voluntary assent of industrial and labor groups to the code provisions was regarded within the N.R.A. as essential to effective enforcement and even to the very life of the act. The general sympathy of the important groups affected was the more significant as there existed some doubts of the con-

nouncement or formulation of policy and permitted policy to grow out of accumulated decisions concerning specific codes. . . . Until almost the end of the code making period there was no clearly formulated policy for the guidance of administrators. There was a tendency to concentrate upon the form of the device proposed in spite of the fact that the same device might have very different results in the different circumstances of different industries. When, toward the end of the NRA, broader lines of policy began to develop, there was sharp conflict with already existing precedents. . . . The policy of the Administration was also handicapped by the lack of adequate information concerning the thousand industries for which it attempted to make and administer codes. Policy was necessarily made largely in the dark. . . . Policy shifted so frequently that no program can be said to have been adequately tried." (75 Cong. 1 sess., *Message from the President of the United States*, H. doc. 158 (1937), pp. 129-31.) This message transmitted to Congress a Report on the Operation of the National Industrial Recovery Act. This report was based on an extensive study of the work of the N.R.A. made by a Committee of Industrial Analysis of the Department of Commerce during a period of some 21 months following the Schechter decision. For a more extensive discussion of policy developments see Lyon and others, *The N.R.A.*, Chaps. XXVIII-XXIX.

¹ The ordinary procedure was to secure the approval of each of the three advisory boards discussed below.

stitutionality of the law, and the Administration desired to avoid any controversy which would result in a legal test.⁹

A fourth important innovation of the N.R.A. procedure was the extensive employment of organized industry groups as administrative and enforcement authorities. This was in part the result of a lack of qualified administrators familiar with industry conditions; in part it was a measure of necessity born of the need of securing industry co-operation.

Finally, there were established within the N.R.A. three advisory boards—the Industrial Advisory Board, the Labor Advisory Board, and the Consumers Advisory Board—each charged with representing the separate interests of its group in the code-making process, and advising the deputy administrators in charge of framing and administering the various codes. The result was an emphasis on the presentation of partisan interests and on bargaining for advantage among those interests. With no clear policy nor any earlier analyzed experience to guide him, and with the need of securing voluntary assent to the code, the administrator in charge of code formulation, though presumably representative of the public interest, often became a mere arbitrator among warring groups with their relative strengths determining the final formulation of policy.

This method of legislation lent encouragement to the organization of partisan interests and to a greater solidarity within partisan groups. With the benefits of code making being won by those who were strongest in bargaining, there was a premium upon definite group proposals and a united group front.

One provision of the law lent a particular stimulus to the organization of labor groups and conversely acted as an incentive to a stronger organization of employers. The law required that every code must contain three conditions: (1) "that employees shall have the right to organize and bargain collectively through representatives of their own choosing," and shall be free from employer inter-

⁹ The Administrator declared: "There is not a code or a code provision in the whole category that was not agreed to by business." (Hugh S. Johnson, *The Blue Eagle from Egg to Earth* (1935), p. 293.) Labor and consumer groups also generally assented to the codes before final approval. The latter group, however was not sufficiently powerful or well organized to be regarded as an important force.

ference in so doing; (2) "that no employee and no one seeking employment shall be required as a condition of employment to join any company union or to refrain from joining . . . a labor organization of his own choosing"; and (3) "that employers shall comply with the maximum hours of labor, minimum rates of pay, and other conditions of employment approved or prescribed by the President." By these provisions of the law the representatives of labor were given a powerful position.

The legislative process of code making in the N.R.A. was thus not the work of representatives chosen by popular vote and presumably interested in the wider concepts of public interest, nor exclusively of their executive or administrative agents charged with a similar responsibility, but was in large degree entrusted to representatives of special interest groups, chosen by these groups and charged with preserving and improving the competitive advantages of those groups.⁹ It was, therefore, necessarily one of conflict and compromise, which may be not inaccurately characterized as that of organized group law-making, with powerful industrial groups opposing powerful labor groups, and not infrequently opposing one another.¹⁰ The Consumers Advisory Board, it should be said, never acquired a position of influence comparable to that of the other two advisory boards.

⁹ These groups operated through representatives who submitted proposals for them. Disputes among these representatives as to the wisdom of proposals, and their merits in terms of the interests of various sub-groups, were frequent.

¹⁰ The special governmental committee of review above mentioned described the N.R.A. as "a rather radical experiment in incorporating interested economic groups as agencies of government." 75 Cong. 1 sess., *Message from the President*, H. doc. 158, p. 186.

The spirit and nature of the code-making process were probably never better expressed than in the pungent words of the administrator, General Hugh S. Johnson: "Take the shaping up of the Bituminous Coal Code—there were ultimatums (from one side to the other, not from us to either) and 'crackling oaths went to and fro across the fist-banged board,' but you do not get a dozen warring districts which have never known peace in our lifetime and the labor in all these districts, together with each other and with their employees to agree for the first time in history by suavity and slickness or by reading economic lectures by a professor. . . . Once in the white-hot heat of negotiations, we had to fly to Harrisburg to try to help Governor Pinchot, in a state-wide strike where a miniature war was already in progress. We wrote the speech on the plane, delivered it under his helpful auspices and then asked him to fly back to Washington with us to help." Johnson, *The Blue Eagle*, p. 240.

Under this procedure, unique in American life, the N.R.A. constructed so-called "Codes of Fair Competition" for industries. In these codes a variety of new powers equally unique in American life were granted the government and its agents. To understand the significance of these shifts of power it is necessary to analyze the codes themselves.

III. SUBSTANTIVE CHANGES EFFECTED

The N.R.A. approved a total of 557 basic codes for industries, 189 supplementary codes, and the labor provisions of 19 joint N.R.A.—A.A.A. codes.¹¹ It was in these codes that N.R.A. legislation took form.

The most significant effect of the N.R.A. upon the relations of government to industry was greatly to diminish the reliance upon private initiative in the allocation of resources, the organization of production, and the distribution of income, and greatly to increase the power of government officials and of specially interested groups, the latter to a considerable degree acting in an official capacity. The increased powers of government related to six major phases of economic life: (1) price-making; (2) the use of productive capacity; (3) the creation of capacity to produce; (4) the forms of specialization employed; (5) the wages and hours of labor; and (6) industrial relations. Each of these requires separate consideration.

Government's power over prices increased. While there have always existed limitations on the free discretion of the individual to determine prices, there was no more significant aspect of the development of the private enterprise system than those institutional changes which made it possible for individuals to exercise a dominant role in price determination.

The right of the individual to determine prices was extensively modified by the N.R.A., and added power in this matter given to government officials and to the industrial groups of which the individual was a part. This extension of governmental controls took several forms which may be classified as minimum price determination, cost protection, loss leader control, emergency price-fixing,

¹¹ 75 Cong. 1 sess., *Message from the President*, H. doc. 158, p. 21. The stated number of supplementary codes excludes seven appendixes to supplements of the Fabricated Metal Products Code and a supplement under the Retail Trade Code.

and the provision of waiting periods in open price systems. Lying behind these extensions of governmental power was the desire to cushion the downward movement of prices which the depression had brought, and in many instances to favor particularly groups of producers who were unable effectively to compete with their rivals.

Of these controls over prices, so-called minimum price determination was the most extreme. There were many codes which granted to the code authority power to determine the minimum prices at which the individual members of the industry might sell, with practically no restrictions or guides to the making of these decisions by the code authority. Such, for example, was the case where the only requirement was that the prices fixed should be "fair and reasonable" or should equal the "lowest reasonable cost of production," or the cost of the "lowest cost representative firm." Other grants of power were more limited, as for example those which provided that no individual might sell below the "average industry cost" as determined by the code authority.¹⁷

Perhaps less extreme but far more common were the so-called cost-protection plans. Ostensibly these plans were designed to prevent an individual from selling below his own costs. In many instances, however, the individual was given no discretion concerning the elements to be included in his cost, or the values to be attributed to those elements. The results in a number of cases were, in effect, no different from direct price-fixing by the N.R.A.¹⁸

Prohibition of so-called loss-leader selling was a third form of governmental price control. While the loss leader, and the variety of forms in which control over loss leaders was exercised, are too complicated a topic for discussion here, it may be pointed out that the code provisions dealing with this practice consisted typically of a requirement that a seller should charge as a minimum a specified

¹⁷ For an extensive analysis and discussion of shifts in price control, and the other changes mentioned in this section see Lyon and others, *The N.R.A.*, Chaps. XXIII-XXV.

¹⁸ See the same, pp. 585-99.

The problems of constructing cost systems were serious. By Jan. 9, 1935, 39 had been approved and systems submitted for some 230 other industries. For a discussion of this problem and some of the administrative reasons for hesitation in approval, see the same, p. 586, and Chap. XXIX.

addition to his invoice cost. Whether this was a transportation charge, an allowance for wages, a mark-up including other costs as well as wages, or some other addition to invoice cost, the effect was the same—the requirement that an individual should fix his minimum price in accordance with some standard set by government, rather than in terms of his own judgment. Loss-leader provisions in codes were confined almost entirely to the field of distribution.

Emergency price-fixing was another, and one of the most interesting, means of restricting individual price determination. Emergency price-fixing rested upon a so-called declaration of emergency in an industry. Such declarations usually grew from complaints within the industry that the prices being charged by certain units were at a “destructive level.” If, after consideration, N.R.A. officials reached a conclusion that an “emergency” did exist, it might be “declared” and a minimum price in the industry fixed.¹⁴

A final type of action which diminished the discretion of the individual in price-making was the creation of open price systems containing “waiting periods.” The manner in which waiting periods in open price systems operated need not be elaborated here.¹⁵ Their effect was to limit individual freedom to change prices in response to estimates of market conditions, and often consequently to lessen the incentive for individual price reduction, because of a probable lessening of the gains to be had thereby.

Partly as a means of buttressing the price controls set forth above, many N.R.A. codes provided restrictions on indirect means of price-cutting. It is possible, where only nominal prices are fixed, to cut below those prices by means of joint or supplementary transactions which in effect extend a concession on the primary transaction. The devices which have been employed for this purpose are legion. Typically they consist of such transactions as free deals, the furnishing of a service below the customary price, or the payment of an unusual price for a service rendered by the buyer. Restrictions on

¹⁴ Both the standards that were employed in declaring an emergency and the theory of their social effect are open to serious question. For a more extended discussion, see the same, pp. 605-10.

¹⁵ For an extensive discussion see the same, pp. 610-12, and Leverett S. Lyon and Victor Abramson, *The Economics of Open Price Systems* (1936), particularly Chap. III.

the use of these devices were included in many N.R.A. codes. In some instances these restrictions were designed to penalize those groups of producers who found these pricing devices an especially effective competitive weapon.

Government's power over the use of productive capacity extended. While regulations concerning prices were perhaps the most important means by which the power of government was expanded under the N.R.A., significant limitations were also placed on individual responsibility through direct controls over production. These regulations were of several different types.

Many codes placed limits upon the number of hours within a given period during which an individual might operate his plants or the individual machines within his plants. In certain instances these limitations were specified in the codes themselves; in other cases the details were left for administrative decision. In a number of instances the code authority, and in some a majority of the members of the industry, were given the right to alter the provisions specified in the codes. So long as the limits fixed were below those which would otherwise have prevailed, the effect of these measures was to restrict production.

Production quotas were a second plan used for limiting the discretion of the individual concerning the quantity of production which he might undertake. The number of industries to which production quotas were applied was comparatively small; but some of the industries in which they were used, for example, the petroleum and copper industries, were of great importance.

The bases for production quotas varied from instance to instance, but they all show important differences from the criteria of individual enterprise. While an individual would ordinarily be expected to base his production policy on the opportunities available to him for profitable sale, the production quota plans established under the N.R.A. typically required that a quota be determined for the industry as a whole, on some such basis as that needed to "balance production with consumption," and that this quota be divided among the individual units of the industry so as to be "equitable," or on the basis of their relative ownership of the existing productive capacity or their relative past use of that productive capacity. Under

any of these standards it is obvious that the individual could do little through his own policies to vary the amount of the orders which he could fill. The allocation of resources to productive uses came thus to be determined by the N.R.A. operating as an administrative agent of government.¹⁶

The purpose of these restrictions on production was often declared, somewhat ambiguously, to be "balancing production with consumption."¹⁷ At other times more explicit purposes were declared. Most common were the objective of spreading the "available" business, of regularizing production, of eliminating the so-called graveyard or night shift, or of stimulating the capital goods industries. These regulations were also frequently introduced as a means of maintaining prices, or of protecting certain groups within an industry, though this was not always presented as an objective.¹⁸

Government's power over the capacity to produce expanded. A direct check on the individual's freedom to produce what he believes to be profitable may be made not only by controls over the use of productive capacity, such as those discussed above, but in longer-run terms by establishing limitations on his capacity to produce. Such restrictions were applied in a number of instances in N.R.A. codes.¹⁹

Several types of measures were provided in N.R.A. codes to restrict productive capacity. First, there were provisions restricting the construction of capital equipment. A second device was to place limitations on the changing of the existing facilities from one type of production to another. Third, there were limitations on the removal of existing facilities from one locality to another. There were also limitations on the re-opening of plants not operating within a specified time prior to code approval, and, in the field of distribution, limitations on the opening of new routes or the extension of existing

¹⁶ Some code provisions permitted periodic revision of quotas. For a discussion of this and other types of control over production capacity, as well as the industries to which these various controls were applied, see Lyon and others, *The N.R.A.*, Chap. XXIV.

¹⁷ While a critical evaluation of these controls is beyond the scope of this study, it may be noted that it is possible to balance many different volumes of production with consumption, merely by varying the price.

¹⁸ For a further analysis, see Lyon and others, *The N.R.A.*, pp. 637-46.

¹⁹ For the number, see the same, p. 633 ff.

ones. All had the effect of extending considerably the power of government over the determination of productive capacity in individual industries. They were supported within the industries affected as means of warding off the impact of new competition, or of additional competition from the more enterprising of the existing producers.

A few codes placed limitations upon inventories. Such limitations do not restrict production so long as the amount produced is marketed. It is only when they conflict with the individual's belief as to what accumulations of stock are wise that they become in fact restrictions on production and thus diminish the realm of free individual discretion. They may have the effect only of centering attention on a more careful relation of production to market opportunities.

Government's power over specialization enlarged. Individuals vary widely in their abilities and skills; and they have a tendency, if they are free to do so, to choose those specialized occupations and to make such use of the available techniques as will provide scope for their best talents. Similarly, the geographical areas of our country differ in the products they can best produce, and so long as freedom of choice of occupation and flow of the factors of production are permitted, there is a tendency toward geographical specialization in production. As we saw in Volume 1, it has been the policy of our country in the broad range of industry and trade generally to permit such specialization of tasks or areas and such use of techniques as individuals see fit, on the theory that in this manner individuals will move to those occupations for which they are best fitted, that products will be produced by those techniques and in those areas in which they can most economically be produced, and that there will be preserved a continuous incentive to find new opportunities for effective specialization and new techniques of production, with a corresponding enhancement of the national income. The N.R.A. profoundly modified this policy.

Many N.R.A. codes contained provisions significantly restricting the freedom of individuals to determine the specialized activities or combinations of activities which they would perform, and the geographical areas within which they would produce and sell their

products. As before, it is unnecessary to examine these restrictions in detail. Illustrative of the rules limiting the tasks in which individuals might specialize²⁰ are the regulations against direct sale by manufacturers; the regulations limiting manufacturers in the performance of storage or installation functions or in working on materials provided by others; the provisions against sale on consignment or from stocks in the hands of salesmen; the provisions against financing purchasers; and the provisions for the classification of customers. There were many others, similar in their general effects of extending the power of government in the determination of individual specialization.

Of the rules relating to geographical specialization the most important were those establishing basing point systems in industries.²¹ Of correlative significance were the provisions for so-called zone protection. These latter provisions prohibited sales within a given zone by producers outside of that zone, excepting under certain price restrictions which protected the prices of those within the zone. Other provisions affecting geographical specialization were the "anti-dumping" rules, which prohibited sales outside of "normal" territories at prices below those established for the normal territories; the requirements for mill base prices which prohibited or restricted freight allowances; and the requirements that prices be uniform for the entire United States.

The general effect of the regulation of specialization was to improve the competitive position of particular types of producers or distributors, or particular areas of the country, to the disadvantage of those performing other specialized tasks or combinations of tasks, those employing other techniques, or those located in other areas of the country. These controls may be viewed therefore as designed to foster certain types of specialization at the expense of others. It was the advantages which they thus provided for the favored groups that constituted their major basis of support.²²

²⁰ For a general analysis of the N.R.A. controls over specialization, see the same, Chap. XXV.

²¹ For a discussion of the basing point system see Vol. 1, pp. 302-03.

²² In addition to those limitations on individual discretion which have been presented above, the N.R.A. applied a large number of others which, in many cases at least, were believed necessary to make the foregoing types of regulation effective. The necessity of constructing accounting systems, or the bases for accounting sys-

Government's power over the wages and hours of labor extended. The N.R.A. brought to the determination of the prices of labor changes as profound as those involved in the controls discussed above. While prior to 1933 there had been federal laws restricting in certain situations the bargaining among individuals as a means of fixing wages and hours,²⁸ the N.R.A. attempted a vastly greater program limiting the hours of labor and setting minimum rates of wages.

In the early days of the N.R.A., before there was time to frame a separate code for each industry, a blanket code known as the President's Re-employment Agreement was adopted and applied temporarily to a wide range of industries. This agreement provided, among other things, for the fixation of a maximum number of hours of work, minimum wages, rules to govern the adjustment of wages above the minimum, and the prohibition of the use of child labor. Provision was made for the granting of exemptions, and many such exemptions were granted.

The pattern of wages and hours regulation provided under the President's Re-employment Agreement was followed closely in the individual industry codes enacted later. It is beyond the scope of this study to analyze these provisions in detail. Certain of the sig-

tems, where rules required a relationship between prices and costs, was of this type, and has already been mentioned. There was in addition, as we have seen, a very extensive series of rules relating to what may be called indirect pricing. These rules were regarded as necessary to prevent the accomplishment by indirection of what had been forbidden if undertaken directly. It is probable that not all practices which might be classified as indirect pricing were outlawed solely for the reason indicated. In some instances they were undoubtedly regarded as objectionable on the grounds that they were conducive to secrecy or confusion in price making. These efforts to fortify other regulations, particularly to fortify price regulations, took two major forms: they outlawed or restricted certain types of transactions, or they required separate and identifiable charges for different phases of certain types of transactions. The former were the more numerous. In various codes they were applied to such transactions as: making gifts of equipment, making loans to customers, free deals, granting certain types of credit terms. Among the services for which certain codes required separate charges were: making estimates, furnishing display materials, providing packages and containers, making dies.

In addition, there should be mentioned the open price plans, which were designed in part to provide a general knowledge of prices, in part to facilitate the enforcement of the price control provisions of the codes, and in part to restrict the competitive advantages of certain types of producers.

²⁸ See Vol. 1, Chaps. VIII and XVII.

nificant problems, which illustrate the complexity of the regulation undertaken may, however, be indicated. It was not found desirable to establish a single minimum wage, applicable alike in all circumstances. Variations were provided according to the industry involved, the geographic areas affected, the population of the city in which a plant was located, the sex of the workers, the wages paid at some prior time, the class of work performed, the skill and experience of the workers, the age and physical condition of the workers, and the like.²⁴

The hours regulations provided in the codes were less complex and involved fewer difficulties. A first problem was to decide the basic hours limitation. While the bases used varied from industry to industry, the differences were not great. More difficult was the problem of deciding permissible exemptions. Many industries have seasonal or peak loads and require longer hours of work at some periods than at others. To meet this situation, in determining conformance with the allowed maximum in some codes, hours were averaged over a stated number of weeks. In many such instances, there was provided a separate single-week maximum. In a few cases the permissible maximum varied with the peak or seasonal period. In some codes additional hours beyond the maximum were permitted, but only if wages were paid at a higher rate than was customary. Some codes provided for exemptions from the stated maximum hours to permit such work as emergency maintenance and repairs, inventory-taking, and the like. Nearly all the codes exempted certain classes of employees such as executives, office personnel, salesmen, professional and technical workers, watchmen, and janitors from the hours provisions.²⁵

The major purposes of the wages and hours provisions of the codes were commonly stated as: the provision of "living wages" for workers; the enlargement of the purchasing power of the lowest paid workers, who could be counted upon to spend a large proportion of their incomes for consumers goods and hence to stimulate the revival of business activity; and the "sharing of the available work" among a larger number of workers, as a relief measure. Workers supported the provisions in the hope of higher incomes, though

²⁴ For a detailed analysis see Lyon and others, *The N.R.A.*, Chaps. XII and XIII.

²⁵ For further analysis, see the same, Chap. XIV.

many resented the necessity of sharing the work, when they found their total incomes declining. While an assessment of the economic and social significance of these measures is beyond the scope of the present study, it may be observed that the efforts to increase purchasing power by raising wages were in some degree negated by the price control provisions of the codes.²⁸

Government's power over industrial relations extended. A final important sphere in which the N.R.A. significantly extended the powers of government was that of industrial relations. The National Industrial Recovery Act, in its famed section 7 (a), made compulsory the inclusion in every code of fair competition of a provision protecting the "right" of labor to organize and bargain collectively. The purpose of this provision was twofold. It was viewed as a general reform measure to improve the status of organized labor; and it was regarded as a device for aiding recovery from depression by further bolstering wage rates and limiting hours of labor, and by establishing a procedure which it was believed would minimize strikes and lockouts. Among those who were skeptical of the wisdom of this provision, there was fear not only that wage-raising would constitute a bar to the re-employment of labor, but that governmental sponsorship of labor organization and collective bargaining would enhance the danger of strikes, and consequently of unemployment. Those who supported the measure held the contrary view that it would have the effect of allaying the growing labor unrest of the depression period and hence would diminish the danger of strikes.

When the National Industrial Recovery Act was first enacted many trade unionists hoped that the collective bargaining principle established in section 7 (a) would lead to the requirement that the wages and hours provisions of the codes be decided in collective negotiations between employers and organized employees. The Administrator held, however, that the industry members submitting codes of fair competition had the exclusive prerogative of proposing wages and hours provisions, along with the other provisions of the codes, and that these proposals would be viewed on their merits in the regular course of code-making. The wages and hours provisions of the codes came to be determined, therefore, by a pro-

²⁸ For an analysis of this subject, see the same, Chap. XV.

cedure different from what is ordinarily regarded as collective bargaining. The process of code-making, with the partisan interests of industry and labor strongly represented, was not however wholly different from collective bargaining. Moreover, in a few cases the labor provisions of the codes were determined in large part through direct negotiations between trade unions and employers.²⁷

Primarily, the significance of section 7 (a), as supplemented by section 7 (b), lay in the new legal status given the collective bargain. Prior to the N.R.A., collective labor agreements were binding, if at all, only on the signatories. They could be enforced only through suits for the violation of private contracts. Under the N.R.A., collective agreements made under section 7 (a), when approved by the President under the powers granted him under section 7 (b), acquired the same force as regularly enacted code provisions, and became accordingly applicable to non-signatories and subject to enforcement by governmental authorities. This new power provided a strong stimulus to the growth of organized labor.

In one other important way the N.R.A. brought about a modification of governmental controls over industrial relations. Both the labor provisions of the codes and the collective agreements made under section 7 (a) gave rise to many complaints and disputes among laborers and between labor and employer groups. To mediate these controversies, some codes provided for industrial relations boards representing labor and industry, and sometimes other interests. In addition, the President created the National Labor Board, in part as an adjunct of the N.R.A., and assigned to it similar functions. Later, under Public Resolution No. 44, he established the first National Labor Relations Board, which was made wholly independent of the N.R.A.²⁸

IV. PRESUMED REAFFIRMATIONS AND EXTENSIONS OF OLD POLICY

The preceding section has been concerned with regulations under the N.R.A. which brought into effect changes in the relationship of

²⁷ For further discussion, see the same, Chap. XVII.

²⁸ For further discussion, see Vol. 1 of this study, pp. 207-09; Lyon and others *The N.R.A.*, Chap. XVII; and Lewis L. Lorwin and Arthur Wubnig, *Labor Relations Boards* (1935).

government to industry. The N.R.A., however, in its various codes established a number of regulations which presumably did not look in the direction of change. They were alleged rather to support old attitudes of what was fair and unfair in competition from a public point of view. The Recovery Act did not in fact alter the previous status of any law, with the exception of the anti-trust laws from which specific exemptions were granted for provisions of approved codes.

One group of rules reaffirming old attitudes coincides in language with the types of regulations discussed in Chapter XI of Volume 1 as establishing a plane of competition. Placed in N.R.A. codes were a number of provisions which are almost word-for-word repetitions of the Group I rules of the Trade Practice Conference Agreements of the Federal Trade Commission, and are re-statements of well-accepted common law and statutory positions. Illustrative of this type of N.R.A. rules were the prohibitions against misrepresentation, commercial bribery, defamation of competitors, false marking or branding, substitution without knowledge of purchaser, and coercion.

All these were alleged to be and presumably were re-statements of old ideas concerning the plane of competition. It was not possible, however, to be certain in considering any specific provision in the code of a particular industry what its effects would be without a detailed knowledge of the circumstances of that industry. Rules which in one setting may properly be regarded as establishing a plane of competition, may in other settings be merely a means of extending the management powers of government of the character discussed in the preceding section, or of fortifying some of these extensions made by other rules. In a milieu in which emphasis was being placed upon added governmental powers of a management character, it is likely that many rules which under earlier conditions might have been interpreted as setting a plane of competition would now be more soundly interpreted as extending the management powers of government.

Similar issues are raised when one considers a second type of N.R.A. code provision apparently designed to reaffirm or extend earlier relationships between government and industry. Included

in this group are a number of rules which may be interpreted as designed to implement competition. A large number of N.R.A. codes, for example, established open price plans. Open price plans may be so constructed as to facilitate informed competition by bringing before private individuals added knowledge upon which to base judgment. They may, however, be designed to favor one group of competitors over another. In some instances under the N.R.A., it seems fair to state, they were planned for the latter purpose. The same observations are true as regards systems of cost finding.

A large number of codes also contained provisions dealing in one way or another with standards of commodity quality, or standards of commodity performance, or both. As has been shown earlier, rules of this character may be important elements in determining a plane of competition and in implementing competition. Under the N.R.A., however, the complaint was not infrequent that they were in some instances used as a means of favoring certain classes of products or certain types of producers without regard to the physical harmfulness of the commodities involved or their amenability to independent consumer judgments. In this case, they may properly be interpreted as designed to provide controls over the products to be produced and the character of specialization, and thus constitute extensions of governmental power over the allocation of resources and the organization of production.

V. REDIRECTION OF POLICY

The foregoing discussion relates to that period of the N.R.A. when the great majority of codes were being framed. Comparatively late in the life of the N.R.A. influences were introduced which tended to give it a more consistent formulation of policy and one more nearly in line with the policies of government in relation to industry which had preceded the N.R.A.

This change came as a result of a variety of criticisms, mainly concerning the rise in prices which was taking place, the differences in policy as among codes, and certain alleged administrative abuses and oppression of small-scale enterprises. Some of these criticisms originated within the N.R.A., notably in the Consumers Advisory Board and the Research and Planning Division, some in congres-

sional quarters, and some in outside circles. Late in January 1934 these criticisms caused a stay to be put on open price provisions in all codes not yet approved, and an order to be issued to various N.R.A. divisions to study this and other criticized types of regulation. In April of the same year they led to the appointment of an assistant administrator for policy, and of three sub-groups to deal respectively with trade practice policy, labor policy, and administrative procedures. The sub-group assigned the function of formulating trade-practice policy advanced farthest in the formal framing of general proposals. Its work may therefore be briefly reviewed as best illustrating the changes in policy which occurred.

This policy group was authorized to proceed upon the assumption that codes were to be made within the framework of "competitive capitalism." Under this assumption it submitted a series of policy recommendations, all of which were based on the idea of implementing individual enterprise, and of establishing a plane of competitive action in line with previously accepted policy. The first of these recommendations was embodied in what became generally known as Office Memorandum 228. This memorandum authorized open price plans and accounting provisions only in terms believed to facilitate effective competition, and thus reversed in policy much that had been approved in the codes already enacted. At the time of the official proclamation of this policy it appeared that an effort would be made to bring the codes already approved into line with the announced changes.²⁸ However, this pronouncement met with a storm of protest from industry groups. These groups regarded the existing trade practice provisions of the codes as a recompense for the labor provisions, and they resisted any change. To appease them, the Administrator declared that no changes would be made in codes already approved, except through negotiation.²⁹ This meant that the newly declared policy had comparatively little practical effect. It is to be doubted whether it could ever have been enforced within the existing framework of the N.R.A., which involved the voluntary acceptance of code provisions.

The group dealing with trade-practice policy followed Office

²⁸ See NRA Release No. 5600.

²⁹ See NRA Release Nos. 5629 and 5682.

Memorandum 228 with 14 additional policy recommendations dealing with premiums, cost protection, minimum price regulation in emergencies, accounting systems, government purchases, exemptions of government purchases from price filing requirements, classification of customers, discounts and price differentials, resale price maintenance, advertising allowances, free deals, informative labelling, procedures for declaration of emergency, limitation of machine hours and capacity control, and loss leaders. Though the policies thus initiated were in large part confirmed and to some extent extended in the latter days of the N.R.A. by the National Industrial Recovery Board, which in September 1934 replaced the Administrator in control of the N.R.A., they met in practice a fate similar to that encountered by the open price recommendations which preceded them.

Fundamentally, the official policies thus promulgated in the second year of the N.R.A.'s existence were in many aspects clearly different from the provisions found in the codes. Whereas under the codes no consideration was given to the maintenance of competition and in fact in many respects reliance was placed to a greater degree than had ever before been true in America on group action "the final N.R.A. policy was, in spirit and intent, quite in harmony with the antitrust laws, favoring competitive flexibility of price and production as against control."⁸¹

VI. CONTRASTS, COMPARISONS, AND LESSONS

The analysis of the N.R.A. and the experience of the country with that form of relationship of government to economic life has its chief interest for this study in its contrasts with government relationships to industry which have been characteristic in America. Most important is the contrast with the relationships which had earlier been characteristic in the field of privately organized industry generally, for it was those relationships which the N.R.A. most affected. The assumption regarding this large area was no longer that individual initiative, if safeguarded and in an appropriate degree limited, implemented, and promoted, could be relied upon to bring about a socially desirable organization of economic life. Or

⁸¹ 75 Cong. 1 sess. *Message from the President*, H. doc. 158, p. 185.

the contrary, government action was regarded as essential in a much wider range of decisions concerning allocation, conversion, and distribution. With government playing so direct a role in the management of enterprise, no provision was made in the National Industrial Recovery Act to assure the maintenance of competition, and other governmental agencies practically discontinued their efforts in this direction.²³ Unified group action of a sort previously regarded as unlawful was in fact thought indispensable in effectuating the purposes of the act.

Not only did the Recovery Act project government into an unprecedented degree of management in the broad area where reliance for the organization of industry had previously been placed chiefly on individual action, but it brought about an industry-by-industry approach to the great range of economic problems within this area. This approach, which is in sharp contrast with the traditional approach of framing generally applicable laws, found support in the concept of industrial self-government which we have seen was important in the background of the act, and was further stimulated by the necessity for relying heavily on industry groups for code suggestions and the need of securing the approval of industry groups in bringing codes to final enactment. The detailed nature of the management controls undertaken, moreover, required adaptation to the varying conditions of different industries. The result was virtually to convert the whole of privately organized industry into a host of "specially treated areas." In this respect, as well as in respect to the range of governmental powers, government's relation to industry under the N.R.A. took on a resemblance to the relationships in what we have designated the specially treated areas.

Before the N.R.A. the industry-by-industry approach and the type of regulation associated with this approach were confined to a

²³ As we have earlier seen, the National Industrial Recovery Act exempted the provisions of approved codes from the proscriptions of the anti-trust laws. It provided, however, somewhat ambiguously, that codes should not be "designed to promote monopolies or oppress small enterprises." This prohibition was, in effect, disregarded. The essence of the N.R.A. procedure was to substitute group agreement concerning prices, wages, production, and specialization, for individual discretion in the making of these vital economic decisions. Further, the abandonment of anti-trust enforcement, together with the powers which many codes conferred on industry and labor groups, created an atmosphere which strongly discouraged independent individual action.

limited sphere of economic life, and each instance of such treatment can be traced to particular conditions in the industry which could be used to win public support to a policy of giving it treatment different from that accorded the general field of economic life. Under the Recovery Act the industry-by-industry approach was extended to the whole of industry. Each industry was identified for separate treatment essentially on the basis of the fact that its members manufactured or sold the same products or performed the same services. Moreover, inasmuch as the Recovery Act was applicable to almost the whole of industry, the guidance of government under it could not be thought of as necessarily more applicable to one area of economic life than to another. A distinction between privately organized industry generally, and areas specially treated in the sense of being subject to special governmental attention, accordingly disappeared.

Perhaps no single consequence of this substitution of an industry-by-industry approach for the concept of industry as a whole was more important than its effect in obscuring larger social considerations, and in emphasizing the separate interests and promoting the separate organization of partisan groups.

One further comparison with the specially treated areas is in point. Under the N.R.A., governmental powers over the determination of prices, wages, production, and other operational decisions were in many instances not essentially different from those which had earlier been granted to administrative agencies in the specially treated areas. The Recovery Act, however, provided much less clear criteria of action on these matters, and set much less definite limits to the powers of the administrative bodies it established, than was usually the case in previous laws providing for special treatment of certain areas of economic activity.

The innovations made under the Recovery Act did not extend the powers of government as a direct producer. Reliance for the initiation and organization of enterprise and for its actual operation remained, in the sphere of industry affected by the Recovery Act, largely with individuals, and the ownership of resources remained entirely private.

It is not the purpose of these contrasts and comparisons to point a moral concerning the nation's experience with the N.R.A. That

experience did, however, provide important lessons which may be of service to the country if similar plans of organization come under consideration in the future.³³ The National Industrial Recovery Act and its administration added greatly to our knowledge of what may occur as a result of legislation with mixed and possibly contradictory objectives and providing broad and indefinite delegations of administrative power.³⁴ Experience with the National Industrial Recovery Act made it clearly evident that in efforts toward industrial self-government, as in government otherwise organized, conflicts of group-interest and self-interest are extensive and severe, and that the fulfillment and compromise of group interests may become a far more dominant purpose than the public interest in any larger sense.

More specifically, experience with the N.R.A. disclosed something of the complexity of the problems involved in fixing prices and wages, and in deciding a proper policy concerning production, production capacity, specialization, and industrial relations. And it threw a revealing light on the difficulties of designing regulations which will effect desired ends in these matters, even when those ends have been clearly determined. It provided, moreover, considerable experience concerning the effectiveness of a number of measures designed to stimulate industrial recovery, with certain specific legislative, administrative, and enforcement procedures, and with a wide range of devices for subjecting to increased governmental control various aspects of economic life not previously so controlled. Perhaps most important is the lesson that a panacea for widespread and deeply seated ills is not to be found merely in passing "a law" and in establishing "an administration."

On the primary question of whether the N.R.A. was in general promotive of recovery, the record is not clear. The N.R.A. did not in the first place represent a clear and unambiguous program having definite consequences moving in a single direction. Nor is it possible with assurance to isolate the effects of the N.R.A. from

³³ For a general comprehensive treatment of the problems, both of administration and of public policy, which the N.R.A. presented, the reader is referred to Lyon and others, *The N.R.A.*, and 75 Cong. 1 sess., *Message from the President*, H. doc. 158.

³⁴ In the Schechter decision declaring the National Industrial Recovery Act unconstitutional, Justice Cardozo said of the law, "This is delegation running riot."³⁵ (295 U.S. 495 (1935).)

those of the many other forces present during its existence. There is general agreement that in the beginning it "made a definite contribution toward changing the prevailing mood of the country from apprehension to hopeful effort."⁸⁵ However, in the late months of its existence it is probable that the uncertainty and conflict of its policies, together with its efforts to raise wages, fix prices and restrict production, had a retarding effect on recovery. It has been estimated that its policy of spreading work brought about the re-employment of from 1,750,000 to 2,000,000 men.⁸⁶ This however, is no measure of its contribution to recovery.⁸⁷

Although the Schechter decision ended the legal life of the N.R.A.,⁸⁸ the forces which gave rise to it were by no means spent nor were they wholly frustrated by the termination of the N.R.A. New expressions of certain of these forces, to some extent influenced by N.R.A. experience and thus to some degree the outgrowth of that experience, have since appeared both in state and national legislative action. In several states "little N.R.A.'s" continued in existence for some time, and the recent movement to secure so-called fair-trade and unfair-trade laws may be traced in part to N.R.A. influences. In the federal sphere, the current regulation of the bituminous coal industry is patterned after the controls attempted in that industry under the N.R.A., and proposals for the revival of similar N.R.A. controls have been made for several other industries, notably the cotton textile industry. The present National Labor Relations Act had its origin in part in the forces stimulated by the N.R.A., as did the Robinson-Patman and Miller-Tyding Acts. More ambitious proposals have included a revival in whole or in part of nearly all the major phases of the N.R.A. program. Many N.R.A. ideas are finding expression in the current investigation of the Temporary National Economic Committee.⁸⁹

More significant than these specific results, however, have been

⁸⁵ 75 Cong. 1 sess., *Message from the President*, H. doc. 158, p. 181.

⁸⁶ See the same, p. 79, and Lyon and others, *The N.R.A.*, pp. 837-44.

⁸⁷ For a general discussion of the N.R.A. as a recovery measure, see Lyon and others, *The N.R.A.*, Chaps. XXXI-XXXIX.

⁸⁸ This decision, which held the National Industrial Recovery Act unconstitutional, was based primarily, not on the controls attempted under it, but on the delegation of power which it provided.

⁸⁹ For further analysis, see Vol. 1, Chap. X.

the lessons the N.R.A. has taught organized groups—both industry and labor—concerning the advantages of united action in pressing for the fulfillment of their partisan interests; and the precise crystallization of sentiment within those groups which it brought about. The desire thus stimulated to achieve group advantages has been tempered somewhat, however, by the realization that conflicting groups may pursue a similar strategy, and by the fear that there may be provoked more extensive controls by government.

CHAPTER XXVIII

WAR

War has always drawn government into a host of new relationships to industry. Even at a time when the waging of war meant merely the hiring of soldiers and the purchase or requisition of munitions and supplies, it brought new problems of finance and of securing the necessary personnel and ordnance. In its modern form with its extensive use of mechanized equipment, war has become as much a struggle between industrial systems as a battle among military forces. Successfully now to engage in such a venture where the great powers are opposed, it is necessary to shape to the purposes of war a large part of the economic life of a nation. So extensive and so different indeed are the relationships of government to industry involved in the carrying on of modern war that they cannot well be analyzed in terms of the conditions which prevail in times of peace. We have accordingly in this study set them apart for treatment as a second general type of special occasion for governmental controls.

In the United States, prior to the great conflict which began in 1914, wars were reflected mainly in the increased expenditures of government for national defense and in the conscription of men for military and naval service. The World War, however, brought about a profound change. In this country, as in others, natural resources, labor and management, transportation systems, industrial plants, and civilian organizations all came to be regarded as properly amenable to extensive governmental direction in the carrying on of war.

Three primary factors account for the expansion of governmental powers over economic life in war-time. War increases greatly the cost of a nation's military and naval services; and these services, because they are so vital to social welfare and because they can best be performed through centralized direction have characteristically been a governmental function. Second, in expanding military and naval services there is need for increasing

the production of certain types of supplies that are essential to the performance of these services. The importance of speed and certainty in making these adjustments has generally led to added control by government. Third, certain essential civilian goods and services which in peace-time are regarded as being supplied to social advantage by private enterprise have, because of the reduced production or the increased demands resulting from war, become so deficient as to bring about governmental action in production or in allocation to use.

The significance of these war-time relationships of government to industry will become more clear as we review briefly our World War experience.

I. WORLD WAR RELATIONSHIPS

At the time of our entry into the war there was no contemplation of extensive government action in relation to industry. There prevailed in fact among business men a strong sentiment in favor of maintaining "business as usual," and among government officials there was little realization or anticipation of the tasks which were to be undertaken or the controls which were to be employed. There had been established, in August 1916, a Council of National Defense composed of six cabinet members, which was charged with planning the mobilization of our resources in time of war. However, the powers of the Council were confined to investigation and recommendation, and at the time of our entry into the conflict it had not proceeded far even with these duties.

With the sudden impact of war demands, shortages appeared in many basic provisions, and various departments of our government and our allies were found to be competing with each other for these limited supplies. Speculators were accumulating them, and there was hoarding by some who feared a deficiency in terms of their own needs. Prices rose sharply as these competing bidders sought to outrival each other in amassing supplies, and the government found itself unable to provide its basic needs in the market. Production, moreover, did not appear to be responding rapidly enough to the new orientation of wants. Some believed that the uncertainty concerning prices and costs was having a retarding

effect on enterprise, and that the many new opportunities for employment had induced a degree of labor turnover so great as to restrict total output. However, it was the uncertainty of prospective government controls, rather than of ordinary market forces, that in some instances retarded production, notably in coal.

A first step was made toward what later proved to be an extensive program of control when the government moved to centralize the clearance of its own purchases and those of its allies. In the case of many commodities government purchases had grown to such proportions that they had an important influence on the movement of prices. In the interests of economy therefore, and in some cases to protect civilian consumers, it was thought desirable to centralize the clearance of these purchases. Demands for centralized clearance of purchases came also from producers who found themselves with government orders greater than they could supply and who sought guidance in the form of some system of priorities. Moreover, the system of competitive bidding employed in government purchases had resulted in loading some producers up with orders far in excess of their capacity and leaving others with unutilized facilities, obstructing thereby the production of necessary supplies. Centralized allocation of orders was thought essential to meeting this difficulty.

In the beginning little was done beyond the installation of a better plan of internal organization for purchase. A system of central clearance and a plan of assigning priorities to various demands was devised, and orders were often allocated to specific production areas or even individual plants. The prices of purchase were moreover centrally determined, further to avoid competition among departments and to control costs and minimize "profiteering."

The view developed, however, that if a steady flow of essential war supplies was to be maintained, merely outbidding all rivals and relying on the responses of private producers would not be sufficient. The supply of certain essential war commodities continued inadequate to their need, and their rising prices were complicating severely the problems of government finance. There was consequently inaugurated, piece by piece, an elaborate program of control over industry that came eventually to reach nearly every

phase of allocation and many phases of conversion for all-important war commodities.

In general the government's program may be characterized as improvised step by step. No broad comprehensive plans, beginning with a survey of all basic resources and providing for conversion to war uses of those which could be, were ever drawn up. Nor were there such general plans either for the area of industry taken over by government or for that subjected to extensive regulation. The starting point of control was always some specific deficiency in war supplies, or a rise in prices, and the programs of regulation proceeded always outward from these recognized difficulties to the various measures which might be employed to correct them.

The magnitude of the task of war supply may be portrayed to some degree in quantitative terms. During the course of the war the government is estimated to have spent for military purposes some 22 billion dollars, a sum larger than the total cost of the federal government during the entire period from 1791 to the outbreak of the war.¹ Affected by these expenditures of government were some 30,000 different types of commodities, relating to all of the 344 census categories of industries.² Many of these products were wholly or partly new in design and required new types of equipment for their manufacture. A large number were required in quantities greater than had ever before been produced in our country.

The changes which were introduced in the relationships of our government to industry during the World War may be placed in two categories. One was the great extension of direct governmental production—applying to all phases of allocation, conversion, and distribution. The other was the provision of a variety of new powers over that area of industry which remained in some degree privately organized. We may begin with an analysis of the former.

¹ Leonard P. Ayres, *The War with Germany, A Statistical Summary* (1919), p. 135. The method of making these estimates is not set forth.

The official estimate of the cost of the war made by the Secretary of the Treasury places the figure even higher. He estimates net war expenditures to have been over 33 billions of dollars. There is included in this calculation, however, over 9 billions for loans to foreign governments, as well as an undisclosed amount for other loans. See *Annual Report of the Secretary of the Treasury, 1920*, pp. 104-06.

² Ayres, *The War with Germany*, p. 52.

A. Extension of Governmental Production

The World War involved our government in an enormous extension of direct production. Mainly, this increase consisted of the recruiting and training of troops and the actual conduct of battle. From about 200,000, our army was increased to some 4 million, and in all the armed forces of our nation grew to nearly 5 million. Of this number, nearly 3 million were recruited through conscription.³ The government itself performed this process of "production," diverting from other uses nearly a fifth of the nation's male working population, and converting their efforts into military and naval services.⁴

War calls, however, not only for men but also for transportation, for food and clothing, and for arms and munitions. For the provision of these services there was reliance in large degree on privately organized production, supplemented, however, as we shall see, by many new regulatory activities of government. In some of these fields, however, the enterprise of private producers was found wanting and government embarked on a further program of direct production.

The most notable instance of such action concerned railway transportation. The war occasioned a great re-direction, as well as some increase, of traffic requirements. Millions of men, and the munitions and supplies to arm, feed, and clothe them, needed to be moved first to the training cantonments and then later to the coast for transport over sea. There were in addition increased movements of materials to the points of concentration of the war industries. The result was a congestion that in certain areas amounted almost to blockade. An expansion of facilities and the adjustment of inter-road routes appeared necessary to speed up the movement of traffic. The roads themselves were slow to provide these changes. They were not able easily to finance, or ready to risk, extensive new construction, nor were they quick to agree on methods of re-routing. These circumstances, together with the great advantages that appeared to inhere in operating all the roads

³ For an analysis of the data concerning governmental operations during the World War, see the same.

⁴ U.S. War Industries Board, *American Industry in the War*, by Bernard M. Baruch (1921), p. 82.

of the country as a single unified system, led finally to complete governmental operation of all phases of railway transportation.

Governmental operation of transportation was extended also to ocean shipping. The war requirements taxed these facilities even more than it had those of railway transportation. The major problem was to secure the ships, and this we shall discuss in the next section of this chapter. Procured through hire, purchase, or commandeering, they were in many cases actually operated by government in the transport of men, munitions, and supplies.

In a few scattered instances the government carried on production in fields other than transportation. At certain stages the army exercised control over all phases of the production of its wool clothing from the assembly of the raw materials to the inspection of the finished product, and even requisitioned and rationed the total supply of raw wool.⁸ The government also undertook its own production of toxic gases, for a time (because of labor difficulties) employed its own labor to cut fir and spruce for airplane manufacture, and produced some of its own munitions and ships. Just before the Armistice, plans were completed for an expenditure by the government of some 200 million dollars on power station construction, primarily to assure the industries of the Atlantic seaboard a supply of power.⁹

Several factors played a prominent role in bringing about these various instances of direct governmental production. New equipment, expensive in character, and of doubtful value for post-war purposes, was required in many instances. Often, moreover, the total burden of finance was extremely heavy. Private enterprisers were consequently slow to provide capital. In other instances, particularly in the production of toxic gases, the physical dangers of employment made difficult the recruiting of a labor supply without the aid of governmental constraints.

B. Government in Relation to Privately Organized Production

Much more extensive as regards the range of individuals affected were the war-time controls over that area of industry which re-

⁸ Ayres, *The War with Germany*, pp. 51-52.

⁹ Charles W. Baker, *Government Control and Operation of Industry in Great Britain and the United States during the World War* (1921), p. 64.

mained in some degree privately organized. While these controls were motivated by the same desire to assure the prompt fulfillment of war demands as was present in the case of direct government production, there was, in contrast, an effort to avoid disturbing the existing system of private enterprise. With few exceptions the regulations employed were confined to the allocation to their various uses of raw materials, productive factors, and finished goods. Rules concerning allocation were never made applicable in blanket form to all of any kind of productive resources. Instead, these regulations were in terms of specific orders, and they left free of control any remaining uncovered capacity. The initiation of enterprise and the organization of the actual processes of conversion remained almost entirely in private hands. The controls undertaken were in some instances based on consultations with the affected parties, and often took the form of voluntary agreements. This was notably true of the work of the War Industries Board.

Many of the regulations had no explicit legal foundation. They were supported, however, in the patriotic fervor which swept the country, and in the feeling which became widespread that the prompt and proper organization of industry to fulfill war needs required a greatly extended program of governmental regulation. The government sought to bolster its legal powers by efforts to secure the co-operation of producers, laborers, and consumers for its plans. Industrial leaders were placed in important administrative posts, and organized trade groups were asked to facilitate price-fixing, the allocation of resources, speed-up of production, reduction of labor turnover, and other goals of war-time control. Unorganized industries were encouraged to undertake organization so that the problem of effectuating controls might be simplified. Consumers were appealed to as patriotic citizens in an extensive program of "education."

Recalcitrants there were of course and these were forced in line through the exercise of certain sanctions. The value of having it known that an individual had complied with the government's war program, a rather high one in the patriotic spirit of the times, was capitalized for this purpose; and acquiescence was achieved at times through threats to requisition or commandeering, or to impose adverse priority allocations. The measure of success achieved is

evidenced in part by the lack, during the war, of any legal tests of the government's exercise of war powers.

A detailed analysis of the many regulations imposed will not be undertaken. They were of three general types: those designed to assure the prompt fulfillment of our war needs at a minimum cost; those designed to make certain that our economy did not minister to the needs of enemy nations; and those designed to assure private individuals of a "reasonable" supply of their basic needs at "fair" prices.⁷

Fulfilling war needs at minimum cost. Perhaps most significant among the means employed to secure the fulfillment of war needs were the efforts to assure the war industries a supply of materials and facilities essential to production. The primary method of accomplishing this end was a system of licenses and priorities. The industries and plants producing commodities considered essential to war purposes were classified according to their relative importance, and lists indicating these classifications were widely circulated. Producers and distributors of certain designated raw materials, finished and semi-finished products, electrical energy, fuel, and transportation were requested to follow the priorities assigned in these lists, in filling orders. In the case of railway transportation

⁷ For details of the World War experience see: U.S. War Trade Board, *Government Control over Prices*, by Paul W. Garrett (1920); War Industries Board, *American Industry in the War*; 65 Cong. 3 sess., H. doc. 1485, *Report of Capital Issues Committee* (1918); 65 Cong. 3 sess., H. doc. 1836, *Report of the Capital Issues Committee* (1919); 65 Cong. 2 sess., H. rep. 448, *War Finance Corporation: Conference Report* (1918); Annual Reports of the War Finance Corporation; 73 Cong. 2 sess., H. doc. 227, *Annual Report of the Secretary of the Treasury on the War Finance Corporation* (1934).

Several secondary sources are also of importance: Baker, *Government Control and Operation of Industry in Great Britain and the United States during the World War*; Simon Litman, *Prices and Price Control in Great Britain and the United States during the War* (1920); "National and World Planning," *The Annals of the American Academy of Political and Social Science*, July 1932; F. W. Taussig, "Price Fixing as Seen by a Price-Fixer," *Quarterly Journal of Economics*, Vol. 33 (1919), pp. 205-41; Roy G. Blakey, "Sugar Prices and Distribution under Food Control," *Quarterly Journal of Economics*, Vol. 32 (1918), pp. 567-96; Lewis H. Haney, "Price Fixing in a Competitive Industry," *American Economic Review*, Vol. 9 (1919), pp. 47-56; Lewis K. Morse, "The Price Fixing of Copper," *Quarterly Journal of Economics*, Vol. 33 (1918), pp. 71-106; Wilfred Eldred, "Wheat and Flour under Food Administration Control: 1917-18," *Quarterly Journal of Economics*, Vol. 33 (1918), pp. 1-70; W. F. Gephart, "Perishable Produce under Food Regulation," *Quarterly Journal of Economics*, Vol. 33 (1918), pp. 621-34.

these priorities were put into effect directly by government; in many other cases they were embodied in voluntary agreements. A special procedure involving the grant of licenses was employed in allocating the use of fuels, and of ocean shipping. In none of these instances was there any attempt to govern all uses of the resources involved. The requirement was merely that preference be given the industries and plants designated in the priorities lists according to the order of their priority. Any remaining unutilized facilities might be employed in such manner as their owners saw fit. Moreover, priority allocations were ordinarily employed only where there existed a shortage of supplies for the essential war industries.

Special measures were taken in the case of labor and of capital. The labor situation was characterized by the prevalence of strikes, and by a high turnover induced by the wide and growing variety of attractive opportunities. To minimize the losses from strikes a National War Labor Board was established to mediate disputes, and an appeal was made to the patriotism of the workers. The problem of reducing labor turnover was a more difficult one. It was met by standardizing working conditions, as a means of reducing the incentive to movement, and by urging employers to cease advertising for labor, and to utilize instead the facilities of the United States Employment Service. By this latter means war industries were further assured an adequate supply of labor, as the Employment Service in making its allocations was guided by the priorities lists discussed above.⁸ The power to standardize wages, hours, and working conditions was placed in the hands of a War Labor Policies Board. However, before it had proceeded far the war had come to an end.⁹ Plans were also developed for increasing the effective supply of labor by training individuals for new types of work, by diluting skilled with unskilled labor, and by utilizing prison labor. But they were not carried far. In none of these cases, except of course the use of prison labor, was there any enforced conscription. Reliance was on the co-operation of laborers, organized labor groups, and their employers.

⁸ War Industries Board, *American Industry in the War*, pp. 88-90.

⁹ The same, pp. 86-88.

The policy of discouraging labor turnover is in contrast with the peace-time objective of stimulating a prompt adjustment of productive factors to new uses, and might appear in some degree to negate a similar objective in time of war. In peace time the short-run losses of energy involved in the adjustment of labor to new uses would generally be regarded as more than offset by the longer run gains from better allocation. In war time, however, short-run considerations are elevated to a much more significant position. The dangers of improper use of labor were expected to be met in some degree through the system of priorities, the allocation activities of the Employment Service, and the incentive created by the selective service draft to seek employment in war industries.

Efforts were also made to assure war industries of adequate finances. A Capital Issues Committee was established to pass upon issues of securities for capital purposes in excess of \$100,000. During the course of the war it passed upon some 2,289 applications involving new securities with a par value of over two and a half billion dollars. Only those enterprises serving definite military or economic needs were given the approval of the Committee. The Committee had no authority to prevent the flotation of those issues it disapproved. It relied upon the co-operation of the banking and investment institutions, the organized banking groups, and the borrowers themselves, in securing obedience to its rulings.

A War Finance Corporation was organized to meet the problem more directly. Set up with a capital stock of 500 million dollars to be subscribed by the federal government,¹⁰ it was authorized to make advances either to banks or directly to industry for the financing of enterprise essential to the prosecution of the war.¹¹ It was contemplated that only in exceptional cases would loans be made directly to industry. Soon after its establishment, the directors of the Corporation announced that direct loans would be made only where not available through the usual banking channels, and only on adequate security.

¹⁰ Only 140 millions were actually called for by the board of directors of the Corporation.

¹¹ The War Finance Corporation conceived its functions to include also the support of the market for government securities. See *First Annual Report of the War Finance Corporation* (1918), p. 3.

An analysis of the operations of the War Finance Corporation indicates, however, that its activities were not in fact directed primarily to assisting the financing of war industries. Up to the close of the war, it advanced only 71 million dollars to assist the financing of industry, while during this same period it purchased more than 377 millions worth of government bonds. Of the advances designed to assist industry, 40 millions were made directly to public utilities, and nearly 4 millions to cattle raisers to enable them to hold their cattle off the market. The limited character of the efforts of the War Finance Corporation to assist war industries is further revealed in its own explanation of the paucity of its industrial loans. The directors declared that in some cases funds could be secured through the regular banking channels, and that in many other cases the Corporation did not wish to assume the risks arising from the uncertainty of the duration of the war, and from the possibility of the cancellation of war contracts.¹² It was precisely these risks which the War Finance Corporation was designed to assume.

Separate means were adopted to provide finances for shipbuilding. The need for added shipping facilities was extremely great, and private enterprise, because of the heavy initial outlays and the uncertainties of post-war worth, did not respond with sufficient rapidity. Accordingly, to stimulate ship construction, the Shipping Board incorporated the Emergency Fleet Corporation with powers to make available to private businesses, in advance of construction, funds for the building and equipment of plants, for the cost of yards, for the training and even housing of men, and for the actual construction of ships.

Another control adopted to assure war industries of an adequate supply of resources was conservation and curtailment of non-war uses. A program of conservation was carried on, largely through informative and propagandistic activities of government assisted by organized lay and trade groups. Consumers were urged to observe lightless nights, and gasless, heatless, and meatless days; and housewives, restaurants, and hotels were asked to conserve the use of foods. Efforts were made to stimulate simpler habits of food consumption, based more largely on elemental food values,

¹² The same, p. 5.

and in general to encourage the minimization of adornment and splendor.

Conservation was applied also at various stages of production and distribution. In some few cases of acute shortage, sales per person were restricted or deliveries for purposes regarded as "un-essential" were prohibited. Limitations were placed on the trips of salesmen, the return of goods, the frequency of deliveries, the number and types of intermediaries in distribution, the variety of styles, the frequency of style changes, and the range of choice in sizes, materials, and colors. Imports were regulated as to source and form to conserve shipping space. Partly under government stimulation and direction, production, packaging, and distributing methods were developed which involved the use of less scarce materials or less time or labor. Substitutes achieving these various purposes were developed in many cases.

Outright curtailment of production was rarely imposed. There was a desire to avoid crippling an industry and those in the community who were dependent upon it, partly because of the immediate dislocation, but also with a view toward simplifying the problems of post-war readjustment. Complete suppression of some industries was considered but was foregone for these same reasons. The major device employed in curtailment was the withholding of basic supplies through the system of priorities. In the case of lumber and of cement an effort was made to discourage production by a refusal to raise prices to meet rising costs.

A second important means of speeding up the supply of essential war commodities, beyond assuring the war industries of an adequate supply of resources, was the specification to industry of methods of production and distribution designed to accomplish this end. With a view to hastening along the necessary supplies, and at times to improving the quality of war materials, efforts were made by government to develop and have adopted new techniques of production, more economical or more readily available substitutes, and new channels of distribution.

A third group of measures was designed to counteract certain forces which, it was believed, were repressing the willingness of individuals to undertake production, and were resulting in the

withholding of certain available supplies from use, and in an unnecessary raising of prices both to government and to civilian purchasers. The notion was prevalent that uncertainties concerning the relative movements of costs and prices were having a retarding effect on production, and that the speculation which accompanied and which was perhaps in part the cause of these price movements was further restricting the immediate availability of supplies. There was also the feeling that the rise in prices, and limitation of supplies, which were taking place were bringing about inordinately high profits in many lines of industry, out of all proportion to those necessary to stimulate the needed increases in supply.

Speculation in ordinary times is generally regarded as having a desirable long-run stabilizing effect on prices and production. However, the temporary withholding of supply which may result from speculation is often less defensible in war than in peace, because of the importance of an immediately available supply.

To curb speculation and to diminish both uncertainty and "profiteering," there was undertaken a program of price and cost stabilization. Many important war commodities and resources were in one form or another regulated in price. In some instances, prices or profit margins were directly fixed by government. In other cases, long-term contracts were limited, and restrictions were placed upon resales and the amount and time length of holdings. The systems of priorities and centralized allocation of orders which we have discussed earlier were also thought of as having a stabilizing effect on prices. The fact that priorities could not be purchased had a tendency to limit bidding, and the co-ordination, timing, volume, and allocation of orders were designed to minimize the disturbances which government purchases would occasion in the market. In addition, efforts were made to overcome the retarding effects of cost and price uncertainties by placing government orders on an assured return basis, generally a "cost-plus" basis. Affected by these programs of stabilization were not only a wide variety of raw materials, but also in some degree labor, fuel, and a great range of finished products. By these various means, it was thought, purchases would be confined to "real" needs, prices would be kept

down, costs would be stabilized, and producers who had been deterred from operation would go forward vigorously with their plans.

The most extreme devices utilized to acquire war materials were the direct requisition of supplies and the commandeering of productive facilities. Employed only infrequently, their use was confined largely to the procurement of finished goods rather than the raw materials for war industry. Where supplies were not forthcoming, however, or were not made available at what were regarded as reasonable prices, there was occasional resort to these measures. Their most extensive use was by the Shipping Control Committee to acquire private ships for war purposes. Prominent also were the requisitioning activities of the War Department, which during the course of the war secured in this manner some 141 million dollars worth of supplies, and of the Navy Department, which made even more extensive use of these devices. Perhaps the most important use of the power of requisition and commandeering was as a threat to compel assent to other measures of war-time control.

The measures discussed up to this point relate only to domestically produced supplies. But there were a number of significant commodities which could be procured effectively only from foreign sources. Utilizing as a weapon its control over imports and exports, the War Trade Board engaged in bargaining operations with various nations to secure for us the supplies of which we were in need. In general, the policy followed was to confine exports to those which were necessary to assist or encourage the provision of our war needs. One example is the regulation of wheat and wheat flour exports which (apart from shipments to the allies) were prohibited after November 1917, except for the subsistence of certain employees manufacturing war supplies for our use.²⁸ Caustic soda, which is essential to the manufacture of glycerin, an ingredient of explosives, was permitted to be exported only on the guarantee of an equivalent import of glycerin. Supplies of which Switzerland

²⁸ For a general discussion of these controls, see *Report of the War Trade Board* (1920), pp. 62-109. These controls were later relaxed to permit shipment to those countries which had previously depended upon us for these materials.

was in great need were released only upon the release to us of certain milk products of which we were short. Shipping facilities were procured from several countries by similar tactics.

The War Trade Board operated in one other way to increase our supply of scarce commodities. Our allies were reluctant to release to us certain commodities of which we were in need, because they feared they might be wasted in non-war uses or perhaps fall into the hands of the enemy. By demonstrating that the distribution of those commodities would be so regulated as to forestall such an eventuality their release for import was secured.

Withholding supplies from the enemy. The war involved our government in an effort to strengthen our military position not only by assuring the provision of our own essential war needs, but also by weakening the enemies' position through obstructing the procurement of their necessary supplies. Individual traders, it was thought, could not safely be relied upon to conduct their operations with these ends in view. The War Trade Board accordingly controlled exports and imports for this purpose as well as for the purposes discussed above.

All imports and exports were subjected to license, and controls were exercised over the sale and transfer of vessels and bunker supplies. The practice was to designate specific commodities for regulation as war exigencies appeared from time to time. However, by February 1918 all export and import commodities had been placed on the restricted or conservation lists.¹⁴ In the case of each of these items there was a rigid visé of consignor and consignee, and some judgment was made whether directly or indirectly they might come into the hands of the enemy. In addition, there was established in the Treasury Department the Office of Alien Property Custodian with the power to seize enemy holdings and administer them, and the Treasury undertook to control credit and specie movements to restrict the enemy finances.

Assuring civilian supplies at "fair" prices. Even before our entry into the war, allied purchases had brought about a rise in the prices of many important consumer goods, and the purchase of military

¹⁴ *Report of the War Trade Board (1920)*, p. 8; and Garrett, *Government Control over Prices*, p. 351.

supplies by our government following our entry added to this advance. This led to a third important type of war-time control over private industry—the assuring to civilians of “fair” prices for certain of their basic purchases.¹⁵

The basic act in this program of control over the prices of consumer goods was the so-called Lever Food and Fuel Control Act of August 10, 1917. Under the powers conferred upon him by this act, the President established the Food and Fuel Administrations, and through these agencies virtually every staple food commodity and nearly all fuels were subjected to some form of price regulation.

Only in the cases of wheat, coal, and coke did the Lever Act provide explicitly for direct price-fixing by government. The price of wheat was in fact fixed temporarily by the act itself.¹⁶ However, under the general powers which the act provided to license the manufacture and distribution of foods and fuels, to requisition “necessaries,” and to commandeer factories or plants manufacturing necessities, the Food and Fuel Administrations were able to negotiate voluntary agreements fixing both the wholesale and retail margins for an almost all-inclusive range of important food and fuel products.¹⁷ In addition, the price agreements negotiated by the Price-Fixing Committee of the War Industries Board, covering mainly raw materials and semi-finished goods employed in manufacture, were made applicable to purchases destined for eventual civilian consumption, as well as to those to be processed into goods for governmental purposes. Further, the War Trade Board, in licensing the import of many commodities, imposed upon their sale a requirement of observance of the price controls enacted by the Food and Fuel Administrations and the War Industries Board.

A more informal type of control was employed in dealing with the important item of housing rentals. The winter of 1917-18 brought many complaints of inadequate housing and high rentals.¹⁸

¹⁵ In some degree the fixation of the prices of goods for civilian consumption was motivated by a desire to maintain the flow of the price-fixed government supplies.

¹⁶ Garrett, *Government Control over Prices*, pp. 40-57, and 160 ff.

¹⁷ For further analysis, see Chaps. XXIII and XXIV.

¹⁸ See, for example, 65 Cong. 1 sess., *To Provide Housing for War Needs*, Hear-

The war had occasioned a great redistribution of population incident to the mobilization and training of troops, and the expansion of war industries. As a result, many communities were faced with housing shortages, and there occurred a rise in rentals.

To meet this situation, efforts were made through the Bureau of Industrial Housing and Transportation of the Department of Labor to stimulate private housing construction, to improve commuting facilities, and to bring about a maximum utilization of existing housing facilities. In addition, the United States Housing Corporation during the course of the war expended some 28 millions to finance housing construction.

An effort was also made directly to control rents. Only in the case of the District of Columbia were any specific legislative controls provided. However, under the auspices of the Bureau of Industrial Housing and Transportation, community committees, representing real estate operators, labor, the legal profession, and the public were established in 76 communities, to negotiate the settlement of rental disputes, and similar work was carried on in 50 other communities by other local organizations.¹⁹ These committees had no explicit powers to fix rental charges. They relied on patriotic appeals, and threats of increased taxes and adverse priority allocations for fuel. There was a wide diversity in the standards of fairness which they employed.

In addition to these direct and indirect controls over prices, certain other war-time regulations were designed in part for the protection of civilian consumers. The War Industries Board, in clearing orders for supplies, gave consideration to the effect these orders would have on the prices and supplies of civilian goods. In the cases of more extreme shortage, as we have noted earlier, supplies were rationed in an effort to get away entirely from the market as an arbiter in the distribution of goods and services. Further, the

ings before (House) Committee on Labor on H. R. 9642 (1918); U. S. Dept. of Labor, Bureau of Industrial Housing and Transportation, *Report of the United States Housing Corporation*, 2 vols. (1919-20); Edward L. Schaub, "The Regulation of Rentals During the War Period," *Journal of Political Economy*, Vol. 28 (1920), p. 4.

¹⁹ "Adjustment of Rent Profiteering Cases by the Department of Labor," *Monthly Labor Review*, Vol. 8 (1919), pp. 283-85; *Report of the United States Housing Corporation*, pp. 16-17, 35-36.

efforts to speed up production and stimulate conservation, discussed above, were directed in part to the satisfaction of civilian needs.

II. RECENT AND PROPOSED CONTROLS

The close of the war brought about a rapid abandonment of virtually all the new relationships of government to industry to which it had given rise. There remained, however, a heritage of experience, and of new sentiments and conceptions, which since that time have given rise to many new proposals and a number of actual innovations in the war-time regulation of industry.

Three phases of World War experience, as revealed in retrospect in the calmer days of peace, were particularly important in bringing about changes in the war-time relationships of government to economic life. The conversion to war uses was found to have been appallingly slow in many instances; and in the case of certain important commodities such, for example, as planes and artillery, it was realized that scarcely any production had been brought to completion before the Armistice. In many respects more important was the consciousness which grew of war-time "profiteering" and of the immense costs, extensive inflation, and heavy debts of the war, and the antagonism to which this realization gave rise. These feelings were co-mingled with a strong sense of futility which provoked insistent demands to avoid our future embroilment in another such conflict by controls over war-time trade. In the period since the Armistice, the efforts to correct these shortcomings have constituted the major streams of development in the war-time relationships of government to industry.

A. More Efficient Mobilization of Industry

First to be attacked was the problem of more efficient mobilization of industry for future wars. In 1920 the National Defense Act was amended so as to provide for the immediate mobilization of man power and industrial resources in time of war.⁴¹ Under these powers first the War Department, and later the Army and Navy Munitions Board, have undertaken to formulate general plans for industrial mobilization. Industrial plants have been surveyed to

⁴¹ 41 Stat. L. 759 (1920).

determine their convertibility to war uses, and on the basis of these surveys individual plants have been assigned to the production of specific war commodities. Industry has been apprised of these plans and their tentative assent and suggestions solicited. Detailed outlines of proposed war-time policies, procedures, and organization have been formulated, model contracts drawn up, and the Army Industrial College established to train a nucleus of administrative personnel. Legislation providing for the effectuation of these plans has been prepared for immediate congressional action at the outbreak or threat of war.²¹

Under the most recent plan, it is contemplated that on the outbreak of war there shall be established an entirely new agency, the War Resources Administration, composed of civilian personnel and charged with administering the organization of industry for war purposes. Should such an administration not be immediately established, it is planned that these same functions shall temporarily be exercised by the Army and Navy Munitions Board, which is composed of the Assistant Secretaries of War and Navy. The threat of a European war led to the appointment, on August 9, 1939, of a civilian advisory body known as the War Resources Board. There was some expectation that in the event of our involvement in war, this board would be constituted the War Resources Administration.²² However, after preparing a report to the President on the Industrial Mobilization Plan, the Board was dissolved within a few months of its creation.

The efforts to assure efficient mobilization of industry in time of war have not, however, been confined to mere plans. To familiarize industry with the manufacture of war materials, to yield information on the problems of production and the costs involved, and to support a skeleton organization of productive facilities and build up a reserve of supplies to meet emergency situations, there was inaugurated in 1938 a system of "educational orders," Congress appropriating for this purpose 2 million dollars a year. In 1939 this program was considerably expanded by a congressional appropria-

²¹ These plans have been revised from time to time. In their latest published form they may be found in 76 Cong. 2 sess., *Industrial Mobilization Plan Revision of 1939*, S. doc. 134 (1939).

²² See War and Navy Joint Press Releases of Aug. 9 and Aug. 17, 1939.

tion of nearly 35 million dollars to cover the succeeding two-year period.²³

To assist in the development of improved designs and processes of production in the manufacture of these materials of war, army engineers have been working with the various plants engaged in their production. Plans have also been formulated and are being put into operation to train certain types of skilled labor, such as aviation mechanics, of which there exists a shortage in terms of war needs, and efforts are being made to build up a navy auxiliary through an amplified merchant marine supported in part through government subsidy. Thought has also been given the subsidy of added power lines and power stations to link up sources of supply with the industrial and commercial centers, and to provide an emergency "back-log."

Designed also in part as measures preparatory for war have been the recent Tin Control and Helium Control Acts.²⁴ Our sources of tin supply are deficient in terms of our needs for war, and tin is an important war commodity. To conserve our limited supplies, an act of February 15, 1936 prohibited the export of tin plate scrap except upon the grant of a license. Helium, in contrast with tin, is a commodity of which we enjoy a virtual world monopoly. However, because of its usefulness to potential enemies, and to conserve our own supplies, the export of this commodity has also been prohibited except on license.

One characteristic of these plans for mobilization has been predominant throughout. There has been the desire to work, so far as is consistent with military effectiveness, within the framework of a system of private enterprise, and with the least disturbance to its existing form. All the types of control practiced during the World War—licensing, priorities, price control, and the like—are con-

²³ Even more significant has been the recent expansion in the total expenditures for national defense, a development which may be explained largely by the continuous threat and final eventuality of a European war. From a low point of a little over half a billion dollars in 1934, these expenditures rose to more than a billion (including emergency expenditures) in 1939. The estimates for 1940 and 1941 (also including emergency expenditures) show an even greater rate of increase, the figures for these two years being respectively a little over 1.5 billion, and a little over 1.8 billion. See *The Budget of the United States Government for the Fiscal Year Ending June 30, 1941*, pp. xxi, xxii, 1021, 1024.

²⁴ 49 Stat. L. 1140 (1936), 50 Stat. L. 885 (1937).

templated, and in even more extensive degree. But they are designed, as in the last war, wherever feasible to make use of private initiative. Government action is proposed mainly to assure war industries the necessary resources and facilities, and to maintain and stimulate the incentive of private producers to engage in the production of war materials. The aim is to preserve profit opportunities and win industry co-operation. The power to requisition and commandeer is to be used only sparingly, and then largely as a threat. No plans are made for extensive direct operation of industry by government, nor for elaborate government personnel.

One further general characteristic of these plans is of interest. It is contemplated that the new powers of government in time of war shall be administered largely by specially created agencies, rather than through the expansion of existing ones. By following this procedure, it is thought there will be greater freedom to secure, and a greater likelihood of attracting, the best personnel. And it is expected that the problem of post-war readjustment of governmental functions will thereby be simplified, because of the greater ease of discontinuing the work of the less entrenched agencies.

B. Taking the Profits Out of War, Reducing Its Costs, and Equalizing Its Burdens

In contrast with these plans for the more effective mobilization of industry are the proposed war-time controls which have been designed to take the profits out of war, to equalize its burdens, and to reduce its "costs." During the last war, the use of inflationary measures in governmental finance was in part responsible for a high level of industrial profits, and left us with a huge governmental debt. To avoid these consequences, it has been proposed that future wars be financed more largely through taxation, primarily on corporate and individual incomes, and that more extensive controls be undertaken over prices. It is realized that these regulations might diminish the effectiveness of private enterprise in filling war demands, and to meet this possibility it is proposed that there be provision for conscription of individuals in management positions, and, if necessary, for the commandeering and direct operation of many war industries. By these means, it is thought, a war can be financed

without profiteering or inflation and heavy debt, and with diminished costs and a more extensive dispersion of its burdens.

The early efforts to secure the elimination of war profits came from the American Legion. Beginning in 1922, through the activities of the Legion, legislative proposals to achieve this objective have been introduced into every session of Congress. Their suggestions have comprised a universal draft applicable to all forms of man power and resources. To investigate the merits of these proposals, a War Policies Commission was appointed in 1930. After lengthy hearings covering a period of two years, it recommended that the President be given extensive price-fixing powers in time of war, and that practically all war incomes above "normal" be confiscated. Legislation embodying these proposals was successful, however, in only one house of Congress.

Public interest in the problem remained at a low ebb until 1935, when a special Senate Munitions Investigation Committee began to hold hearings. Dramatically, this investigation revealed many instances of war-time profiteering, and public antagonism grew. More important, however, with the Munitions Investigation, the efforts to limit the profits of war and to equalize its burdens developed into a movement to plan for the more effective war mobilization of industry, but without a weakening of the original objective. The Munitions Committee reviewed the War Department plans for mobilization and reported them insufficient for the purposes of avoiding profiteering, inflation, and high costs. Provisions for administrative personnel, it held, were inadequate; and the plans for regulating prices, it declared, were foredoomed to failure because the strategic bargaining position given industry—as reflected in the reliance on voluntary co-operation in the face of extraordinary need, and the absence of provisions for direct government operation except as a threat or in great emergency—would make effective enforcement impossible without their consent. Accordingly, the Committee advanced its own proposals for heavy taxes, for the draft of business leaders into the civilian service, and for extensive powers to requisition and to commandeer and operate plants. A majority of the Committee recommended government ownership of a portion of the facilities for munitions production.

In its final report the Committee expressed some doubt whether it would ever be feasible to impose heavy taxes and rigidly control prices, or to take over and operate any extensive area of industry, no matter what powers were placed in the hands of government. Nevertheless, legislation embodying these proposals was introduced into Congress.²⁵

The contrast between these proposals for the war-time mobilization of industry, and those of the Army and Navy Munitions Board outlined in the preceding section of this chapter, rests in the relative importance attached to the preservation of individual enterprise. In each of the plans military effectiveness is a dominant objective. In the proposals of the Army and Navy Munitions Board, objectives other than military are regarded as not controlling if their achievement impairs the effectiveness of private enterprise in fulfilling military needs. In the proposals of the Munitions Committee, however, the limitation of profits, the avoidance of inflation and debt, the minimization of war costs, and the dispersion of its burdens are elevated to a plane correlative with that of the fulfillment of war needs, and wherever necessary to their achievement government action is proposed in displacement of private initiative. The conflict between these two somewhat opposed notions of propriety in the war-time relationships of government to industry continues to be reflected in the proposals for legislation now before Congress. Both sets of views remain strongly held and the direction of compromise is as yet not clear.

²⁵ A number of hearings and government reports have dealt with these developments. See, for example: 73-74 Cong., *Munitions Industry*, Hearings before the Special (Senate) Committee Investigating the Munitions Industry pursuant to S. res. 206, 39 pts. (1934-37); 71 Cong. 2 sess., *War Policies Commission*, Hearings before the Commission appointed under the authority of Pub. res. 98, 3 pts. (1931); 72 Cong. 1 sess., *Documents by War Policies Commission*, H. doc. 271 (1932); 74 Cong. 2 sess., *To Prevent Profiteering in War*, Hearings before a Sub-Committee of the (Senate) Committee on Finance on H. R. 5529 (1936); 75 Cong. 1 sess., *Taking the Profits Out of War*, Hearings before the (House) Committee on Military Affairs on H. R. 1954 (1937); 75 Cong. 1 sess., *To Prevent Profiteering in Time of War*, Hearings before (Senate) Military Affairs Committee on S. 25, 2 pts. (1937); 75 Cong. 1 sess., *Prevention of Profiteering in Time of War*, S. rep. 480 (1937); 74 Cong. 1 sess., *To Prevent Profiteering in War*, S. rep. 577 (1935); 74 Cong. 1 sess., *Prevent Profiteering in War*, S. rep. 889 (1935); 75 Cong. 3 sess., *War Profiteering*, S. rep. 1870 (1937).

C. Preventing Our Involvement in Another War

A third post-war movement which has brought about changes in the relationship of government to economic life is in contrast with these efforts to take the profits out of war and to plan for more effective mobilization. Preventive in nature, it has had the purpose of forestalling our future embroilment in another conflict. In some degree, the measures we have discussed above have had this objective. Advance knowledge of extensive conscription, and of the limits which price-fixing and heavy taxation would place on the personal gains which individuals might expect from war, has been thought of as diminishing the incentive to engage in such conflict. In addition, there have been a number of measures designed directly to prevent our involvement in war, primarily by circumscribing our trade and financial relationships with belligerents. This phase of public policy has often been spoken of as "neutrality policy."

Measures of this character are not new either in American or in world history. From the beginning we have considered our war-time trade as a neutral nation to be bound by the conventions of international law.²⁸

International law imposes upon a neutral government the obligation not to supply belligerents with arms, ammunition, or implements of war, nor to lend them money. It is also implicitly understood that a neutral government may not itself supply any commodities to a belligerent. The private citizens or corporations of a neutral country are not restricted by international law in their dealings with belligerents. The belligerents, however, have rights of search over the merchant ships of neutral nations, and may legally seize as "absolute contraband" military goods destined for the enemy, or as "conditional contraband" other goods destined for enemy military purposes. Further, by the "doctrine of continuous voyage," military goods shipped to a neutral country, but destined for a belligerent,

²⁸ The international law of neutrality had its beginnings as early as the twelfth century, in the Hanseatic and Mediterranean cities, and grew to importance in the sixteenth century, with the rise of the state system. It was regarded as an essential adjunct to the growth and development of international trade, and as a significant means of limiting the boundaries of war. Edwin M. Borchard and William Potter Lage, *Neutrality for the United States* (1937), pp. 3-5.

may be seized by belligerents as contraband. No obligation is placed on neutral governments to assist in enforcing these rights of belligerents. Neutral governments are, however, obliged to prevent private citizens, natural or alien, from preparing within their borders a military expedition against any belligerent.

During the World War some of these distinctions lost meaning. The allies began seizing almost all goods destined for the enemy, thus virtually abandoning the distinction between contraband and non-contraband, on the theory that war governments have controlling powers over a nation's economy and can therefore divert anything to a war purpose. Further, they applied the doctrine of continuous voyage so as to include all shipments which *could* reach Germany, placing the burden of proof that they would not on the shipper or consignee.²⁷ A similar situation, it appears, is developing in the current war. The allies have in fact announced the policy of seizing even exports from Germany.

We have not, however, always confined our neutrality controls over foreign trade to those imposed by international law.²⁸ Early in our history, the disregard of our neutral trading rights by both belligerents in the Napoleonic wars gave rise to a fear of our involvement. To avoid this and to bring pressure on Britain and France to cease certain of their policies, particularly the impressment by the British of seamen seized on our ships, there was passed the Embargo Act of 1807. This act, together with certain amendments passed in 1808, practically prohibited the shipment of any goods from the United States, by land or by sea, and the clearance of any American vessel for any foreign port. There followed smuggling and distress to our trading and manufacturing interests at home. Under the pressure of these forces, there was enacted the Nonintercourse Act of 1809 which raised the embargo, except as to Great Britain and France, and excluded from United States waters all vessels of those two countries.²⁹

²⁷ For a more detailed discussion of these rules, see the same, pp. 7-20.

²⁸ For a list of American neutrality regulations, see Francis Deák and Philip C. Jessup, *A Collection of Neutrality Laws, Regulations and Treaties of Various Countries*, Vol. 2 (1939), pp. 1079-1262.

²⁹ Louis M. Sears, *Jefferson and the Embargo* (1927), pp. 55, 73 ff; Edward Channing, *A History of the United States*, Vol. 4 (1927), pp. 346-401; and

During the succeeding century, up to our entry into the World War, the regulation of our trade with belligerents, in wars in which we did not participate, was governed primarily by the international law of neutrality. In general, we followed the policy, technically at least, of treating all belligerents alike,²⁰ and of insisting on our right to trade with both belligerents and neutrals, subject to the law of contraband.

In the period since the World War, a profound modification has taken place in our policy concerning war-time trade. Many of the neutral trading rights which we have traditionally insisted upon have been waived. Two somewhat dissimilar sets of forces have led to this change. The feeling was widespread, following the World War, that our involvement had resulted in an important degree from our trade with the allies, and a movement developed to curb such dealings with the belligerents in future wars. Many of those who favored such a policy proposed a mandatory embargo on the sale of arms and munitions to any belligerent.

In contrast is a second set of forces. In the post-war period, a strong movement developed to attempt the prevention of wars by the united exercise of sanctions against the aggressors. This movement resulted eventually in the establishment of the League of Nations. While the United States was not formally a member of the League of Nations, there were many here who came to favor the regulation of our trade with belligerents so as to impose sanctions on the nations regarded as aggressors, and some who sup-

Samuel E. Morison and Henry S. Commager, *The Growth of the American Republic*, Vol. 1 (1937), pp. 299-303.

The failure of these measures to keep us out of war is often cited in current discussions as revealing the dangers of attempting to maintain trade as a neutral nation in time of war. In contrast, this same experience is also advanced as evidence of the futility of limiting the movement of goods and ships as a means of preventing involvement in war. It does not appear, however, that our entry into war with Great Britain in 1812 can be ascribed in any important degree, either to our early efforts to defend our trading rights as a neutral, or to the restrictions which we later imposed on our trade with the belligerents. (Morison and Commager, *Growth of the American Republic*, pp. 304-111; and Borchard and Lage, *Neutrality for the U.S.*, pp. 30-31.) For further discussion of the embargo period, see Chap. XX of this volume.

²⁰ For an exposition of the view that our policy during the World War, prior to our entry, was designedly favorable to the allies, see Borchard and Lage, *Neutrality for the U.S.*, pp. 33-211.

ported such controls merely as a device for favoring one belligerent over another. To carry out these controls, there was generally recommended the grant of broad discretionary powers to the President to impose embargoes on our trade with one or another belligerent. In addition to these two groups favoring the modification of our war-time trade policy, there remained a large faction which supported adherence to our "traditional" policy of insisting on our neutral trading rights under international law.

The first post-war neutrality legislation was the Embargo Act of 1922.³¹ Under this act, the President was permitted to embargo the shipment of arms—but only to Latin-American countries, or to countries in which we exercise extraterritorial jurisdiction, and only in cases of purely domestic violence. In the late twenties and early thirties a movement developed to extend the controls over our trade, particularly in arms and munitions, to cover international wars, and to grant the President broad discretionary powers in the administration of these controls. The so-called Borah Resolution,³² embodying such a proposal, was introduced into Congress in 1933 at the time of the Manchurian crisis, but it failed of enactment. There was fear of granting discretionary powers to the President which might be employed to favor one belligerent over another. However, when in 1934 the President asked for powers specifically to embargo arms shipments to both belligerents in the Chaco War he was granted it.³³ The resolution granting this power made it conditional upon a finding by the President that the embargo "may contribute to the re-establishment of peace between those countries." This phase of the resolution was attacked as an unconstitutional delegation of legislative power, and as involving the grant of too broad a discretionary power to the President. The Supreme Court however, upheld this type of power in the field of foreign affairs.³⁴

The forces favoring more extensive controls over war-time trade

³¹ 42 Stat. L. 361. A similar law was passed in 1912, 37 Stat. L. 630. This was an amendment of a much broader statute of 1898, 30 Stat. L. 739.

³² 72 Cong. 1 sess., S. j. res. 229.

³³ 48 Stat. L. 811 (May 28, 1934). Revoked Nov. 14, 1935.

³⁴ *U.S. v. Curtiss-Wright Export Corporation*, 299 U.S. 304 (1936). See Borah and Lage, *Neutrality for the U.S.*, pp. 312-13, for a criticism of this decision.

with belligerents were not, however, at rest. The Munitions Investigation of 1934-36, discussed earlier, gave them added impetus. Many instances of war-time "profiteering" were disclosed in these hearings, and the feeling was revived that the anxiety for profits by munitions makers had led us into war. On the wave of sentiment generated by these disclosures, there was finally enacted the important Neutrality Act of 1935⁴⁹ which brought about a fundamental shift of policy.

Under this act, the President was required, whenever a war broke out between two foreign states, to proclaim the fact. Thereafter, the export to the belligerent countries of "arms, ammunition, or implements of war,"⁵⁰ either directly or through transshipment, was made unlawful.⁵¹ This action by the President was made mandatory,⁵² and the provision was to expire on February 29, 1936. To administer the act, there was established a National Munitions Control Board,⁵³ and a system of registration and licenses. All manufacturers, importers, and exporters of the articles subject to the provisions of the act were required to register with the Secretary of State, and exports and imports of these commodities were prohibited at all times, except upon license. The transport of arms, ammunition, or implements of war in American vessels to countries declared by the President to be at war, or for transshipment to those countries, was prohibited. And it was made unlawful to use American ports as a base for supplying men or cargo to a belligerent warship at sea,⁵⁴ and for submarines of a foreign nation to enter American ports or territorial waters, if the President so proclaimed. Further, the President was empowered to prohibit the passage of

⁴⁹ 49 Stat. L. 1081.

⁵⁰ Defined later so as to include little besides lethal weapons.

⁵¹ During the World War, prior to our entry, there had been considerable agitation for a similar rule. None was ever enacted, however.

⁵² In fact, as it developed, the President was left with an important discretionary power. If he saw fit, he could refuse to recognize the existence of a state of war, and the provisions of the law would have no application. This has occurred on several occasions.

⁵³ This board consisted of the Secretaries of State, Treasury, War, Navy, and Commerce, with the Secretary of State designated as chairman and executive officer.

⁵⁴ A similar rule was enacted during the World War, in March 1915.

American citizens on the vessels of belligerent nations, except at their own risk.⁴¹

The President criticized the inflexibility of the provisions of this act, and the lack of discretionary powers accorded the President was attacked also by those who favored a policy of "taking sides" with one or another belligerent, either as a device for preserving peace or merely to favor one nation over another. Many of those who supported such a policy did so because they believed the imposition, or even the non-imposition, of an embargo, even if applied alike to all belligerents, would almost inevitably favor some belligerents and harm others; and they wished to make a choice of the ones to be favored. Those opposed held that if there was to be an embargo, a mandatory one requiring similar treatment of all belligerents would leave us less open to a charge of discrimination, and hence would be less likely to involve us in war. There was also a move to bring additional commodities, which might be put to war purposes, within the scope of embargo. Some favored such a measure because they believed the fewer our dealings with belligerents the less the probability that we would become involved in war; others supported it because they hoped this expansion of the prohibited categories would be accompanied by a discretionary provision which could be employed to favor one belligerent over another.

However, when the act came up for amendment the following year none of these suggestions was adopted. The Neutrality Act of 1936⁴² reaffirmed with minor changes the mandatory embargo provision of the earlier act, and extended it to May 1, 1937. In addition, there were two new sections. One prohibited the purchase or sale of the newly issued securities of a belligerent government, or any new loans or credits to such a government, while a presidential proclamation declaring the existence of a state of war

⁴¹ For an analysis of the administration of this law, and of certain amplifications during the Italian-Ethiopian War said to be within its "spirit," see Borchard and Lage, *Neutrality for the U.S.*, pp. 316-22.

During the World War, a proposal to warn American citizens against travelling on armed belligerent merchantmen was presented to Congress in the Gore-McLemore Resolutions. The resolutions were, however, defeated because of presidential opposition.

⁴² 49 Stat. L. 1152.

was in effect. The President was, however, empowered to exempt from this section ordinary commercial credits.⁴³ The other new section exempted from the provisions of the act American republics engaged in war against non-American states, providing they were not co-operating with a non-American state in such a war.

Both the Neutrality Act of 1935 and that of 1936 were applicable only to international conflicts. Up to this time, the only law providing for the regulation of trade with nations in civil conflict was that relating specifically to Latin-America and China, discussed earlier. The revelation of shipments of war materials to Spain, during the Spanish Civil War, brought about a similar special rule applicable to that country. On January 8, 1937 there was enacted a joint resolution of Congress prohibiting, during the period of civil strife, the export to Spain, or to any foreign country for transshipment to Spain, of arms, ammunition, or implements of war.⁴⁴

The approaching expiration on May 1, 1937 of the embargo provision of the Neutrality Act of 1936 led to congressional reconsideration of the problem of neutrality, and eventually to the enactment of the Neutrality Act of 1937.⁴⁵ Again, the opposing forces favoring mandatory and discretionary embargoes were at work, as well as the school which supported adherence to our traditional policy of insistence on our neutral trading rights. The embargo on shipments of arms, ammunition, and implements of war to nations in conflict was once more made mandatory, this time, however, without a limit on the period of its effectiveness. A new section was added applying a like embargo to nations in civil strife, but in the administration of this section the President was given important discretionary powers. He was to proclaim such an embargo only if he found the export of these commodities "would threaten or endanger the peace of the United States." No limit was placed on the period of effectiveness of this new section.

⁴³ New loans to governments in default on their public debt to the United States had been banned earlier, apart from the belligerent status of those governments, by the Johnson Act of 1934, 48 Stat. L. 574.

⁴⁴ 50 Stat. L. 3. See, for discussion, Raymond Leslie Buell, "U. S. Neutrality in the Spanish Conflict," *Foreign Policy Reports*, Vol. 13, No. 17 (1937).

⁴⁵ 50 Stat. L. 121. See 75 Cong. 1 sess., *Neutrality Act of 1937*, H. rep. 320, 363 (1937); and 75 Cong. 1 sess., *Amendments of the House to the Neutrality Act*, H. rep. 723 (1937).

Pressure was again brought, in the course of the consideration of this measure, to extend the embargo to include additional articles and materials beyond arms, ammunition, and implements of war.⁴⁶ In its final form, a compromise was reached providing for the restriction of trade in these added goods to a "cash-and-carry" basis. The President was granted broad discretionary powers in the administration of this policy. He was empowered, in time of war or civil strife, where he found it "necessary to promote the security or preserve the peace of the United States or to protect the lives of citizens of the United States," to prohibit the transport in American vessels of such additional articles and materials as he might enumerate. A similar provision empowered the President to prohibit the export of "any articles or materials whatever until all right, title and interest therein shall have been transferred to some foreign government . . . or national." Both these provisions were to expire May 1, 1939.⁴⁷

The grant to the President of discretionary power to require the cash-and-carry sale of many commodities was both applauded and criticized. It is clear that such a provision is likely to redound to the advantage of any belligerent in possession of cash and in control of the seas. While some approved this policy, as a means of curbing our relations with belligerents, or for the somewhat different reason that it made possible the exercise of sanctions against aggressor or other nations,⁴⁸ others expressed the fear that this opportunity o

⁴⁶ Another suggestion was to limit all exports to a "normal peace-time quota.

⁴⁷ In addition, the act of 1937 re-enacted, and made applicable also to nations in civil strife, the provisions of the earlier acts prohibiting the transport in American vessels of arms, ammunition, and implements of war to belligerent powers; the purchase or sale of newly issued securities or the making of new loans to belligerents (with the exemption of commercial credits, at presidential discretion); the travel of Americans on belligerent vessels, and the use of American ports as bases for belligerent warships. Armed merchant ships as well as submarines of belligerent powers were to be kept out of our ports, and the President was empowered to prohibit the arming of American merchant vessels engaged in trade with belligerent nations. The exceptions applicable to American republics were re-enacted, and the National Munitions Control Board re-constituted. For further analysis, see U. S. Dept. of State, *International Traffic in Arms* (1938); and Raymond Leslie Buell, "The Neutrality Act of 1937," *Foreign Policy Report*, Vol. 13, No. 14 (1937).

⁴⁸ A proposal specifically directing the President to lift embargoes against the victims of aggression was proposed, but rejected. See 75 Cong. 1 sess., H. J. res. 527 and H. J. res. 536 (1937).

favoring one belligerent over another might lead to our involvement in war. The discretionary phase of the policy was especially criticized on this ground. A similar skepticism was expressed concerning the wisdom of granting the President discretionary powers to embargo the shipment of military goods to nations in civil strife.

In the two years which followed the enactment of the Neutrality Act of 1937, a sharp change took place both in American public opinion on foreign affairs, and in the position of the Roosevelt administration on these matters. There resulted from these changes an important modification of our war-time trading policy.

The shift in public opinion, and in the Administration attitude, which took place was conditioned in large degree by events in Europe and in the Far East. The growth in influence and the aggressive acts of the great totalitarian powers provoked in America a feeling of the existence of common bonds with the democratic states of the world, and diminished the strength of the isolationist sentiment. The use of force as an instrument of national policy came to be widely condemned, and the feeling grew that we might properly participate in the exercise of sanctions against aggressor nations and even perhaps lend aid to the victims of aggression.*

The means most commonly suggested for taking a more positive stand in opposition to aggression was the repeal of the arms embargo, perhaps accompanied by the substitution of a cash-and-carry requirement, and the grant to the President of broad discretionary powers in regulating trade with belligerents. It was known that Great Britain had greater financial resources, and was a predominant sea power. It was further known that the Administration was favorable to the interests of Great Britain and France. The legalistic-traditional school also favored repeal of the arms embargo, but on the somewhat different ground that such a change of policy was in keeping with our neutral trading rights under international law. In other circles the prospective stimulation of production and employment was a motivating factor. Those who feared that these measures would involve us in war were appeased by a proposal to permit only cash-and-carry sales.

* See William T. Stone, "Will Neutrality Keep U.S. Out of War," *Foreign Policy Reports*, Vol. 15, No. 14 (1939).

During the spring and summer of 1939 a bill embodying such a general program of change was introduced and debated in Congress, and in modified form passed the House.⁵⁰ However, the forces of isolation were still strong, and a feeling prevailed that a war in Europe, though apparently imminent, might yet be averted irrespective of our efforts. Congress adjourned on August 5 without taking further action.

Within less than a month, however, war broke out in Europe and the President summoned a special session of Congress to deal with the question of neutrality. This session convened on September 21, and there began at once a series of stormy debates. The isolationist bloc was joined by a group which formerly had favored the defense of our neutral trading rights, but which grew to fear that the President would employ a grant of discretionary powers to establish a "balance of power policy" in Europe or the Far East which might involve us in war, and by a group which contended that any change in our neutrality laws after the outbreak of war would constitute an unneutral act. The proponents of repeal of the arms embargo argued that it was senseless to distinguish, in the regulation of trade, between instruments of war and materials which could readily be fashioned into such instruments, and they cited our experience with the early Embargo and Nonintercourse Acts as evidence of the unenforceability of a general embargo. Many of this group openly sponsored favoring the allies by making it possible for them to secure their matériel in the United States. They countered the argument that this might involve us in war with the contention that by supporting the democratic "peace-loving" nations against the "aggressors" we were minimizing the necessity of our having eventually to go to war. By restricting sales to a cash-and-carry basis, they argued, there was little chance we would become involved. This latter phase of the proposals became, along with the repeal of the arms embargo, the focal points of discussion. One group proposed a continued grant to the President of power to exempt "commercial credits" from the restrictions against the

⁵⁰ June 30, 1939, 76 Cong. 1 sess., H. j. res. 306. See 76 Cong. 1 sess., *Neutrality Act of 1939*, H. rep. 856 (1939). A partial arms embargo was retained and Congress as well as the President given power to declare "a state of war" bringing it into effect.

making of loans to belligerents or the purchase or sale of their securities. Others feared such an exemption might be employed to permit the indefinite renewal of short-term loans, so as to accomplish, in effect, long-term loans. This objection was met by a proposal to forbid renewals. Finally, after six weeks of strenuous argument, there was passed, on November 3, the Neutrality Act of 1939.⁵¹

By this act both Congress and the President were granted discretionary power over the issuance of a presidential proclamation declaring the existence of a state of war. The President was required to issue such a proclamation only where he or the Congress through a concurrent resolution found it "necessary to promote the security or preserve the peace of the United States or to protect the lives of citizens of the United States." The embargo on arms, ammunition, and implements of war which under the Neutrality Acts of 1935, 1936, and 1937 had been automatically imposed by the issuance of such a proclamation, was repealed. In its stead, there was substituted a cash-and-carry provision applicable broadly to all sales to belligerents, and important restrictions were placed on the movement of American vessels.

Upon the issuance of a proclamation by the President, declaring the existence of a state of war, it became unlawful for any American vessel to carry passengers or any articles or materials whatever to a belligerent state. Further, no articles or materials (except copyrighted articles or materials) could lawfully be exported from the United States to any belligerent nation, until all right, title, and interest of American citizens was transferred to some foreign purchaser, and no loss incurred by any citizen in the sale of goods to belligerents might be made the basis of any claim by the government of the United States.⁵² Prohibitions were again enacted against

⁵¹ 76 Cong. 2 sess., Pub. res. 54. See 76 Cong. 2 sess., *Neutrality Act of 1939*, S. rep. 1155 and H. rep. 1475 (1939).

⁵² A complex set of exemptions was provided, permitting transportation by American vessels over lakes, rivers, and inland waters bordering on the United States, and by aircraft over lands bordering on the United States; and allowing all American goods except arms, ammunition, and implements of war to be exported by these means and to these areas, independent of divestiture of American interests. Further exemptions were provided for the travel of American citizens, and for the sale and transportation, by air and in both American and neutral vessels, of any

the purchase or sale of the newly issued securities of the belligerent governments and the extension of new loans or credits to them, and the exemption for commercial credits which was included in the 1936 and 1937 acts was repealed. In addition to these powers over the sale and transport of products to belligerents, the President was empowered, when he found "that the protection of citizens of the United States so requires," to define "combat areas" within which American citizens or vessels might not travel.⁵³

The problem of preparation in advance of war. Not wholly revealed in the discussion which has preceded is the significance of the problem of organization for war as it now faces the democratic countries of the world. In the same manner that nations which organize their economies for purposes of war have an advantage in combat over those that do not, nations which accomplish such organization in advance of war have a superiority over the more dilatory. There is involved in advance preparation of this sort increased peace-time expenditures by government and perhaps added regulations over industry of the type employed in war. How far government controls and expenditures of this character may be extended, and over how long a period of time they may be carried on without fatal damage to the institutions of democracy and private enterprise, is a question of great consequence to those countries in which these institutions still enjoy respect.

articles except arms, ammunition, and implements of war, to certain sections of the Western Hemisphere, to certain ports in the South Atlantic, and to any ports in the Pacific or Indian Oceans. This provision was designed primarily to permit continued commerce with the possessions of Great Britain and France in these areas, and to allow the travel of American citizens.

⁵³ Further, the 1939 act re-enacted the earlier proscriptions on the travel of American citizens in belligerent vessels, on the use of American ports as a base for belligerent warships, and on the entry of armed belligerent merchant ships, or submarines, in American ports or territorial waters. Restrictions were placed on the arming of American merchant vessels in commerce with *any* foreign state. The National Munitions Control Board was re-constituted. And the exemptions provided in earlier acts for American republics were re-enacted.

PART VI
GOVERNMENTALLY ORGANIZED
PRODUCTION

CHAPTER XXIX

GOVERNMENT AS A PRODUCER OF FINAL GOODS AND SERVICES

The proper scope of the functions of government is, as was pointed out in Volume 1 of the present study, a subject of perennial controversy. In our country, certain important governmental activities relate to the operation of the private enterprise system of production and distribution, and to individuals as private economic agents. These activities and the questions of public policy related thereto have been discussed at length in earlier chapters. We shall now turn to other phases of government's relationship to economic life, those in which the government is itself a producer in the sense that it exercises primary discretion in the allocation and use of economic resources and directly distributes income to individuals.

I. THE MEANING AND BASIS OF PUBLIC PRODUCTION

It is hardly necessary to point out that the use of governmental agencies for the production of final goods and services neither alters the fundamental nature of the economic process nor obviates the necessity for the basic decisions involved. Whether this process is in the hands of private enterprise or government, an allocation must be made of the natural and human resources of the country; the conversion of these resources must be organized and administered; and the product must somehow be distributed. The difference lies in the mechanism of the process, not in its essential nature. This does not mean that the difference in the mechanism is unimportant. The issue as to whether a given service should be produced by government agencies or by private industry hinges upon the relative advantages of the two mechanisms from the standpoint of those who are doing the deciding. The whole character of an economic society and the scheme of social relations may be vastly different, according to the degree in which it relies upon private and public production, respectively; though in this connection the more fundamental differ-

ence may be in the conscious ends of public policy, rather than in the formal means.

Since economic production is a conception not commonly applied to the activities of government in our predominantly private enterprise economy, it may be repeated, as was pointed out in Volume 1, that a comprehensive meaning of production must include all the processes by which services are made available to the community by the utilization of resources. The "real income" of society is the aggregate of all such services. In these terms resources devoted to military activity are productive in exactly the same sense as resources devoted to food supply. The productive uses to which resources are put may be regarded as unsatisfactory by individuals on ethical or other grounds, but this is as true of private as of public production.¹

A considerable part of the topic of government production has been treated by implication in the earlier chapters of the present study where the activities of government in implementing and regulating the operation of private enterprise have been described. When government enforces business contracts or operates a regulatory commission, it directly employs personnel and otherwise organizes and makes use of economic resources, and in so doing may properly be regarded as engaged in productive activity. The present chapter will not go over this ground again. It will not treat of government in its relation to persons as private economic agents. It will be confined to the analysis of services designed to be of direct use to members of the community in their role as consumers. The distinction appears to be somewhat arbitrary, since all activities of government are presumed to promote the common weal, but as the analysis proceeds it will be seen to have real significance.

¹The treatment of public production in the present chapter runs on different lines from that which is found in statistical measurements of the national income where the effort has to be made to measure in money the contribution of government activities to the total national income. For an illuminating discussion of the statistical problems involved, see National Bureau of Economic Research, *Studies in Income and Wealth*, especially Vol. 1 (1937), Part V and Vol. 2 (1938), Parts V and VI. The discussion in this source also adds much to an understanding of the nature and significance of public production beyond what it is possible to include in the brief treatment in the present study.

The topic is one of special importance at the present time for the reason that there are strong pressures at work to expand the range of public production. On this account it seems desirable both to present a generalized picture of the range of final services rendered by government and to consider the reasons which lie behind the expanding range of activities.

At the outset public production for the direct use of final consumers must be roughly classified into two parts, with quite different financial bases. There are the services provided without direct charge to the user and supported out of tax revenues and public borrowings; and there are the commercial services paid for by the user. There are also mixed types of subsidized services, supported partly from public funds, partly from sales. This distinction will be followed through much of our treatment; but because of their relatively greater importance in the American economy, the tax-supported free services will be accorded a major portion of analysis.

Throughout the whole analysis, three major questions will be the primary topics under consideration: (1) Why is it felt appropriate that public agencies should produce some services and not others? (2) Why should some be rendered free and others at a charge? (3) Why is it appropriate for government to be "in business" in some fields and not in others? The answers to such questions are not in the least obvious. They not only take one to the central problems of political theory, but also call for a knowledge of the historical development of social environment and popular attitudes. Their consideration may help to illuminate the frontiers of controversy along which contemporary government is defining its range of activities.

The general and compelling incentive for public production is the felt need or desire of members of the community for services which either could not or would not be provided on a private commercial basis, or would be provided only in amounts and forms or on terms regarded as unsatisfactory by those who exercise public authority—that is to say, proximately by legislative bodies and in some ultimate guiding capacity by the electorate. This general form of statement could be broken down into a number of specific factors conducive to public production, more elaborate than is practi-

cable here. It may, however, be helpful to list the following somewhat overlapping factors as being of major importance: (1) the necessity of the service to the maintenance of political existence and social order, as in the case of armies, police, and courts; (2) the impracticability of selling desired services on an individual basis, as in the case of street lighting or the prevention of epidemic disease; (3) the general desire for a fuller supply of services than would be available on a private basis, as in the case of education and medical care; (4) the absence of suitable private organization at the time new services are needed, due to prohibitive risks—for example, the Panama Canal; (5) possibilities of lower costs or greater convenience or more adequate service even where appropriate private organization could be made available, as in the case of postal and water supply systems.

While these formal categories are helpful in understanding the reasonable basis for public production and distribution of services, they do not expose the complex social factors which continuously modify the ends of public policy in pursuit of that vague and elusive ideal, "the general good," particularly the pressures of interested groups which cause the ends of public policy to be diverse and often mutually inconsistent, fitted together in a rough patchwork by political opportunism.

II. PRODUCTION OF FREE FINAL SERVICES

In its historical origins the American federal government was regarded primarily as an agency for achieving political and economic unity among the states, safeguarding certain stated personal and property rights, conducting relations with foreign nations, and protecting the national existence. At the outset, therefore, federal activities which could be regarded as production of final services were almost wholly confined to such generalized services as were necessary to those ends. Since the more detailed care for the well-being of citizens was conceived to fall within the functions of state and local governments, the work of these governments will be treated first.²

² Because of the lack of adequate statistical data we do not discuss in detail the services of the smaller cities and villages, or of counties, townships, school districts, and other non-municipal local units. The range of services provided by these

The nominal seat of most political authority for promoting "the general welfare" originally lay in the state governments. In practice they assigned large powers of self-government to local units, and it was at the level of these units that the remarkable expansion of public services during the past century began. On this account, and because the production of final services is still heavily concentrated at the local level, the general description can best start with the activities of local units.

Free services produced by local agencies. When one analyzes the nature of the public services now generally available in local communities, it is clear that they are of several broad general types. Stated in the order of the amounts spent upon them, from largest to smallest, the census categories of municipal public services (omitting the commercial public service enterprises) in 1936 were as follows:⁸

Schools and libraries
 Charities, hospitals, and corrections
 Protection to person and property
 General government
 Highways
 Sanitation and promotion of cleanliness
 Recreation
 Conservation of health

In some form or other most of these general types of activity have long been engaged in by urban governments in all countries of high civilization, though before the nineteenth century most of them usually existed in very rudimentary form. The remarkable aspect of experience in the past century, in other countries as well as in America, has been not so much the creation of new general fields of public service, but the multiplication of detailed services within the general fields and their extension to smaller communities.

With differences in detail, there has been a considerable uniformity in the growth of public service throughout American com-

agencies is similar to that shown for cities, though of course the relative amounts of expenditures for different purposes are very different for the various units.

⁸ U. S. Bureau of the Census, *Financial Statistics of Cities Having a Population of Over 100,000, 1936* (1938). Before the depression beginning in 1929, "charities, hospitals and corrections" stood in sixth place. The rise of this item in relative position is due to the expansion of public relief to the economically distressed.

munities. It is not possible here to describe the growth in detail, but a certain concreteness may be given to the picture by reviewing the chronological development of public activities in a typical urban American community. The very thorough study which has been made of Detroit⁴ will serve for this purpose. The developments shown spring partly from the growth of a village to a great city and partly from the complex of cultural influences which have affected all urban communities in the western world.

The number of activities listed grew from 23 in 1824 to 306 in 1930. The 1824 list includes little except the most basic provision for protection of persons and property and routine administration of public property. The chronology of the introduction of what are now regarded as essential services is interesting:

1835	Street paving
1836	Sewerage
1836	Water supply
1842	Elementary school
1850	Street lighting
1858	High school
1865	Library
1865	Organized police patrol
1867	Sanitary patrol
1867	Organized fire fighting
1879	Food inspection
1883	Outdoor relief
1887	Quarantine of contagious diseases
1888	Garbage collection
1895	Street cleaning
1904	Playgrounds
1908	Public health nurses
1909	Traffic control
1912	Technical high school

The record becomes more impressive when one follows the growth of service under different general headings. Under public health the first step after sanitary patrol (1867) was food inspection in 1879. Among the 44 items now listed are:

1883	General hospital
1885	Contagious disease hospital

⁴Lent D. Upson, *The Growth of a City Government* (1931). Mr. Upson's chronological display is much more complete than can be given here.

- 1887 Milk inspection
- 1893 Bacteriology laboratory
- 1902 Medical inspection of school children
- 1906 Tuberculosis hospital
- 1906 Venereal disease clinic
- 1908 School nurses
- 1915 Pasteur institute
- 1920 Health education nurses
- 1920 Medical college
- 1922 Maternity hospital
- 1925 Mosquito control
- 1928 Cancer clinic

Even more impressive is the expansion of educational service to cover 65 items, including:

- 1842 Elementary schools
- 1858 High school
- 1875 Classes for foreigners
- 1881 Teachers' college
- 1883 Truancy police
- 1883 Classes for incorrigibles
- 1892 Free textbooks
- 1895 Kindergarten
- 1899 Classes for the deaf
- 1905 Evening high school
- 1910 Classes for defective speech, cripples, and mental defectives
- 1911 Mental inspection of school children
- 1912 Technical high school
- 1912 Classes for the anemic and blind
- 1917 Junior college
- 1918 Parental school
- 1920 Medical college
- 1925 General college
- 1927 Law college
- 1930 Radio instruction

In all the various recognized fields of municipal service a similar proliferation was occurring, which cannot be fully exhibited here. The nature of the trend may be shown more concretely by listing a few secondary but suggestive items:

- 1890 Zoo
- 1893 Art library
- 1894 Bathing beaches

1896	Inspection of electrical wiring
1898	Band concerts
1906	Comfort stations
1914	Old-age support
1915	Family adjustment service
1917	Recreation camps
1920	Employment bureau
1921	Music, drama, and fine arts libraries
1922	Golf courses
1925	Symphony concerts
1928	Prison farm for women
1930	Municipal lodging house

These items are merely illustrative and indicative, but they suggest a trend of development which has taken place in all urban communities, and to a lesser degree also in small communities. It is astonishing to reflect upon the loss which would be imposed by subtracting the additions of the past generation, and the thorough uprooting of the settled habits of community life if there were also subtracted the additions of the preceding generation. It is impracticable here to review further the course of development of the several types of public service; but as a special example somewhat further mention may be made of public education.

At the present time public provision of educational facilities, from primary schools to universities, is taken as a matter of course and is, indeed, counted among the most essential of public functions.⁵ This situation is utterly different from that which existed in the early history of the United States. At the period when the American continent was being colonized, popular education was not a public objective in England or any European country. In New England, excepting Rhode Island, the towns were early required to support elementary schools, but education was not compulsory and was perhaps regarded primarily as serving a religious rather than a secular public purpose. In a number of colonies parochial schools supported by various religious denominations were the principal educational agencies. In other colonies, especially in the South,

⁵ The support of education is the largest single charge against the revenues of state and local governments. In 1933-34 public expenditure on elementary and secondary schools was \$1,720,000,000. U. S. Office of Education, *Biennial Survey of Education 1932-34* (1937), Chap. I, p. 12.

schools were almost wholly private. The testy Governor Berkeley of Virginia is reported to have said: "Thank God we have no free schools." At the beginning of the American republic, only the New England states (excluding Rhode Island) and New York had extensive systems of publicly supported elementary schools; and in no state did there exist or was there a strong public opinion favoring compulsory popular education at public expense.⁶

The period from the founding of the republic up to about 1850 may be regarded as that in which the battle for popular education was fought and won. No doubt the creation of a literate electorate as a support of stable representative government dictated the interest of statesmen in public education,⁷ a purpose which was re-enforced when during the first quarter of the century, universal manhood suffrage free from property qualifications was introduced in the various states. The motivation also included a humane sentiment which deplored the waste of human capabilities which occurred by reason of ignorance. This sentiment is evident in the fact that in many communities the first public schooling provided was that for waifs and orphans. But the democratic ideal of a "career open to talents," or equality of opportunity, perhaps carried the greater popular weight, since it opened vistas of private advancement to all in fields which had theretofore been the preserves of those only who could afford private education.

The early history of popular education is primarily to be found in local communities,⁸ and is consequently spotty in character. The local sources demonstrate the fundamentally popular character of the movement. Its extent and the rapidity of its growth are among

⁶ Ellwood P. Cubberley, *Public Education in the United States*, 1st ed. (1919), pp. 51-81.

⁷ Jefferson was among the earliest to insist upon the necessity of a literate citizenry. Washington in his Farewell Address insisted that "it is essential that public opinion should be enlightened." John Adams stated that "the instruction of the people . . . ought to be the care of the public" and "no expense for this purpose would be thought extravagant." A similar sentiment was expressed by many other public men in the early nineteenth century.

⁸ From very early days, however, the federal and state governments played an important part. After 1802 the federal government presented to each new state one section (square mile) of public land in each township (36 square miles) for the support of education, and in 1850 this was raised to two sections. The original 13 states made grants-in-aid to local schools out of proceeds from the sale of their own public domains. See p. 1121.

the most interesting phenomena in the history of American life. While the principle of public responsibility for common school education was fully established in the northern states in the quarter-century from 1825 to 1850, the actual introduction of compulsory education has taken place since 1850.

Looking back from the present time, when public education is taken as a matter of course, it is surprising to observe the bitter intensity of the struggle to establish it. One historian ventures to say, "Excepting the battle for the abolition of slavery, perhaps no question has ever been before the American people for settlement which caused so much feeling or aroused such bitter antagonism."⁹ Not the least of the obstacles were the vested interests of church and private schools, and ecclesiastical opposition to secular schools ("godless education"). The fiscal difficulties were also serious, and the movement would no doubt have made much slower progress had it not been for the rapid growth of taxable wealth during the same period.

Economic development did more than afford a fiscal foundation for education. It also created that environment of urban life which outran the mechanisms of a pioneer agricultural country and fostered the growth of new needs and desires. The movement toward public education was a significant part of the broad extension of municipal services reviewed in earlier pages, and in relative importance it took its place well toward the head of the list.¹⁰

The principle of public provision of educational facilities has found no logical terminus. Not only have schools at the elementary

⁹ Cubberley, *Public Education in the U.S.*, p. 119.

¹⁰ Of the later history of public education it is impossible to give any extended account in the present study, but a few high points of interest may be noted. In the matter of coverage, Massachusetts was the first state to require universal school attendance in 1852, but it was not until 1920 that the requirement prevailed in all states. (I. L. Kandel, "Public Education," *Encyclopaedia of the Social Sciences*, Vol. 5 (1931), pp. 414-21.) The provision of public secondary schools became general only in the latter part of the nineteenth century; and the age of compulsory school attendance now reaches into the normal years of secondary school attendance. Forty-one states require attendance to the age of 16 or more. To make the system of compulsory attendance feasible, the wide expansion of teacher-training schools was necessary, and such innovations as free textbooks and school lunches. Coverage has also been expanded by reaching out to special groups of persons, so that one finds special classes or schools for adults, for the deaf and blind, for the feeble-minded and delinquent, for immigrants, and for other groups.

and secondary levels gone on adding new subjects and assuming new functions, but public provision has been extended also to the higher levels of colleges, universities, and professional and technical schools.

It is of interest to note the lack of any strong tendency to regard the provision of educational services as exclusively a public function. Private and religious institutions are tolerated to the extent that they can attract a clientele and meet public standards. Except at the higher levels the public agencies have, however, so far swept the field that they establish the standards and set the tone of the whole educational system.¹¹

In various other branches of public service, particularly "welfare" services, this mixed situation of public and private agencies prevails, but one can trace more or less normal stages by which they have been progressively covered into the public services. These stages are: first, the initiation of a line of activity by a small voluntary group; second, broad voluntary support of the activity; third, in many cases, a subsidy from public funds; and, fourth, public assumption of primary responsibility and support. Contemporary evidence of this process may be seen in most of the activities now supported by "Community Chests." Such activities are in the second and third stages. In different communities such activities as family adjustment bureaus, clinics of all sorts, reconstruction homes, visiting nurses, hospitalization for the poor, and supervision of delinquents and defectives may be found in all four stages.

The brief survey of the field of education illustrates some of the many factors which have led to an expansion of public services, and indicates the fact that the nature of the services appropriately to be provided from public funds is something which depends upon the changing and developing sentiments of a democratic community. Within the boundaries of fiscal and administrative feasibility there are no set limits to public provision of some considerable part of the nation's "real income."

The potentialities for expansion are well illustrated by the pres-

¹¹ In 1933-34, expenditures upon private elementary and secondary schools were \$138,000,000, or a little over 8 per cent of the public expenditures. U. S. Office of Education, *Biennial Survey of Education, 1932-34*, Chap. I, p. 12.

ent situation with respect to health services. Medical science has made possible the almost complete prevention of the spread of contagious and epidemic diseases, necessarily depending upon public agencies armed with authority. But public health services have not stopped with prevention of the spread of mass disease. The tendency has been to individualize the services, especially in the direction of providing medical attention for the poorer members of society. The forces which have carried the health services to their present position are far from spent. The personnel and institutions engaged in providing these services constantly see fields of useful activities outside the existing limits. Extensive surveys have shown that the medical care available to the mass of the population leaves much unrelieved suffering.¹²

It seems not improbable that one of the fields of public service most likely to undergo striking future expansion is that of medical care, though not entirely, or perhaps even mainly, as free services. The most extreme proposal is the more or less complete "socialization" of medical services; but short of that there is a broad possible field for the extension of hospital and clinical services and public support or enforcement of systems of medical insurance.

Unfortunately there are no figures from which one can present a precise statistical picture of the growth and changing structure of the entire range of local governmental expenditures for the provision of public services. Expenditures of local governmental units have risen rapidly. In 1902 they were just under 1 billion dollars.¹³ In 1932 incomplete data reported indicate a total just under 6.5 billion dollars.¹⁴ No later aggregate is available, but it is prob-

¹² See Committee on the Costs of Medical Care, *Medical Care for the American People* (1932); also Interdepartmental Committee to Co-ordinate Health and Welfare Activities, *The Need for a National Health Program*, Report of the Technical Committee on Medical Care (1938).

¹³ U. S. Department of Commerce and Labor, *Wealth, Debt and Taxation*, Special Reports of the Census Office (1907), table I, p. 963.

¹⁴ Twentieth Century Fund, *Studies in Current Tax Problems* (1937), p. 242. The figure is net after deduction of grants from states to local units. Operation of general departments amounted to just under 4 billion dollars, the remainder going for capital outlays, interest, and public service enterprises. Certain items of expenditure of cities, towns, and villages of less than 30,000 population, in 27 states, are omitted.

able that local expenditures have not greatly changed in total amount in the past few years.

The preceding figures cannot be distributed to the various services provided, but in the case of larger cities it is possible to show, by percentages, the allocation of revenues to the general classes of local services at different times. Such a comparison is shown in the accompanying table.

COST OF OPERATIONS AND MAINTENANCE OF GENERAL DEPARTMENTS OF CITIES, BY PERCENTAGES^a

Item of Expenditure	1907	1928	1935	1936
General government	11.8	8.6	7.7	8.2
Protection of person and property	25.3	19.7	17.1	17.2
Conservation of health	10.1	2.4	2.3	2.4
Sanitation and promotion of cleanliness }	7.6	5.2	5.2	5.3
Highways	12.1	8.5	6.2	5.9
Charities, hospitals, and corrections	6.6	6.4	18.8 ^b	19.9 ^b
Schools and libraries	29.6	38.4	31.6	32.3
Recreation	3.3	3.4	2.7	2.8
Miscellaneous	1.2	5.0	8.4	6.0
Total	100.0	100.0	100.0	100.0

^a Bureau of the Census, *Financial Statistics of Cities, 1907, 1928, 1935, and 1936*. Figures for 1907 and 1928 are for cities of over 30,000 population. Those for 1935 and 1936 are for cities of over 100,000 population, the basis of census reporting having been changed. Capital outlays, interest, and public service enterprises are omitted from the calculation.

^b Charities are 13.8 per cent of the total in 1935, and 14.9 per cent in 1936.

The most striking trends are the declining percentages of expenditure upon general government, protection, and highways, the rising percentage for education before the depression, and the rising percentage for charities (relief expenditures) during the depression.

When one goes behind the statistical averages the most remarkable variation is found from city to city, both as to per capita expenditures and as to percentages of expenditure upon different activities. For cities over 300,000 population per capita expenditures have been shown to range¹³ from \$24 to \$57, and in smaller cities from \$16 to \$55. On health, education, and other services some cities spend from two to three times as high a percentage of total revenues as do others. In comparison with England, American cities

¹³ Mabel L. Walker, *Municipal Expenditures (1930)*, table V, p. 118 ff. Figures refer to a series of years in the middle of the 1920-30 decade.

spend a far larger percentage on education and a far smaller percentage on health.

Free services produced by state agencies. At the beginning of the republic the range of activities engaged in by state governments was exceedingly narrow. While sovereign authority, subject to the reserved powers of the federal government and those actions specifically forbidden to the states, resided in the states, in practice extensive powers of local self-government were accorded to counties and municipalities either by ordinary legislative enactment or by provisions of state constitutions. How extensive this delegation was is illustrated by the fact that until quite recent years very few states possessed any sort of state police force. In the course of time, however, the state governments have been drawn into an increasingly broad range of services, most of which stem from those originating at the level of local government units.

The general classification of final free services which was given for local services at page 1103 serves equally well for state governments. In a general way, indeed, the state activities reflect the same consensus in respect to the types of service which should be publicly produced as that found at the local level. The binding of local communities together in a more closely knit relation, as the result of improved transportation and communication, promoted a sense of state unity and involved the state in attempting some equalization of the services available in different localities, which varied widely in wealth, population, and popular attitude.

This tendency was furthered by the fiscal problems which arose when attempts were made by local communities to expand public services. Most local communities have relied upon a general property tax (in practice, mainly a real property tax) as the foundation of their fiscal systems. This is a tax base which is not easily expandable without being felt to be oppressive. In consequence, as increased revenues have been needed to support the expanded range of services, it has been administratively convenient and politically expedient to resort to other forms of taxation, principally corporation, public utility, gasoline, and income taxes. Taxes of this character can be levied by state governments better than by municipalities and other local units. As state governments became more im-

portant agencies for raising funds they were faced with problems of equalizing services throughout the state and determining the appropriate distribution of functions between state and local governments.

The diversity of the relationships existing between state and local governments makes difficult much in the way of general statement.¹⁶ It is, however, possible to state four relationships which have developed in practically all states. (1) From state revenues, grants-in-aid have been made to local communities for the support of locally administered services.¹⁷ (2) The state has imposed standards of performance, and in some cases dictated the types of service, to be carried out by local governments. (3) The state has supplemented some local services and taken over responsibility for others under direct state administration. (4) The state has produced forms of service different in kind from those locally produced. It will be possible to deal with these types of relation only very briefly and merely in an illustrative way.

State grants-in-aid to local communities have, until the past decade, been of outstanding importance in only two fields, highways and education.¹⁸ In the early years of the republic, though local roads were almost wholly a local responsibility, state governments fostered and controlled the building of trunk highways through the chartering of private companies to build and operate toll roads. With the coming of canals and railways this interest lapsed, and it

¹⁶ The most comprehensive and convenient source showing the relations between state and local government units in the provision of free services is Henry J. Bittermann, *State and Federal Grants-in-Aid* (1938). Its footnotes also provide an extensive bibliography related to all the various services.

¹⁷ State aid to local services takes several forms which can be reduced to two major categories: (1) the sharing of certain state-administered taxes with local units without earmarking the purposes for which they are to be spent, and (2) grants-in-aid for the support of specific purposes. When a specific tax (for example, the motor vehicle tax) is shared for supporting a particular service (for example, highways) the nature of the transaction is more that of a grant-in-aid than of ordinary tax-sharing.

¹⁸ "In 1902 the total school and highway grants-in-aid were \$46,069,000 and they increased to \$480,415,000 in 1928, to \$657,226,000 in 1931, and to \$783,695,000 in 1934. Prior to 1933 other grants-in-aid were a minor matter amounting to probably about ten millions of dollars annually. Grants-in-aid for employment relief of various sorts swell the total from state funds in 1934 to approximately \$929,024,000." Bittermann, *Grants-in-Aid*, pp. 40-41.

was only toward the end of the nineteenth century that an active popular demand for improved roads again brought state agencies actively into the field. The popularization of the automobile accentuated this interest, especially after it was demonstrated that benefits would accrue to rural communities and not merely to the wealthier urban dwellers. At the outset this development was largely carried on by state grants-in-aid to county road authorities, with more or less attention to through routes and to standards of road building. In the course of time the states have, however, come to engage in extensive road building on their own account, and in a few cases state agencies have taken over control of the whole non-urban road system. These later developments have been accelerated by the requirements of the federal government in connection with the system of federal grants-in-aid to the states for highway building.

It should be noted that although the use of public highways is almost always free, in the sense that there is no toll or other specific use charge (except occasionally for the use of bridges and two or three "limited service" highways), there is a widespread and increasing tendency to couple state and local highway expenditures with specific taxes on motor vehicles and motor fuel. Not only is it attempted to cover the total of highway expenditures out of specific taxes on the users of the highways, but efforts are made to arrange the tax schedules so that the burden on specific classes of users shall correspond as closely as possible to the expenditure necessitated by the specific use. For example, taxes on trucks and buses are made heavier than on private passenger vehicles with a view to placing on the heavier vehicles the construction and maintenance costs that are due to the requirement of wider and thicker pavements than would be needed for passenger car use alone. Moreover, there is a growing tendency to earmark the proceeds of these levies for highway use. Seven states have enacted constitutional prohibitions on their "diversion" to other uses.

To the extent that specific tax revenues are thus co-ordinated with specific expenditures the provision of highways ceases to belong in the category of "free" services. Because of the imperfect character of this adjustment, however, in addition to the fact that the

federal government makes no comparable allocation of specific tax levies to highway expenditure, it is more appropriate to treat the whole problem in this section, rather than in section 111 under government production of services for sale.¹⁹

In the case of education, the system of grants-in-aid in the first half-century of the republic had great influence upon the rapid growth of publicly supported, locally administered schools. The development appears to have sprung originally less from any direct purpose to introduce public schools than from the existence of surplus state revenues deriving from the sale of public lands. The thirteen original states had complete disposition over their own public domains. The sale of these lands produced revenues far in excess of current needs and the practice grew up of putting them into school funds, the income of which was distributed to local communities for the support of non-sectarian elementary schools. The same practice grew up in the newer states with respect to revenues from sale of lands given them by the federal government for school purposes, upon their accession to statehood. These grants stimulated the establishment of local schools, especially in rural districts.

In the early days it appears to have been thought that the state school funds would be the principal support of elementary education. The funds were, however, largely dissipated by maladministration, so that support of schools gradually fell back almost entirely on the local tax rates. During the past generation there has been a considerable revival of state grants-in-aid to local schools, not so much as a general subvention, but as support for new branches, such as vocational courses and courses for defective groups.²⁰

The fact that local communities have come to rely so much upon state governments as a source of revenue has conferred upon state governments great power to mould the character of local services. The nature of the services required, and the standards of performance imposed upon local agencies, may be determined by legislative

¹⁹ The whole problem of highway costs is to be discussed in a forthcoming publication of the Brookings Institution.

²⁰ Estimated state grants-in-aid for school purposes increased from \$57,543,000 in 1905 to \$423,178,000 in 1934. The latter figure was 23 per cent of all school revenues. Bittermann, *Grants-in-Aid*, p. 67.

action or by administrative action, and in practice the two methods are combined in various ways. Most states, for example, have general laws relating to school services, but the standards are actually fixed by state superintendents of schools or boards of regents and administered in detail by local school officials under the supervision of state officials.

The tendency for state agencies to supplement or replace local agencies is especially strong in connection with institutionalized services. One of the striking developments of the past generation or two has been the demand for more adequate institutional care for the defective, the delinquent, and certain classes of the diseased. Local finances have not sufficed to meet this demand, except in the richer municipalities; and, moreover, economy and administrative convenience have dictated concentration. State institutions have therefore increased in number and variety from prisons and insane asylums to homes for the feeble-minded, industrial schools and farms for delinquent children, schools for the blind and deaf, tuberculosis hospitals, orphanages, reconstruction homes, and homes for the aged and infirm.²¹

State supplementation of local services is also seen in the development of state-supported higher educational institutions. Interestingly, just as state public lands had served to give impetus to local elementary education, so federal public lands gave an impetus to state-supported higher education. The lands allocated to the states under the Morrill Act of 1862 to support instruction in agriculture and the mechanic arts served as the foundation. State governments, in response to the democratic idea in education, have gradually committed themselves to the principle of free schooling for all qualified persons in all those branches of learning that are customarily taught at the university level.²² Public colleges and professional schools to-

²¹ Institutional poor relief has continued to be cared for mainly on a local basis, especially in the time-honored form of the "county poorhouse." In the recent years of depression, however, relief to the unemployed has become an important state activity, supplementing the inadequate local facilities for taking care of the economically distressed population. Also in collaboration with the federal government, states are setting up systems of social insurance for the prevention of economic distress among the aged and the unemployed. These matters are treated in Chaps. XXX-XXXI.

²² How far the actuality is from Jefferson's ideal to "cull from every condition of our people the natural aristocracy of talent and virtue" has recently been forcibly

day account, however, for less than half the funds spent upon higher education, while in the primary and secondary school fields public funds make up more than 90 per cent of the total.²³

The development of state police forces has proceeded rapidly in recent years, very largely in response to the use of automobiles upon improved highways. The need is partly for insuring safety on the highways, but there is the added factor of greater mobility on the part of criminals. Another example is the field of recreation, with the provision of state parks for the general public and the protection of wild life in the interest of huntsmen and fishermen. Many other examples could be given of the progressive supplementation of local by state services.

Of the final group of state services, those entirely separate in character from local services, there are not many that fall under the category of individualized final services. There are, however, a variety of activities concerned with the general welfare (and not centered on facilitation or regulation of private business) of which in many states the most conspicuous are those included under the general phrase, conservation of resources. Into these activities the present analysis will not go.²⁴

The preceding brief review indicates how the circumstances of modern life operated to break down the localism so characteristic of most free final services in earlier periods. In many cases the demand for such services outran local fiscal resources. Moreover, many of the services demanded called for a larger unit of administration than the local unit. There has not, however, been created anything approaching a uniform pattern of state and local responsibilities. The existing degree of centralization varies in the widest degree from one or two states (Delaware in particular) where the state has almost supplanted the local units in the performance of many functions, to others where the historic localism is very slightly impaired except for state control in matters of education and highways.

The statistical data are such as to make possible a rough compari-

pointed out by President Conant of Harvard University, *New York Times*, Mar. 3, 1938.

²³ U. S. Office of Education, *Biennial Survey of Education 1932-34*.

²⁴ Some discussion of this type of governmental activity as regulation of private enterprise will be found in Chaps. XXIII, XXIV, and XXV.

son of functional distribution of expenditures of states at certain dates. This is done in the accompanying table, for the years 1902, 1932, and 1937.

EXPENDITURES OF STATES, 1902, 1932, 1937^a
(Dollar items in thousands)

Item of Expenditure	1902		1932 ^b		1937 ^c	
	Amount	Percent- age of Total	Amount	Percent- age of Total	Amount	Percent- age of Total
General government . . .	\$ 25,897	11.5	\$123,333	4.9	\$150,970	4.4
Protection of person . . . and property	6,804	3.0	86,875	3.5	106,055	3.1
Health	1,173	0.5	37,292	1.5	36,288	1.1
Sewers, drainage, and sanitation	4,154	1.9	235,690	9.4	436,089	12.6
Highways and lighting	4,680	2.1	274,920	11.0	860,361	24.9
Charities	17,789	7.9	604,470	24.1	824,439	23.9
Insane and penal insti- tutions	34,726	15.4	8,054	0.3	6,815	0.2
Education	61,403	27.2	72,965	2.9	77,942	2.2
Parks and recreation . .	1,563	0.7	—	—	—	—
Development and con- servation of natural resources	—	—	112,258	4.5	122,027	3.5
Agriculture	3,240	1.4	6,330	0.3	17,652 ^d	0.5
Interest	9,565	4.2	885,854	35.3	711,876	20.6
Public service enter- prises	3,132	1.4	—	—	—	—
Outlays	2,142 ^e	1.0	57,794	2.3	102,927	3.0
Temporary	39,765	17.6	—	—	—	—
Other	9,496	4.2	—	—	—	—
Total	\$225,529	100.0	\$2,505,835	100.0	\$3,453,441	100.0

^a Source for 1902: Census Office, *Wealth, Debt, and Taxation* (1907), pp. 998-1001; for 1932: Bureau of the Census, *Financial Statistics of State and Local Governments, 1932* (1935), table 3; for 1937: Bureau of the Census, *Financial Statistics of States, 1937*, Summary Bulletin (1939). The percentages for 1902 are not strictly comparable with those for 1932 and 1937, since capital outlays are isolated from operation and maintenance for 1932 and 1937, while for 1902 only outlays for buildings and sites are segregated. If outlays were distributed to the various services, the percentages for the other items for 1932 and 1937 would be higher than those shown. The percentages in this table are not strictly comparable with those for cities in the table on p. 1111, where outlays, interest, and public service enterprises are excluded.

^b Data for 1932 include federal grants-in-aid amounting to about \$300,000,000, and those for 1937 include similar grants amounting to \$586,000,000.

^c Preliminary.

^d Excludes alcoholic beverage monopolies.

^e Buildings and sites only.

Comparable figures are not available for later years. No doubt the most striking change has been an increase under the heading of "charities," representing the mounting relief load of recent years.

The increase of state aid to local units is shown in the accompanying table.

STATE GRANTS-IN-AID AND SHARED TAXES, 1902, 1928, 1935^a
(In millions of dollars)

Local Aid from State Sources	1902	1928	1935
Grants-in-aid:			
Education.....	45.4	323.1	521.8
Highways.....	—	42.1	57.5
Welfare.....	—	10.3	178.7
Other.....	12.9	6.9	15.1
Total grants-in-aid.....	58.3	381.4	773.1
Local shares of state taxes:			
Income and corporation.....	6.4	119.5	59.3
Inheritance.....	.2	4.6	2.6
Motor vehicle.....	—	67.0	70.4
Motor fuel.....	—	64.2	111.3
Sales.....	—	—	9.7
Liquor.....	10.9	—	33.8
Other.....	—	11.8	5.8
Total local shares of state taxes...	17.5	267.2	292.8
Grand total.....	75.8	648.6	1,069.9

^a From Twentieth Century Fund, *Facing the Tax Problem* (1937), pp. 578-79. The actual aid reaching local units from state sources in recent years is much larger than such a table would show, since federal grants to states are largely redistributed to local governments. The vehicle and fuel taxes in the table may be regarded primarily as grants-in-aid for highways.

The expansion of state functions has had certain collateral consequences of some economic interest. One of these is the carrying on of industrial activity within state institutions, especially prisons. In the past much of this was done for strictly financial reasons, and where this led to production of goods for sale in the open market it was a source of grievance to competing private employers and workers. In the past generation there has been a considerable change of purpose. There has developed the desire to rehabilitate individuals and to give them vocational knowledge. Moreover, in response to political pressures, production for sale is on the wane. In the effort to give a utilitarian turn to institutional labor, states have gone more and more into the functions of self-supply, producing in their own shops, mills, and fields the things used by state agencies in their varied activities. The states have thus become directly engaged

in a wide variety of economic activities overlapping the fields in which private enterprise is the usual organizing force.

Nor is self-supply strictly confined to production with institutional labor. Some state highway departments operate rather elaborate maintenance shops, and one state prints its own school textbooks. In a variety of ways activities slip over into the category of competition with private enterprise. Since such competition is analyzed in connection with federal services,²⁵ no further mention is necessary here. But it is interesting to see how the expansion of customarily non-competitive functions has drawn state governments into a more and more complex scheme of relations with the existing world of private enterprise. The present situation is one which involves many conflicts of interest and leaves many points of marginal doubt as to whether economy and convenience call for state participation in production or not.²⁶

Free services produced by federal agencies. Constitutional limitations and conventional attitudes have until the recent past confined the economic activities of the federal government within narrower boundaries than are now considered appropriate. Moreover, in so far as federal activity has been pushed beyond the performance of the usual functions of national states in providing for secure and orderly government, it has very largely related to the implementation and regulation of private enterprise, as was noted in Volume I of the present study. Beyond this, the recent expansion of federal activities has related mainly to providing greater security of livelihood in the forms of emergency relief, social insurance, and categorical assistance which are described in the next two chapters. And, even where the federal government has increased its production of other services to individuals, the development has to a considerable degree been in fields of commercially salable services, as described in the next section of the present chapter.²⁷

²⁵ See p. 1138.

²⁶ The most direct current controversy with private enterprise is over the question whether the production of various state services should be directly organized by state agencies or produced on a private contract basis. A good example is whether state highways should be built by contractors or by a state agency. Further, there is the controversy over municipal or state ownership of public utilities. For discussion, see Chap. XXI.

²⁷ A brief description of the activities of each government department and bureau

At an earlier point it was noted that the free services provided by state governments are very largely developments from those originating at the local level. The same is in a degree true of federal services, and attention may first be turned to types of services which are concurrently provided, either separately or in co-operation, at all three levels of government.

As was noted above, the federal government gave an early stimulus to public elementary schools by giving land for school purposes to the new states.²⁸ The next step, as has been indicated, was the assignment of lands to the states under the Morrill Act of 1862 for the support of instruction in agriculture and the mechanic arts. Under the second Morrill Act of 1890 an annual federal appropriation was begun for the support of the state colleges and universities set up under the early act. Also, in 1887, the federal government began annual appropriations for the support of state agricultural experiment stations. Federal grants to states for the support of vocational schools were begun in 1917,²⁹ and since 1929 the scope and amount of such grants have been increased rapidly. As now administered the work falls into the four general groups of agricultural, trade and industrial, home economics, and commercial education. General supervision of the program is in the hands of the Office of Education. This bureau also carries on a variety of other functions, mainly in the nature of research and the provision of informational and advisory services.

For many years there has been an active campaign for a federal department of education to provide national standards and to

is given in the *United States Government Manual* (1939), prepared by the Office of Government Reports.

²⁸ The beginning of the gift of land for school purposes actually antedates gifts to the states. It was initiated in connection with sale of land to land companies in the "Western Reserve" area, presumably with the purpose of stimulating sales. The formula of giving the central section in each 36 for educational purposes was then carried over to apply to new states when the latter were organized. See Bittermann, *Grants-in-Aid*, pp. 62-63; also Howard C. Taylor, *Educational Significance of the Early Federal Land Ordinances* (1922), pp. 30-36.

²⁹ From 1910 to 1932 the annual grants for agricultural schools increased only from \$2,000,000 to \$2,550,000. In the same period grants for experiment stations and agricultural extension services increased from \$1,342,000 to \$12,975,000. From 1918 to 1932, grants for vocational education increased from \$832,000 to \$8,415,000. See Bittermann, *Grants-in-Aid*, pp. 125-33.

equalize regional services, much as the states now attempt to do within their own borders. At present, however, the influence of the federal government upon the pattern of the school system, beyond the points noted above, is relatively slight.

The federal government entered into highway construction in the early years of the nineteenth century, but dropped out when interest in highway building flagged with the coming of railways. The first indication of reviving interest was the establishment of the Office of Road Inquiry, in the Department of Agriculture, in 1893. Active participation was only resumed in 1916 when the present system of grants-in-aid to the states was initiated.³⁰ These subventions have grown to over 200 million dollars per year, administered by the Bureau of Roads. One of the collateral consequences has been the thoroughgoing revision of state highway administration and the breaking down of the localism which had been dominant in most states.³¹

Until quite recently, as in the case of education, the federal government had gone relatively only a very short way in supporting the various "welfare" types of service. For a number of years, from 1922 to 1930, grants-in-aid were given the states for maternal and children's aid, administered by the Women's Bureau and the Children's Bureau of the Department of Labor. After the cessation of these grants the Children's Bureau continued to act in research, informational, and advisory capacities. The situation has been greatly changed, however, by the provision in the Social Security Act of 1935 for a variety of grants for welfare service. Under this act the Children's Bureau administers annual grants to the states in the total authorized amount of \$8,150,000 for maternal and child-health services, services for crippled children, and child-welfare services.³² The Bureau of Public Assistance in the Social Security Board administers similar grants for aid to dependent children, the aged,³³ and the blind.

³⁰ An appropriation of \$500,000 for this purpose was included in the Post Office Appropriation Act of 1912, 37 Stat. L. 539.

³¹ See Bittermann, *Grants-in-Aid*, Chap. 10.

³² U. S. Children's Bureau, *Federal and State Co-operation in Maternal and Child-Welfare Services under the Social Security Act* (1938).

³³ Grants to states for old-age assistance are entirely separate from the system of old-age insurance administered by the Social Security Board. The activities of the Social Security Board are discussed in Chapter XXXI below.

An important field in which the federal government directly provides services, in addition to subventions to states, is that of public health.⁸⁴ Federal functions in this field are now largely concentrated in the Public Health Service, but the activities originated in diverse places—in the immigration service, in the army, in the care of seamen, and elsewhere.⁸⁵ The development of federal activities in this field arose largely from the desire to prevent the spread of disease, which has no respect for national or state boundaries. The Public Health Service is charged with these functions, and to this end administers the quarantine regulations at ports of entry into the United States and co-operates with state and local authorities in mosquito control and in combating epidemic disease of all sorts. It has had spectacular success in eliminating malaria, yellow fever, bubonic plague, and typhus, and to it also must go much of the credit for improving the standards of state and local health services throughout the country, by precept and example. In addition to these services it operates 26 marine hospitals and 118 marine relief stations, a hospital for immigrants at Ellis Island, two leper hospitals, two narcotic farms, and a hospital for federal prisoners with mental diseases.⁸⁶ The case of the Public Health Service more clearly than any other federal bureau illustrates why certain desired types of public service can be effectively rendered only by co-operation of agencies at the federal, state, and local levels.

In each of the four large fields of state and local free services—namely, education, highways, welfare services, and public health—it appears, therefore, that the federal government possesses highly important agencies. Besides carrying on the administration of grants-in-aid and the direct production of some services, these agencies are the foremost research and advisory agencies in their respective fields and are in a position to exercise a very broad influence upon

⁸⁴ Federal grants-in-aid to states for public health were begun in 1917.

⁸⁵ The present Public Health Service began as the Marine Hospital Service for the care of seamen on American vessels.

⁸⁶ U. S. Public Health Service, *Work of the United States Public Health Service* (1937); also, Robert D. Leigh, *Federal Health Administration in the United States* (1927). Federal health services are not all under the Public Health Service. Other branches are carried on by the Food and Drug Administration, the Office of Education, and the Children's Bureau, while vital statistics are prepared in the Department of Commerce.

the nature and standards of state and local public services. While under our constitutional system the federal government exercises little mandatory authority over state and local activities, a number of federal bureaus have been able through indirect means to achieve a considerable degree of centralization of power in their own hands. The most conspicuous example is the influence of the Bureau of Public Roads over standards of highway planning and construction throughout the country. The following quotation summarizes the far-reaching character of this activity:

The mere volume of this activity [grants-in-aid] gives little indication of the real influence exerted by the federal government on highway development of the country. While federal-aid funds have been applied only to a very limited portion of the total highway mileage, it is this mileage which carries the bulk of intercity motor-vehicle traffic. Moreover, standards of technical performance set by the Bureau for federal-aid work have tended to become standards for development of all main state highways. The federal-aid program has consistently influenced state activity in the direction of programs which give priority to the development of connected systems, constructed and maintained under progressively higher and more uniform standards.

It is an elementary fact that the development of an integrated system of national highways would have been delayed indefinitely or never would have been accomplished in the absence of centralized state control, and in the absence of a force sufficient to secure some unification between state systems, in terms both of physical connection between state highways and in terms of basic uniformity in physical construction.³¹

There is, however, practically no trend toward concentration of administrative authority. To state and local services, therefore, the federal government stands mainly in the relation of a source of subvention and an advisory service bureau.

Because they have grown up at the separate local, state, and federal levels, under separate legislative authorities, these several branches of public service fall into no organic administrative pattern. It is impossible to make any general remarks about the desirability of greater centralization of authority, both because each type of service has its own special administrative problems and because administrative means are relative to a broader statement of public

³¹ 75 Cong. 1 sess., *Investigation of Executive Agencies of the Government*, S. rep. 1275 (1937), p. 362.

purposes. For example, a desire to retain local responsibility as a dominant political principle could offset considerations of higher service standards and the possible greater economy or effectiveness of more centralized authority. On the principle of "he who pays the piper calls the tune," the grant-in-aid is a potentially effective instrument for expanding federal control over state affairs just as it is in extending state control over local affairs. How far the power may come to be used in breaking down local and state administrative autonomy will depend not only upon the tenacity with which the lower units cling to their powers but also upon the nature of the services which are demanded in the future, and, finally, upon the degree in which the greater elasticity of revenue sources of the higher units place them in a position to expand their authority over the lower.

A new phase in the relation of the federal government to state and local services originated with the initiation of the federal relief program. Through the work relief program, federal aid has become much more extensive in the provision of funds for local roads, public buildings, parks, playgrounds, sanitary works, and a wide variety of other facilities. Until 1936 funds were also advanced under this program for direct relief. And through the public works program money has been both lent and given to state and local units for capital construction.²⁵

The increasing federal aid in support of state and local services, and its present complex character, may be seen in the table on page 1126.

The federal government has a special relation to certain groups the members of which are in some sense its wards. These groups receive from the federal government a variety of institutional services which are provided for other groups, if at all, only by state and local agencies. A special interest in the welfare of Negroes after the Civil War led to federal contributions to the support of certain Negro institutions, the best known of which are the Freedman's Hospital and Howard University in Washington. As noted above, health services for sailors are maintained. War veterans have always had special attention from the federal government, which now

²⁵ The relief program is further discussed in Chap. XXX below.

maintains an extensive system of hospitals and reconstruction homes for the disabled. To give only one more example, the Indians have a long-standing status as special wards of the government, and on the Indian reservations they receive a wide variety of services, including education and medical service.

FEDERAL EXPENDITURES FOR GRANTS-IN-AID, 1910, 1918, 1928, 1936*
(In thousands of dollars)

State and Local Aid from Federal Sources	1910	1918	1928	1936
Colleges of agriculture	2,000	2,500	2,550	2,550
Experiment stations	1,342	1,440	3,358	4,992
Agricultural extension	—	2,075	5,878	16,664
Forest fire co-operation	—	99	941	1,528
Other forestry aids	—	—	124	53
Highways (total)	—	2,702	80,802	224,073
Federal aid highways	—	—	—	25,948
Emergency highway work	—	—	—	198,125
U. S. Employment Service	—	—	—	2,131
Vocational education	—	832	6,281	9,749
Vocational rehabilitation	—	—	654	1,245
Public health	—	331	534	5,027
Relief and public works	—	—	—	704,191
Social Security Act (total)	—	—	—	34,139
Assistance grants (aged, blind, and children)	—	—	—	28,424
Maternal and child health	—	—	957	1,239
Crippled children	—	—	—	698
Child welfare services	—	—	—	225
Unemployment administration	—	—	—	938
State marine schools	—	—	—	150
State veteran homes	—	—	—	537
Total grants-in-aid	3,342	9,979	102,079	1,004,416
Quasi grants-in-aid	—	—	—	—
Relief and public works	—	—	—	1,264,337
National guard	—	—	—	33,137
Total quasi grants-in-aid	—	—	—	1,299,474
Grand total	—	—	—	2,301,890

* Bittermann, *Grants-in-Aid*, pp. 132-33, 135.

There is a great variety of federal services which, though logically relevant in the present context, are too numerous and detailed to mention. One large class is that of services designed to aid "the consumer," spread through such diverse agencies as the Bureau of Home Economics, the Consumers' Counsel of the A.A.A., the Bu-

reau of Standards, the Bureau of Labor Statistics, and the Bureau of Fisheries. The services are essentially informational in character, but, going beyond mere information about products, extend to such matters as how to organize consumers' co-operatives and how to educate school children in consumers' problems.³⁹

The remaining federal services which have some relevance in the present connection are mainly those related to provision of livelihood in the forms of emergency relief and social security. Since these are discussed at length in the two following chapters, no further mention of them is necessary here.

The federal budget shows an entirely different picture of services rendered from that of state and local budgets. In 1900 the total was 510 million dollars of which 74 per cent was allotted to the army, navy, soldiers' pensions, and interest on the national debt. As late as 1916 the total was only 724 million dollars, of which 70 per cent represented the same four items.⁴⁰ After the World War ordinary expenditures settled down at around 3 billion dollars; and in 1930 payments on account of army, navy, veterans, and interest were still 66 per cent of the total of 3.4 billions,⁴¹ omitting the item of debt retirement. Since that date the picture has changed most remarkably owing to the free spending of the Roosevelt administration in connection with the economic depression of recent years. For the fiscal year 1937 federal expenditures were almost exactly 8 billion dollars, excluding debt retirement. The table on page 1128 shows the distribution of this amount by major functions. From this table it will be seen that national defense, veterans, and interest, while increasing in absolute amount, have fallen to 36 per cent of the total. On the other hand, two entirely new items, relief and social security, have risen to 36.4 per cent of the total. It is impossible to isolate the cost of what earlier in this chapter have been defined as "final" services. The display is of interest, however, both in showing the difference in functional distribution between federal

³⁹ For further discussion see Vol. 1, Chap. IX.

⁴⁰ Davis R. Dewey, *Financial History of the United States*, 11th ed. (1931), pp. 474 and 495.

⁴¹ The source is Dewey, *Financial History*, p. 533, except that total payment to veterans (instead of pensions only) is taken from National Industrial Conference Board, *Federal Finances 1923-1932* (1933), p. 36.

expenditures and state and local expenditures, and in showing the changing distribution of federal expenditures.

In closing this section, it may be repeated that it has been concerned only with the production of governmental service for indi-

FEDERAL EXPENDITURES BY MAJOR FUNCTIONS,^a 1937,
EXCLUSIVE OF DEBT RETIREMENTS^b

Class of Expenditures	Amount (In millions of dollars)	Percentage of Total
Regular operating expenditures:		
Legislative, judicial, and civil establishments	814.7	10.2
National defense	888.6	11.1
Veterans' pensions and benefits	1,128.2	14.1
Interest on the public debt	866.4	10.8
Other ^b	48.1	0.6
Total regular operating expenditures	3,746.0	46.8
Public works:		
Public highways	350.6	4.3
Public buildings	76.3	1.0
Rivers and harbors improvement	142.4	1.8
Grants to public bodies, including administration	272.9	3.4
Other ^c	237.2	3.0
Total public works	1,079.4	13.5
Relief:		
Direct relief	184.3	2.3
Work relief (W.P.A.)	1,896.7	23.7
Civilian Conservation Corps	385.8	4.8
Total relief	2,466.8	30.8
Loans (net)	-307.1 ^d	-3.8
Subscriptions to stock and surplus	47.1	0.6
Agricultural Adjustment program	515.8	6.4
Social Security	447.7	5.6
Railroad Retirement	5.5	0.1
Total expenditures	8,001.2	100.0

^a National Industrial Conference Board, *Cost of Government in the United States, 1935-1937* (1938), p. 17.

^b Refunds of receipts, settlement of war claims, etc.

^c Tennessee Valley Authority, reclamation, flood control, etc.

^d Excess of credits.

viduals or groups as final consumers, and only with the services which are provided on a non-commercial basis. It is of course entirely impossible to make any accurate separation of government production of final consumption services on the one hand and government expenditures relating to the implementation and regula-

tion of private enterprise on the other, as may well be illustrated by merely mentioning police, national defense, and highways. Nevertheless the Agricultural Act of 1936 required that a statistical separation of this character be undertaken. The estimate made by government economists for the fiscal year 1936 is shown in the accompanying table. Of the production expenditures, 68 per cent

DISTRIBUTION OF GOVERNMENT EXPENDITURES, FISCAL YEAR 1936^a
(In millions of dollars)

Organization Unit or Appropriation Item	Expenditures Directly Productive of Final Utilities Available to:		Expenditures Facilitat- ing Productive Activities of:		Transfers or Loans with Recovery Expected ^b
	Farm Population	Non-farm Population	Farm Enterprises	Non-farm Enterprises	
Federal	494.7	1,955.4	644.7	1,265.2	4,488.6
State and local					
Education	365.3	1,488.3	3.7	46.0	346.6
Emergency relief	68.5	377.8	35.2	134.0	364.3
All other	249.0	2,366.6	246.6	1,061.5	1,957.0
Total	1,177.5	6,188.1	930.2	2,506.7	7,156.5
Percentage (excluding transfers)	10.90	57.28	8.61	23.21	—

^a R. W. Nelson and Donald Jackson, "Allocation of Benefits from Government Expenditures," in Conference on Research in National Income and Wealth, *Studies in Income and Wealth*, Vol. 2, p. 329. Federal expenditures are based on the *Annual Report of the Secretary of the Treasury*. State and local education expenditures are based on Office of Education data, state and local relief expenditures on W.P.A. data. Other state and local expenditures are estimates based on data from sample states and are not to be regarded as highly accurate. The total expenditure figure is not wholly net, since it includes some payments between governmental units.

^b The transfer category is described as "all disbursements made by government that do not represent costs of activities which serve to enhance the production of economic values or create utilities; in such transactions, government serves merely as a conduit for the flow of purchasing power from one economic group to another, the transfer neither adding to nor subtracting from the national income sum" (same, p. 319). The principal federal transfer items were over one billion dollars each for soldiers' bonus and debt retirement and 800 millions for interest. Direct relief and A.A.A. benefit payments were also included in this category.

are credited to final consumption services, 32 per cent to aids to, or controls over, private production. It is hardly necessary to say that this calculation required some highly arbitrary allocations between the two categories. Many of the general, non-individualized services of government were distributed on a fifty-fifty basis.

III. PRODUCTION OF SERVICES FOR SALE

Up to the present time public production of services for sale has had a very slight development in the United States, and for that

reason the record of experience may be discussed very briefly.⁴⁴

Services produced for sale by local and state agencies. Perhaps the most numerous class of cases in which state and local agencies make a charge for services does not, strictly speaking, represent commercial production at all, but rather private contribution to the support of existing services largely supported from tax revenues. Illustrations are charges for entering museums, for using municipal golf-courses, for attending public institutions of higher education, and for care at public hospitals.

Outside this category, and excluding public utility services, an exhaustive enumeration of all cases of commercial sale would no doubt be rather long, but the examples are scattered, and the types of service not numerous. In local communities, perhaps the most common case is the provision of public markets. Many cities have public wharves and docks and a few have grain elevators and other warehousing facilities. The motives for such extensions of service are varied, running from mere public convenience (in the usual instance of markets) to a dissatisfaction with rates (as is often the case in warehousing services) which is deemed to justify direct public competition.

One also finds occasional instances of direct public competition in the interests of final consumers, as in operating a public coal yard or filling station. This sort of thing is, however, much limited not only by local sentiment, but also by the terms of municipal charters. Such activities, moreover, are somewhat ill-defined in law, and in various jurisdictions they have been limited by court decisions.

In view of the remarkable expansion of tax-supported services, it is interesting that American local governments have undertaken to so slight an extent the operation of public utility enterprises on a commercial basis, as compared with European communities. There are of course numerous instances of municipally owned gas and electric plants and transportation systems, but the rule has been otherwise. The presumption against public commercial enterprise

⁴⁴ Brevity of treatment here is further justified because American experience with public production for sale is examined elsewhere in this study in the chapters on public utilities and transportation (Chaps. XXI and XXII).

holds over very strongly, and even where it weakens, private vested interests stand in a strong position to resist change. The fact that the monopolized utility services have developed under private investment and management has given rise to one of America's most interesting experiments in economic control, the regulation of utility monopolies by public commissions. This form of government regulation is discussed above in Chapter XXI.

American experience in the matter of local public utilities is like European experience in the sense that, as in most European countries, private and public operation have both been utilized; but the extent of public operation has been much smaller in the United States, and the prejudice against government's engaging in commercial enterprise (or what the English call "public trading") has been more pronounced.

The outstanding exception to the policy of having private monopolies in the public utility industries has developed in the case of water supply. Many communities were originally supplied by private companies, but in the course of time most of the latter have been taken over by local governments, for a variety of reasons mainly connected with a growing interest in public health and sanitation and problems of supply related to increasing population.

A number of years ago, especially just after the World War, there were also some cases of converting local transportation systems from private into public systems, because of financial difficulties resulting from rising costs and the resistance of the public to higher fares. These forces are well illustrated by the entrance of the city of New York into the supplying of rapid transit subway service. Buses, cheap taxis, and private cars have undermined the profitability of street-car companies, and have also created a situation highly conducive to further participation of local governments in the operation of local transportation agencies.

As another example of the development of publicly operated utility services, in quite recent years, somewhat under the stimulus of the policy of the federal government,⁴⁸ municipal ownership of plants for distributing electricity has been growing. This movement is a direct challenge to the monopoly position of private companies

⁴⁸ See p. 1135 below.

and a confession of weakness in the regulatory system. It creates a broad battle front of conflicting interests which looms as one of the major elements of political disturbance in the calculable future. In its nature it escapes the boundaries of a strictly local problem, since it is tied up with a movement for public operation of generating and transmission facilities on a much wider than local scale.⁴⁴

Local public enterprise is reduced to more precise perspective in the following census figures for 1936, covering only cities of over 100,000 population.⁴⁵ Out of 94 cities, 84 operated public water supply systems and only 11 operated public electric light and power systems. Public markets were operated by 53; docks, wharves, and landings by 42; and cemeteries and crematories by 31. Only 43 operated one or more of a miscellaneous list including ferries, toll bridges, street railways, gas supply systems, and radio stations. Water revenues made up 61 per cent of all revenues from publicly operated utility enterprises. Electrical revenues were only a little over one-fifth those of water revenues, and 58 per cent of electrical revenue was accounted for by the two cities of Los Angeles and Seattle.

In another field, in very recent years and under the stimulus afforded by a federal program,⁴⁶ numerous municipalities are undertaking public housing projects, a field in which many European communities have been active since the World War. Along with electrical distribution, housing looms on the horizon as one of the two fields in which municipal enterprise is likely to undergo the greatest expansion in the years immediately ahead.

Enterprise by state governments in the public utility field is almost non-existent, though in a few states the idea of state generation of electricity has been actively discussed. For example, New York State has made plans for operating hydro-electric generating facilities if the projected treaty between the United States and Canada for a Great Lakes-St. Lawrence River waterway is con-

⁴⁴ American experience with the regulation of public utilities is reviewed in Chap. XXI of the present study. Some further observations upon public operation of utilities will be found at pp. 1134-36 and 1156-58 below.

⁴⁵ Bureau of the Census, *Financial Statistics of Cities 1936*, pp. 27, 29, 102-04, and 141-43.

⁴⁶ See below, p. 1136.

summed. A few states operate state-owned grain elevators. Some states are also participating in public housing projects. But to all intents the states may be said not to be in the utility business, nor in any other except on a very minor basis.⁴⁷

There are various minor instances of commercial enterprise carried on by state governments in competition with private business. Most important, though rapidly declining, is the sale in open markets of prison-made goods. Most other examples represent activities which are incidental to other governmental functions, such as operating restaurants or commissaries for the convenience of public employees or inmates of institutions.

Services produced for sale by federal agencies. The commercial activities of the federal government have in the past been held within very narrow boundaries, though in recent years they have shown a marked tendency to expand. The principal tangible commodities manufactured and sold by the federal government in the past have been maps and publications. In one way or another, however, the federal government is involved in a number of other selling activities. For example, it built and now operates the Panama Canal. It has a monopoly upon Alaska fur seal skins. Mostly its selling consists of incidental conveniences, as in the case of restaurants, or else is a matter of disposition of surplus or unwanted supplies accumulated in connection with various government services of self-supply.

The only federal utility service of long standing is the post office. Postal service, the idea of which was inherited from England, was provided for in the Constitution and has been universally accepted through the whole of American history as properly a public monopoly. Two additions in relatively recent years have, however, aroused much opposition from business interests with which they compete: one, the parcel post, the other, postal savings service. The reason for adding these services was the relatively slight additional cost of adding them to the existent postal organization and the great convenience of the service which they afforded.⁴⁸

⁴⁷ In 1932, state expenditures for operation of public service enterprises were only \$6,000,000, or one-fourth of one per cent of all expenditures.

⁴⁸ The post office affords a very striking illustration of the fact, true in some degree of all public service industries, that public ends may exist which are not

The World War provided the occasion for departures from past American practice in the matter of public enterprise. The most striking development was the temporary taking over of the whole responsibility for the management of the railways. Since the railways were returned to private management soon after the war, this left no aftermath in the expansion of public enterprise. The situation developed otherwise in connection with water transportation. The government established barge-line service on the Mississippi River and tributaries which is still operated by the Inland Waterways Corporation. The extensive ship-building activities of the government were liquidated after the war.⁴⁹ The government had on its hands, however, a large number of ships; and, while dismantling or scuttling many and selling others, it has remained in the ocean shipping business (both freight and passenger) ever since. The business is carried on by the Maritime Commission.⁵⁰

One field of federal commercial activity which has had a considerable expansion in recent years is that of the development of water resources. It is the commercial development of hydro-electric power which is the principal point of interest. It seldom, if ever, happens however, that hydro-electric power is dissociated from the pursuit of other objectives such as flood control, national defense, transportation, water supply for irrigation and domestic use, and other purposes which may or may not involve commercial sales.

The principal federal agency engaged in developing water resources is the Bureau of Reclamation, whose initiation of electrical generation projects has developed into a phenomenon of great significance. From administering relatively small and isolated irrigation projects the Bureau leaped into great prominence just after the World War in connection with plans for utilizing the waters of the Colorado River. In the outcome, the Bureau constructed at Boulder Dam the largest electrical generating plant in the United States. It does not itself directly operate the plant, but leases water

reducible to simple principles of commercial calculation. Uniform nation-wide rates for first- and second-class mail and the relative loading of costs against different classes of mail are matters in point, only partly analogous in character to problems in railroad and electrical rail structures.

⁴⁹ This does not apply to naval building, a considerable fraction of which, since the war, has been done in government yards.

⁵⁰ For further discussion, see Chap. XX.

rights under long-term contract to agencies which sell to final consumers.⁵¹ It is of interest to note that it was under the Hoover administration, not under the New Deal, that the federal government first embarked on an extensive program providing for the generation of electrical energy. The more recent Bonneville Project in the Columbia River Basin goes a step further by selling electricity direct to consumers in adjacent territory. The Tennessee Valley Project (not under the Bureau of Reclamation) is a part of the same picture, but since it is specifically dealt with elsewhere in this study⁵² it need not be further treated here.

The development of a federal hydro-electric program illustrates two purposes of entirely different order. One is the desire to develop water resources in a number of different ways, electrical generation being but one part. This purpose antedates the New Deal. The other is the purpose to discipline privately owned public utilities by placing them under pressure of public competition both in generation and in distribution, and to explore the demand for low-priced electricity. This is the distinctive New Deal objective.

As part of this program the federal government has promoted the acquisition or construction of local distributing systems by public agencies and co-operatives. This is accomplished by P.W.A. loans and grants to local government units and by loans of the Rural Electrification Administration. The latter, a lending agency designed primarily to promote the extension of power lines into rural areas, has made its loans mainly to co-operative groups.⁵³ It may also lend indirectly to users of current for the purchase and installation of electrical and plumbing appliances.⁵⁴ The financing of consumer

⁵¹ The largest operator is the city of Los Angeles, which produces for itself and for the Metropolitan Water District, which needs energy for pumping the water supply also made available to the Los Angeles area by Boulder Dam. A minor fraction of the energy is produced by a private company, the Southern California Edison Company.

⁵² See Chap. XXI.

⁵³ As of June 1939, 88.7 per cent of the 621 borrowers of R.E.A. were co-operatives; 7.9 per cent were public bodies; and 3.5 per cent were private utilities. Of the \$223,913,830 lent or earmarked at that date, 91.5 per cent had been set aside for co-operatives, 6.8 per cent for public bodies, and 1.7 per cent for private utility. *Report of Rural Electrification Administration, 1939*, pp. 56-57.

⁵⁴ The usual procedure in equipment loans is to lend to the agency distributing the current, which assigns the notes of those purchasing equipment to R.E.A. as security.

purchases of electrical appliances is the primary function of the Electric Home and Farm Authority. The Authority takes over from dealers conditional sales contracts and acts as a finance company in collecting the installments. Loans of this sort are made only in areas where rates for electricity are regarded as low enough to make the increased operation of electrical appliances feasible among families of average income. To promote the program the Authority has entered into agreements with many manufacturers for reducing prices of appliances. The whole program is part of the broader government plan to increase the use and decrease the price of electricity, particularly to low income groups, and is especially promoted in those areas such as the Tennessee Valley⁵⁵ where the government is itself engaged in the generation of electricity.

Another important activity into which the federal government has entered since 1933 is that of promoting the provision of housing. An original intention of the Public Works Administration was to stimulate low-cost construction by loans to private and local government agencies. When this plan failed to make headway the Housing Division of P.W.A. undertook actual construction, and by 1936 had 50 projects in 35 cities. The administration of these properties is now in the hands of the United States Housing Authority, which plans to relinquish responsibility by leasing or selling the properties to local housing authorities. In the meantime the federal government is a landlord. The primary activity of the United States Housing Authority is, however, to make loans and grants to promote and aid the production of housing facilities by local government units.

Another agency with extensive responsibilities in the housing field is the Farm Security Administration of the Department of Agriculture. In addition to administering four "subsistence homestead" communities, the F.S.A. (originally the Resettlement Administration) has built for sale on easy terms some 4,000 small houses in approximately 200 communities; and has in addition constructed four suburban "greenbelt" communities, including houses, stores, laundries, theaters, schools, and recreational facilities.⁵⁶

⁵⁵ Compare Chap. XXI.

⁵⁶ The business activities in these communities are organized as co-operatives.

Beyond its interest in public housing projects, the federal government has taken an interest in the financing of individual home ownership. In 1932 the Federal Home Loan Bank Board was organized to protect the solvency of private mortgage loan institutions and to stimulate new lending by these private organizations. In 1933 it became the board of directors of the Home Owners Loan Corporation, which was organized to make mortgage loans directly to individual home owners. Inspired by the depression, the new agency's task was to refinance home mortgages on a long-term, low-interest basis in order to prevent foreclosures.⁵⁷ Since loans were largely used to pay off old mortgages, private lending agencies were rescued from the "frozen" state of their assets and were placed in a position to resume new lending. Funds were also advanced, in connection with refinancing loans, to finance reconditioning of buildings and to pay off back taxes.⁵⁸

The Federal Housing Administration engages in activities closely related to the home lending program. Its primary purpose is to stimulate private lending for home construction and modernization by guaranteeing bank loans for repairs and improvements and administering a mutual mortgage insurance fund for mortgages on both new and old homes.

Beyond the home loan program, the government from 1932 on carried on extensive lending activities through the Reconstruction Finance Corporation, the Public Works Administration, the Farm Credit Administration, and other agencies, throwing its resources into the gaps of credit collapse in order to salvage special situations and to stimulate renewed activity. The parts of the lending program devoted to financing private business enterprises (especially railroads, farms, banks, and financial institutions generally) lie outside the present discussion.⁵⁹

⁵⁷ Some of the lending to farmers by the Farm Credit Administration has been rather similar in nature to that of the H.O.L.C. Many loans by the Farm Security Administration, made to special classes of indigent farmers, frankly included amounts for actual subsistence, pending the rehabilitation of the borrowers as producers. At times they faded indistinguishably into relief payments, and indeed some of the outlays were in the form of subsistence grants rather than loans.

⁵⁸ As of June 12, 1936, when new lending ceased, the Home Owners Loan Corporation had made 1,017,827 loans in the aggregate amount of \$3,093,450,641. Federal Home Loan Bank Board, *Seventh Annual Report, 1938-39*, p. 125.

⁵⁹ The general outlines and purposes of the federal lending activities are treated in Vol. 1, Chap. VII of the present study.

As a final item of lending activities one may note the financing of local public works by the Public Works Administration. In addition to the housing and electrical projects mentioned above, loans have been made for the erection of schools and hospitals and for the construction or improvement of highways, bridges, tunnels, and plants for producing such local services as water supply and sewage disposal.⁶⁰ Such lending was undertaken in 1933 to stimulate economic activity, but it has an additional importance in furthering other objectives of the government. After lapsing somewhat in 1937 it was renewed with great vigor in 1938 as part of the "spending" program.

In conclusion it is necessary to mention a broad field of federal production which does not fit into the distinction between government production of free and salable services. This is the production of goods and services incidental to other governmental activities. The controversial importance of this sort of production is that it occurs in fields already occupied by private enterprises and therefore represents an obvious form of government competition. A report to the House of Representatives⁶¹ in 1933 stated that there were some 225 lines of industrial activity in which government agencies competed with private sources of supply. The army, navy, and prisons were shown to be the greatest "offenders," not only in such large matters as operation of naval construction yards, but in the manufacture of uniforms, paint, ship stores, fire-arms, and many other items. Such sundry items as blueprints, brushes, postal bags, laundry service, dredging service, and tabulating machines were produced. In a number of instances actual competition in the open market was involved, as in the case of return envelopes, sporting fire-arms, restaurants, and barge lines.⁶²

⁶⁰ It should be pointed out that Public Works Administration funds for the various purposes stated are not all provided on a loan basis. Public Works Administration is also permitted to make outright grants up to 45 per cent of the cost of a project. Such grants are of course federal subsidies to local services. These are in addition to the amounts spent on local projects under the relief program of the Works Progress Administration. See pp. 1176-77 below.

⁶¹ 72 Cong. 2 sess., *Government Competition with Private Enterprise*, H. rep. 1985 (1933), commonly known as the Shannon Report.

⁶² The whole controversy has been given a new turn under the program of public relief. The direct cost of the program could be somewhat reduced by putting relief clients to work to produce the products needed for relief clients. Little has been

In reviewing the history of public production in the United States, it is of interest to note that production for commercial sale shows no such long and consistent expansion as is the case with the production of free services. Indeed, until the past decade the former was of negligible proportions, with the two exceptions of public water supply and the post office. Should there be any considerable expansion of "public trading" it will come no doubt as the consequence of dissatisfaction with the way in which the public is served by those industries in which the monopolistic elements are strong. It is the relative failure of competition to play the role which is expected of it in a private enterprise economy that breeds the sentiment for a larger public role in commercial production.

But beyond this there are other factors at work, such as a humane interest in housing conditions and emergency factors which have led to the expansion of public lending activities. As a result of the depression, moreover, there has risen a doubt concerning the possibility of private investment in the future in amounts sufficient to meet the needs of relatively full employment. In this doubt, whether justified or not, lies the possible seed of a growth of public enterprise.⁶⁸

IV. SOME FACTORS UNDERLYING THE EXPANSION OF GOVERNMENT PRODUCTION

Public production is so much the center of public controversy that it is worth while to consider further (1) certain general factors which underlie and have resulted from its expansion, and (2) certain relations which it bears to the system of private production. The first of these topics will be dealt with in the present section under a few general headings, and in the interests of brevity the discussion will have to be only suggestive. The second question will be discussed in a later section of this chapter.

Urbanization of population. One hundred years ago the great bulk of the population in this country lived on farms. Today the

done in that direction, partly because of opposition of private enterprises to such competition, partly because of the fear of administrative officials that it might cause loss of employment in private occupations and so create a widening circle of dependence upon public sources of livelihood, and for other reasons. See pp. 1182-84 below.

⁶⁸ For further discussion, see Vol. 1, Chap. VII.

population is only one-quarter rural. The metropolitan communities of 100,000 inhabitants or more, of which there were only 4 in the country a century ago, with about 4 per cent of the total population, now embrace nearly one half of the population.

The propinquity of large numbers of people in a limited area increases both the need for, and the practicability of, public functions that are unnecessary or impossible in a rural community. The concentration of buildings makes the fire hazard a matter of public importance, while it also makes central fire protection possible. It makes economical the supplanting of individual private wells by water mains, and individual waste disposal by sewers and refuse collection. The heavy traffic on city streets offers a powerful incentive for paving. The congestion of population necessitates public sanitation and precautions against the spread of contagious diseases. The lack of convenient access to the open country creates a demand for parks, playgrounds, and other public recreational facilities. With a sizable community to draw on, the educational system can be elaborated and specialized, with vocational training and other features for which there is a demand. While rural areas and small towns are now receiving a great deal more government production than did similar places a century ago, indicating the effects of factors other than urbanization, the influence of the latter has been very strong in presenting the example of services to which lesser communities have come to aspire.

The shift to employee status. Closely related to urbanization is the increasing proportion of the population in the status of employees, owing to the decline in the relative importance of agriculture and the growth of large-scale organization in industry. More than three-fourths of income receivers are now in this status, of whom over 90 per cent are in non-agricultural pursuits.

An important characteristic of the employee status from the present standpoint is insecurity. Self-employers, like farmers or small merchants, while they are by no means immune to personal and business vicissitudes, are less likely to be periodically in need of public assistance than is the industrial wage earner. The phenomenon of mass unemployment has thrown government into the business of unemployment insurance, and into relief activities on a grand

scale.⁶⁴ The influence of the recent depression on these developments is well known.

Insecurity of the aged. In a number of complex ways the conditions of modern employment, including the necessity for a high mobility of labor, have joined with other social factors in undermining the unity of the family, a fact which has contributed to the increased insecurity of the aged. Moreover, as a result of urbanization and other factors the average number of children per family has been steadily declining, with a resultant narrowing of the base of support for the aged. These developments have generated a sentiment for old-age annuities under public auspices, opening up a new field for government activity.⁶⁵

The humanitarian tendency. Whatever the environmental conditions and available means, there still remains a wide latitude of choice as to public services to be rendered. The choices depend upon deep-seated popular attitudes politically expressed. A great many services have stemmed from the general humanitarian movement which developed in the nineteenth century.

The humanitarian interest has focused upon care for the well-being of the defective, the delinquent, and the economically unfortunate. The rise of this interest was first manifested in the mushroom growth of numberless voluntary societies 'to aid this or that group. As sentiment for many of their activities increased, they have been covered into the field of public services.

The process has continued cumulatively, so that a comprehensive list of "welfare" services now adds up to imposing proportions. Moreover, the controlling principle has moved far away from earlier conceptions of "charity" and "benevolence" to one of social obligation; and, while the amelioration of immediate distress has remained an objective, special efforts have increasingly been made on the one hand to aid individuals to overcome their defects and maladjustments, and on the other to remedy the environmental conditions which harbor the seeds of defect.

The widening of suffrage. Certain developments in the political sphere have also promoted and facilitated the broadening and ex-

⁶⁴ See Chaps. XXX, XXXI.

⁶⁵ See Chap. XXXI.

pansion of government production. The first of these is the widening of suffrage.

For many years the right to vote was narrowly restricted in most states by property qualifications. The last century has seen the gradual abandonment of these limitations and the widening of suffrage to include adult citizens generally.⁶⁶ The result has been a growing divergence between the distribution of income and private spending power on the one hand and the distribution of voting power on the other. The latter has approached the goal of equality, while the former has not.

When universal manhood suffrage was first agitated, there was alarm in some circles over the possibilities inherent in the divorce of political from economic power. It was feared that the electorate would seize its opportunity to enjoy the benefit of free government services at the expense of the minority who were favored by a disproportionate ownership of wealth and income. While the more extreme fears of that time have proved unjustified, there can be no doubt that the widening of suffrage has been a factor of profound importance in expanding the scope of government production, particularly "free" production where the distribution of benefits is more equal than the distribution of burdens. Universal suffrage has not, however, led to the catastrophic assaults upon economic inequality anticipated by the gloomy prophecies of a century ago. One very important reason, among others, is no doubt the great increase in general economic productivity, which has permitted popular standards of living to rise and created opportunities for personal advancement.

The changed basis of taxation. The pressure for an increased volume and variety of free government services has been reflected in a search for, and conditioned by the development of, new sources of tax revenue. As was noted above, the simple increase in wealth has made it possible to raise increased revenues from old tax sources. But in addition the tax structure as a whole has been radically trans-

⁶⁶ Something akin to a property qualification survives in a number of states in the form of a poll tax, payment of which is a condition for voting. Moreover, in a considerable number of communities the right to vote on certain special questions relating to taxes and expenditures is still subject to a property qualification of some kind.

formed in the last few decades. Of particular significance is the increasing importance of (1) taxes that concentrate the tax load on the well-to-do minority of the population, and (2) taxes which, although of more general incidence, are so indirect as to create little awareness of the burdens involved.

So long as the general property tax supplied the great bulk of all government revenues, and ownership of real estate was very widely diffused, there was not much chance for any great expansion of free government production, or of services sold on a subsidized basis, that did not command the substantial support of those sections of the community that provided the money. While the property tax is still the bulwark of most local revenue systems, it has been broadly supplemented by other tax sources, some local but more of them under state and federal administration. The increase of state and federal services, noted above, has moreover brought recourse to a variety of new sources of taxation.

One development has been an increase in the relative importance of indirect taxation of more general incidence, which the masses of the electorate hardly realize they are paying. Such, for example, are special taxes on corporations and other business enterprises, customs duties, excises on the production of particular commodities, and taxes on payrolls (except when expressly deducted from wages). The effect of such taxes on economic inequality is often obscure, and the principal motive for their expansion is not so much the concentration of the ultimate burden as it is the avoidance of taxpayer resistance.

Progressive income taxes (and in a less degree inheritance taxes) have permitted government to tap a huge source of revenue without touching the great majority of the electorate, or even of the property-owning classes. As developed by the federal government, for example, they have affected in most years only 5 to 10 per cent of the income recipients of the country. The significance of this fact from the standpoint of the expansion of free government services is too obvious to need emphasis. Progressive taxation is the most powerful weapon ever developed in this country for the attack on economic inequality, in addition to being a large—potentially very large—source of financing for free public services.

The development of these new revenue devices has given an impetus to centralization in government, for the reason that many of them are unsuited to local administration. An even more fundamental basis for centralization of revenue administration lies in a popular demand for added services without regard for the differing economic resources of different local communities or geographic areas. But centralization in government has not proceeded entirely, or perhaps even primarily, from the collection and administration of revenue. Many of the new services for which there is a demand can themselves best be administered on a non-local basis. State institutions for the defective and for higher education and systems of arterial highways are good examples.

The influence of inertia. In connection with the development of public services, inertia operates in two ways: one to retard their introduction, one to influence the continuance or expansion of those already introduced. As in other social processes, an enlargement of governmental production must overcome the effects of custom and vested interest. Hence, changes and adjustments in public policy tend to lag behind the developments which give rise to them.

The exact scope of public production is always in process of being redefined. The actual services produced by government at any given time include many that are firmly established, and others that may be thought of as marginal, in the sense that the political forces for and against them are about equally balanced. Outside the list of services actually produced there is an indefinitely long list of proposed services that government agencies might produce, and of these some also may be regarded as marginal; that is to say, political forces are approaching a balance on the question of their inclusion or exclusion.

The process of expansion may move glacially for a time, only to be abruptly accelerated by some crisis, such as war or depression. The recent economic cataclysm is a case in point. The last few years have seen an unprecedentedly rapid evolution in the functions and responsibilities of government. Once the ice of tradition begins to break up, the changes that result are not restricted to conditions peculiar to the crisis itself, but cover inevitably a wider area. Latent sentiment for innovations is focused and released.

It is in part because of inertia that new forms of governmental production, once undertaken, are likely to "stick." Also important is the influence of the vested interests that are built up. The social inertia that opposes retrogression is scarcely less significant than the inertia opposing innovation.

The inherent tendency to growth. At an earlier point striking evidence was given of the way in which functions divide and subdivide. The tendency for public services to expand, once they are started, is due to a great many factors, the relative importance of which differs widely in different situations.

One very important factor is, however, worth special mention, namely, the tendency of administrative bureaucracies to strive for their own expansion through an enlargement of their responsibilities is a commonplace to all observers of government. This is seldom due mainly to the desire of the officials to enhance their personal emoluments and prestige, though this motive is often an important factor. It may spring also from a natural, and in itself laudable, desire to do a better job than is possible on the scale currently attempted, or to extend the benefits of the activity to a larger number of people. In any event, as the experience of any legislative body will bear out, the organization set up to administer a government service is likely to prove a source of persistent pressure for larger appropriations and wider responsibilities. In extreme cases it is a direct instigator and mobilizer of outside pressures. In many others it creates outside pressure more indirectly by continuous self-advertising. The evolution of the public school system is a good illustration of the influence of "insiders" on the expansion movement. It has been these professionals, the teachers and administrators, who have supplied the bulk of the drive and leadership in the incessant campaign for more and better education, and have contributed largely to convincing legislative bodies and the public generally of their need.⁶⁷

There is, moreover, typically a let-down of popular resistance once the principle is established that the government should supply a service. The inauguration of the service may be attended by fierce controversy and a complete mobilization of public sentiment for and

⁶⁷ See Cubberley, *Public Education in the U.S.*, Chap. VI, pp. 155-81.

against it, but its subsequent elaboration, if it proceeds in a gradual manner, is unlikely to crystallize at any stage a resistance comparable with that attending its initiation. The small modifications and additions are relatively undramatic, however great their cumulative effect over a period of years.

The situation is thus created in which the bureaucratic organizations in a degree aid and abet the external groups pressing for expansion, as is exemplified by the pressure of automobile associations, motor vehicle manufacturers, road contractors, petroleum companies, and various other interests for the construction of more and more hard-surfaced highway mileage, or by the efforts of war veterans' organizations to obtain more liberal compensation, hospitalization privileges, and the like.

V. THE BASIS OF CHOICE IN DETERMINING THE RANGE OF GOVERNMENT PRODUCTION

The process of determining the scope and nature of public production is a political process, directly carried on by legislative bodies subject, under conditions of popular government, to some control by the electorate. Behind the choices made lies a history of social environment and social attitudes which would have to be explored fully in order to illuminate the processes of political choice. In democratic states individuals and groups are free to exercise political pressure in accordance with their own criteria of what is wise, prudent, or palatable. But they are not free to enforce their standards against the decisions of those who exercise political authority. Nor is it possible to find any definitive, objective standards of what is "in the public interest" in the matter of government production. It is, however, worth while to examine further the problems of choice which are presented, with particular reference to the question whether there is a basis for rational pursuit of public advantage.

When government services are sold on a cost-of-production basis there is likely to be involved an allocation of productive resources and a distribution of product resembling, in a general way, the allocation and distribution which would accompany private production of the same types of goods. If those to whom a government service is made available pay in proportion to the amount consumed, and if they are free to take it or leave it at the offered price, their

decision to forego some consumption of privately produced goods in order to enjoy it may be considered *prima facie* evidence that they reap advantage by the shift according to the private calculus of well-being. The problems of policy involved here are simply those of whether the government should organize commercial production in any particular case instead of leaving it to private enterprise. If only those goods are produced which can profitably be sold in competition with private enterprise, certain limits are placed upon the expansion of public production. The strictly economic comparison is perfectly clear, even though other considerations may have a bearing upon public policy decisions.

The case is less simple, however, when public services, instead of being sold to individuals on a cost-of-production basis, are partially subsidized or distributed free by some rationing system and are paid for by general taxation.⁶⁵ The resemblance to private allocation of resources and distribution of product vanishes. The natural effect is to expand the consumption of the free or subsidized goods apart from the decisions of those who bear the expense, and the absorption of resources in their production alters the flow of the factors.⁶⁶ When one section of the community pays taxes to support free or subsidized services for other sections, or when it is taxed disprop-

⁶⁵ That government distributes goods and services free does not mean, of course, that they are made available to consumers in unlimited quantities. Whenever the demand exceeds the available supply they must be rationed in some way. Services that cannot readily be allocated on an individual basis, like police protection, are restricted by limiting the total amount furnished. Goods or services that can be individualized, school textbooks for example, are restricted by limiting the amount issued to each individual. Both types of restriction may be considered forms of rationing.

⁶⁶ It is easy to assume that the more resources are used in public production the fewer will be available at the moment for private industry. This would always be the case under the hypothesis that all available productive resources were fully utilized. In some considerable degree, also, it is true in actual circumstances. It is, however, a grave error to suppose that public production necessarily involves a diminution of private production. It may or may not do so, depending on circumstances. Free services, like education or public health measures, may over a period of time so increase the productivity of the country's human resources generally as to more than offset the diversion from private production of the resources absorbed in the supplying of these services. Again, the expansion of public production may occur at a time when the volume of human and mechanical resources available to private industry exceeds the current utilization, so that the increased absorption of such resources by government may for the moment have no restrictive effect on private activity. Indeed, it may be temporarily stimulative. See Vol. 1, Chap. VII.

portionately for such benefits, there arises the question of whether the community as a whole gains more from such services than it loses through a curtailment of its ability to purchase the products of private industry, or through any other losses in private efficiency or individual freedom which may result. There is also involved the further problem of weighing one man's net gain against another's net loss and the community's gain against individual sacrifices.⁷⁰

The benefits from many fundamental government services, such as national defense, the preservation of law and order, and the maintenance of public health are so widely diffused and so impossible of allocation to particular individuals as to make any weighing of individual gains and losses quite out of the question. The benefit is essentially social and indivisible. Even in the case of services like public education, which are technically capable of measurement in individual terms, the element of diffused social benefit is so large as to obscure the calculus of individual advantage. It is only when indirect and diffused benefits are relatively unimportant that we can possibly weigh the net gain of one person or section of the community against the net loss of another person or section, and even here no satisfactory calculus exists.

If a proposed government service is of a type that permits appraisal in terms of individual advantage it may be contended, in harmony with democratic principles, that approval by a majority of the electorate is proof of a net social gain from the service. This contention, however, assumes at least that the individuals composing the majority are informed as to the cost and the benefit to them of the government production in question. In practice, the voter rarely knows the extent of his own burden incident to any class of free government production, and he often finds it impossible to appraise his benefit. It is not the taxes that people pay that influence their choice of alternatives in this case but only the taxes that they realize they are paying. And there may be many indirect burdens involved unrelated to taxation, which may also be difficult to assess or to allocate. With the present elaboration of taxes that are

⁷⁰ It should be noted that, strictly speaking, these losses and gains are not directly comparable.

painless to the masses of the population a rational choice is often quite impossible. Where some proposed extension of government production is financed by these taxes the cards are stacked in its favor.

In most cases, proposed new services are not identified with any particular source of tax revenue, so that the voter must weigh his presumed benefit against an increase in his individual tax burden that is completely incalculable. Like other increases in public expenditure, the one in question will necessitate, eventually at least, an increased yield somewhere in the tax system, but where this will be derived from cannot satisfactorily be predicted. Even if taxes were entirely of the direct and visible variety, like real estate or income taxes, this uncertainty as to how a new government service is going to be financed would preclude a valid prejudgment of individual advantage. With the prevalence of indirect and "painless" taxes, one uncertainty is added to another. Uncertainty is aggravated by the fact that new government production is frequently financed in the first instance by long-term borrowing, repayment of which extends over a period of years.

It is not only the individual tax burden that defies measurement; the individual benefit to be derived from the public provision of a service is often difficult to appraise even if the service be of the kind that can be individualized, and even if the element of diffused benefit be ignored. The average person is probably a more competent judge of the products of private industry that come within his experience than he is of projects for collective action. He can decide between a new automobile and a trip abroad, or between a cup of coffee and a cup of tea, with a reasonably intelligent pre-vision of their relative benefits; but when he attempts to weigh his probable gains from a four-lane highway or a new national park, let us say, he is on a much more shaky footing. The difference lies in the greater difficulty of determining the precise benefits of government production. This difficulty in judging individual self-interest is a very significant defect in the process by which extensions of public production are decided upon, even if we accept the net advantage of a majority of the electorate as an adequate criterion of the public interest—which it may not always be.

There is in free public production,⁷¹ moreover, an inevitable regimentation of expenditure and consumption not inherent in most forms of private production, or even in government production for sale on a cost-of-production basis. This regimentation is clearly justifiable (once the productive superiority of government and the essentiality of the service are established) in cases where the advantages flowing from public production are so general, and so widely diffused, that they do not readily admit of allocation to particular individuals, or where the service is not in such form as to be easily salable to individuals (police protection, sanitation, and public health measures may be cited), or where, although allocable in part, the advantages are also very widely diffused (public education). A very large share of public production now current falls within these categories. When, however, new public services of the individualized type now being supplied through private production and purchase are being considered, the element of regimentation may be regarded as a definite defect of free government production, except in so far as some decided public advantage in the free distribution of a service can be determined to exist. There can be little doubt that in so far as benefits are reasonably separable and identifiable individually, the product separately salable, and no social advantages inhere in a wider consumption than can privately be afforded, the mechanism of choice by which private production is controlled has decided advantages as a mechanism over that controlling public production of free services. This is because it permits each individual not only to weigh particular costs but also to consume what he thinks he wants, if he can afford it, and to pay in proportion to his consumption, without organized regimentation of other individuals.

The drift toward the public production of free or highly subsidized services readily susceptible of distribution on a price basis has come not primarily because of inherent defects in the mechanism

⁷¹ Free public production, it should be noted, implies not only free distribution, but also government production. The factors bringing about one need not necessarily bring about the other. Free distribution of a service may be carried on by government, even though the service is privately produced—or individuals may merely be given the funds with which to purchase a privately produced and distributed service.

of choice by which the products of private industry are distributed, or in the productive mechanism of private enterprise, but rather because of the unequal distribution of the purchasing power through which it operates. This is well illustrated by the existence of public recreation facilities and by the current agitation in behalf of "socialized medicine." If the ability to pay for medical services were distributed with even approximate equality, most of the incentive for subsidizing them from tax revenues would at once disappear. The proposal to supply them wholly or partially free to the low income groups is clearly an attempt to redress the effects of inequality in financial capacity.⁷³

To the preceding points which challenge the adequacy of the simple test of majority will as a criterion of the general welfare,⁷⁴ we must add from a practical viewpoint the fact that extensions of government production do not always reflect the wish of a majority. A majority opinion may not exist; or legislators may be ignorant of it; or even when they correctly sense it they may disregard it in favor of minority pressure groups whose potency at the next election promises to outweigh the consequences of such disregard. Everyone is familiar with instances where minorities have traded support for each other's positions to constitute legislative majorities for or against proposed public services when these majorities had no reflection in popular sentiment.

With respect to the great bulk of public services there exists little controversy, since they constitute many of the most prized elements of "real income." But choices are constantly being made by legislative bodies along the borderline of new extensions, and it is here that controversy reigns.

Legislative choices raise very delicate questions of the proper basis for allocating public funds as between the alternative claims

⁷³ Even if income distribution were equal, public sentiment would doubtless support some governmental control over individual choice in the consumption of medical services, on the ground that the public interest required the maintenance of certain minimum standards. Thus, for example, a certain standard of medical care for children might be enforced on the parents. Given income equality, however, it would not be necessary to make the stipulated medical services free in order to make them compulsory, since everyone would presumably be able to buy the amount required.

⁷⁴ See Vol. 1, Chap. II for comment on minority interests in a democracy.

of various benefiting groups, and of levying the costs among those who supply the funds. The criteria of judgment in such matters are highly personal, which makes inevitable the clamant pressure of special groups representing conflicting interests, ideals, and judgments of relative importance.

VI. THE RELATIONSHIP OF PUBLIC TO PRIVATE PRODUCTION

There is a decided difference in the economic basis of public production for free distribution and for sale, respectively, and in the relation of the two types of public production to the private enterprise system. Each will therefore be examined separately.

Free services. The collection and expenditure of public revenues is an integral part of the whole process of economic production and distribution. From the standpoint of a whole community no economic services can be called free. Government agencies must secure from somewhere the wherewithal to go into the market and purchase either the products of private industry or the labor and supplies which are to be converted into services. The services are "free" only in the sense that they are free to the user at the time of use and that there is no correlation between the extent of individual use and individual contributions to defraying the costs of production.

When public production is supported by tax revenues, there occurs, in addition to some displacement or curtailment of private enterprise, an increased tax load upon those engaged in private industry.⁷⁴ Even if the free public services are provided entirely through the distribution of the finished products of private industry—and hence involve no net curtailment of private production except to a limited extent in the distributive lines—the taxes required to finance it necessarily constitute a burden on some private activity.⁷⁵

It may seem at first glance that so long as government uses its

⁷⁴ This is true even if those engaged in the public production bear their proportional share of the tax load.

⁷⁵ The fact that no net curtailment of private production (aside from distributive lines) would be involved does not mean an absence of contraction and expansion in individual lines. To the extent that the free products rationed out by government differed from the products that would have been purchased otherwise by the taxpayers who finance the free distribution, there would result inevitably a responsive transformation of the pattern of production.

tax revenues to purchase the products of private industry for free distribution, industry gets back what it gives, hence on balance cannot suffer from the arrangement. The government in such cases simply substitutes itself for its citizens as the purchaser of goods and services. Why then can it not go on indefinitely increasing taxes on the one hand and rationing out free goods on the other? The answer to this question is to be found in an analysis of the effects of such a bilateral expansion of taxes and free distribution on the motivation of private enterprise.

The nature of the possible impairment of economic efficiency through increased taxation and free distribution of services must be examined from two angles: that of the recipients of services and that of the payer of taxes.

If the goods and services distributed free by government from the proceeds of taxation were rationed out to individuals in proportion to their tax payments, taxes might conceivably absorb their entire incomes without reducing their incentive to maintain and enlarge them. But this principle of distribution, even if it could be followed, would run counter to one of the main purposes of modern taxation, which is to make benefits independent of burdens. If benefits were to be proportional to tax payments it would appear to be better, except in the case of the public services that cannot be individualized, to let the taxpayers keep their money and decide for themselves what they would do with it. There is little point to the free distribution of goods and services that can be individualized except as this makes possible a divorce of individual benefits from individual tax contributions.⁶

Should the free or subsidized services provided by government be distributed on any bases other than in proportion to taxation, there may result an impairment of the incentive to gainful effort. This would arise not only from the decline in the proportion of the income of some individuals that would be left for their own use after taxes but also from the expansion of the volume and variety of free consumption that would be supplied to other individuals

⁶ Even if it were desirable for government agencies to produce the individualized goods and services, these could be sold at cost rather than supported by taxation, and would be so sold except for the desire to distribute them without regard to individual financial contributions.

without regard to their efforts. Taxes without compensating benefits would be the deterrent force in one instance, benefits without compensating sacrifice in the other.⁷⁷

That the dissociation of individual consumption from individual productive effort inherent in the development of free tax-financed distribution has not had as yet notably adverse consequences on individual initiative may be attributed to the relatively minor coverage of such distribution to date. Unless he "gets on relief," no one can live on the free goods now available. Moreover, to supply these goods on the present scale, it is not necessary to tax so heavily as to destroy generally the incentive to work for the expansion of what is left of income after taxes.

When the possible deterrent effects of taxes are examined more closely, it appears that different taxes would operate in different ways. If all taxes were levied against individual incomes and none against business enterprise, an increased tax would diminish purchases from some existing enterprises, but, as taxes were expended, would increase purchases from other enterprises. There would be a temporary disturbance with damage to some business during a period of readjustment, but no necessary long-run diminution of productive activity unless taxes were so high that individuals were discouraged from engaging in the productive activities whence they derived their incomes.

If on the other hand all taxes were levied against business enterprises, effects of diverse sorts could arise according to the form of tax and the possibilities of shifting it to some one else. If shifted to individuals in the form of higher prices, it may diminish the purchases of those commodities, and increase the sale of the ones supported by taxation. Even if the tax cannot be shifted, the result may be the same. There is an increase in the costs of doing business with no offsetting increase of revenue to the payer. This will likely di-

⁷⁷ It is safe to say that such a bilateral impairment of incentive if carried far enough would be fatal to the successful operation of any type of economic organization. Some tie-up between effort and reward is necessary, human nature being what it is, no matter who owns and controls the productive mechanism. The only alternative is to substitute fear and punishment for hope and rewards, incentives which are incompatible with private enterprise as we know it, if not with successful collectivism.

minish production at some points by reason of the insolvency of marginal producers, and bring about a rise of prices, but as in the preceding case with some increase of production of whatever the tax revenues are spent for directly and indirectly.

Up to some point, therefore, it is to be said that the effect of increased taxes on business is merely a temporary disturbance,⁷⁶ not a fundamental deterrent to productive enterprise. How far the correlative expansion of taxation and free distribution could go without seriously undermining the vitality of private enterprise and individual effort one cannot say. It might be possible to advance far beyond the present horizon if taxation were so ordered as to minimize its depressing effects on the willingness to engage in business, and if the free goods dispensed were such as would not weaken seriously the willingness to work for goods that are not free. It is necessary, however, to recognize the dangers inherent in the development of the trend toward tax-supported free distribution. Clearly fatal to private enterprise when carried to extreme limits, it may sap the vitality and effectiveness of the system long before those limits are reached.

We may summarize by saying that, while the expansion of government production tends to curtail private production through the absorption of resources that would otherwise be available to it, the expansion of the free public distribution of privately produced goods tends to reduce private activity only in so far as it weakens the vitality of the incentives that activate private production through seriously diminishing the prospects of profit or the need for personal effort or both.

Production for sale. Production of "free" services paid out of tax revenues from private sources is subject, as was seen above, to fiscal limitations. But in the case of unsubsidized public production for commercial sale the same limitation does not hold. When government itself engages in business enterprise, its costs are defrayed out of the proceeds of sales like those of any other business enter-

⁷⁶ The whole analysis can be reversed. If taxes were reduced by one-half, many businesses would be benefited thereby in the form of lower costs and increased sales. But many other businesses, those that had been the direct or indirect recipients of expended taxes, would be damaged.

prise. Consequently, there lies before government a relatively unlimited area within which it might engage in enterprise, if the political forces which guide policy were so to dictate.

In the matter of political motivation, the reasons for introducing public production for sale have historically been in some respects not unlike those already noted in connection with free services. That is to say, there have arisen strongly felt needs or desires for services which either are not produced under private enterprise or if produced are felt to be inadequate or discriminatory by popular standards, or inefficiently produced. This sentiment may arise especially in cases where services can be made quickly or more broadly available only by some compromising of the strict business principle of cost-covering sales and thus involving the use of subsidies.

If government possesses a superior efficiency in production, as, for example, in national defense, there may be a clear case for its undertaking productive enterprise. However, if the purpose is merely to popularize a service by subsidy there is no necessary need for direct public production. There exists the option of subsidizing private enterprise. There have been plenty of examples of the latter in American experience, of which a notable instance was that of subsidizing private companies for railroad building; and the practice has also been applied to the provision of concerts and school lunches. The choice to operate subsidized production by public agencies thus involves various considerations of economy, convenience, and quality of service. Concerning these considerations it is impossible to say much in a general way, since they are always relative to particular circumstances.

A great deal of our semi-commercial public production has originated on special occasions like war or economic emergency and has been continued beyond those periods. At present the major lines of controversy center about the question whether government production should be extended to industries of a monopolistic character. Industries of this type raise peculiar difficulties of policy in an environment where competitive organization is regarded as desirable. Since private monopolization of important services is regarded as highly dangerous to the public interest, the decision in practice lies between subjecting these industries to detailed public regulation

and the undertaking of public enterprise. There is a perpetual frontier of controversy over which of these alternatives is preferable in relation to particular services in particular circumstances.

The advance of public operation in the monopolized industries has been limited by the fact that they have grown up in private hands. Given the desire for experiments in public production, the difficulties of transfer from one system to the other attain the highest present importance. In this connection, Supreme Court interpretation of "due process" in relation to property values acts as a deterrent to the public acquisition of privately owned utility properties. It is this combination of circumstances which encourages public competition as an adjunct to regulation. The device of competition, being inappropriate as a principle of organization in the regulated monopoly industries, can only be regarded as a matter of temporary strategy. Meantime its introduction involves uncertainties in the future status of private companies and thus tends to retard private investment. One of the considerations which has to be faced is whether long-run advantages will accrue which justify these short-run disturbances. Such considerations are of especial contemporary importance in relation to electricity. No definitive answer is possible short of the culmination of actual experiments. Just over the frontier of actual present experiment lie a number of bitterly controversial proposals for further federal entrance into commercial production—for example, in the public utility and railway fields.

Government competition with monopolized private enterprise has been suggested for other industries than those subjected to public regulation as monopolies. The proposal, stemming from a sense of the relative failure of anti-trust law policy,¹⁹ is that government agencies should be set up to operate competing manufacturing plants in those industries in which monopolistic elements are strong, with the purpose of keeping prices down and employment up. The first question which such a proposal raises is whether in fact plants so operated could attain a competitive level of costs and actually reduce prices on a basis of strictly business competition. There is no *a priori* reason why this would or would not be the outcome. Whether in fact the result would be achieved would depend upon the same man-

¹⁹ Anti-trust policy is treated at some length in Vol. 1, Chap. X.

agerial qualities which determine the success or failure of private industrial managements. The extent to which government could organize businesses capable of operating successfully in the fields of competitive industry is something upon which past experience in this country throws little light.

An important question which arises in connection with such proposals is the effect upon private investment and industrial experimentation, not only in a particular industry to which public competition was being applied, but also in other industries to which it might be extended. There is no doubt that the short-run effect would be damaging to vested interests and deterrent to private investment and initiative; but whether the long-run outcome might be a more adequate implementation of competitive organization, with little fundamental alteration of the outlines of economic society, is a question which experience alone could determine. This would depend a great deal on the policies followed by public businesses, and the frequency of change in such policies. Public competition outside the utility field is, however, one of the less active subjects of controversy, since there appear to be hardly any publicly felt burdens sufficiently pressing to overcome the common American attitude that it is the function of government to facilitate a satisfactory organization of the means of livelihood, and not to engage in commercial production directly.

It is, however, impossible in these times, when private employments are not available to millions of persons, to avoid serious consideration of the question whether, by an expansion of its activities, government could provide a permanent alleviation of this condition. There exists a hypothesis popular in some quarters that relatively full employment has been made possible in the modern world only by the large volume of new investment; that such investment by private persons has probably undergone a permanent shrinkage; and that the void must be filled by public investment. The hypothesis itself is subject to question. There is, however, no doubt that if the rate of new private investment does not recover there will for a time continue to exist serious structural maladjustments in the economy. Equally beyond doubt is the fact that governmental attempts to fill the void by feats of enterprise might undermine the

private sector of the economy and aggravate the disease it was attempting to cure. Consequently, it is necessary, if government action should seem to be required to supplement the sources of livelihood provided by private industry, that its further entrance into investment activities and public enterprise, to avoid disastrous consequences, be conducted with the utmost caution and all possible intelligence.

VII. CONCLUSION

The foregoing discussion has presented a brief picture of the growth and scope of public services in the United States, some of the more general factors underlying that growth, the main characteristics of the process of choice by which government production is decided upon, and some general aspects of the relation of public to private production. It has not attempted to appraise the developments, nor to say whether the evolution of the public services has been carried too far, either in general or in particular. The latter task is hardly one which could be attempted here. It would require an elaborate and detailed examination of particular branches of services, of the repercussions of public upon private economic activities, and of the consequences of fiscal practices, a task quite impossible in the present context.

It is futile to discuss the question whether in general the public gets more for its money from private or from government production. There is obviously a need for both types of production. The only real issues are presented on the borderline of controversy between the two fields, where public opinion has not yet clearly crystallized for or against the production of a particular class of goods or service under public auspices. There is no calculus by which we can definitely prove in these cases that a contemplated extension of government production is or is not in the social interest. The verdict rests in part on knowledge of which we cannot be certain, and it inevitably depends, moreover, on individual judgment, and on the summation of individual judgments represented by public opinion.

Since public representatives in fact decide (whether wisely or unwisely) upon the extension or contraction of public services, it is essential, as we have already said, that so far as possible the public

be made aware not only of the benefits expected but of the size and distribution of the accompanying burdens. In view of the fact that in most cases the voters decide on particular extensions of the public services with only the haziest notions of the relationship between their individual burdens and benefits, and the further fact that mistakes are difficult to liquidate because of the vested interests they build up, it must be apparent that the will of the majority is no guarantee of the wisdom of policies adopted.

There is another reason for this inference. Because the question of the expansion of the role of government necessarily comes up for consideration as a series of separate individual cases, to be evaluated on their real or supposed merits, the trees are judged but never the forest. The cumulative effects of thousands of such particularistic decisions do not get into the calculations. Yet they may be in the end of tremendous importance. Thus, for example, the growth in the powers and responsibilities of government occurring through the process of piecemeal addition may necessitate changes in its structure, and in its relationship to its citizens, that would have been regarded with acute disfavor had they been contemplated at the time particular cases were being decided.

In the process of expanding public services these various implications are not in practice always fully considered. As in most human affairs, a relatively opportunistic viewpoint is the prevailing one, and almost necessarily so. If the immediate, concrete advantages of a particular extension of government production are difficult to judge, how much more so are the long-run consequences of thousands of extensions. The instinct of the practical man is to stick to the case in hand and leave the remote implications to fate. But no one should doubt that the more remote implications deserve serious consideration, or suppose that the particularistic approach provides an adequate rationale of public policy.

CHAPTER XXX

PUBLIC RELIEF

The giving of relief to persons with insufficient private means of subsistence has become in recent years one of the principal forms of government economic activity.¹ So important is it, both in itself and in its repercussions on private industry, that it deserves special consideration in the present discussion. Let us present first a brief statement of the development of public relief policy.

I. THE EVOLUTION OF RELIEF POLICY

In practically all western countries until quite recent times the care of the indigent was carried out on a local basis mainly of ecclesiastical support and private charity. England is the only country with a long history of national legislation on the subject. The Elizabethan Poor Law of 1601 "definitely recognized the responsibility of the state for its dependent classes by the provision that each parish levy a rate, or tax, for such relief to be collected by overseers of the poor appointed by the justice of the peace." It attempted, moreover, "to classify dependents and to provide specific treatment suitable to the needs of each group—work for the able-bodied poor, almshouse care for the infirm and apprenticeship for children."² This act, with some of its subsequent modifications, served as the basis for early American practice.³ Chronic indigence

¹ In addition to published documents cited in this chapter, invaluable assistance was afforded by many persons who made available both unpublished documents and their personal knowledge. A special debt is owed to Mr. Paul Webbink of the Committee on Social Security of the Social Science Research Council, whose critical reading of the manuscript aided in removing various small errors of fact and defects of emphasis. He is not, however, to be regarded as in any respect responsible for opinions expressed.

² C. W. Pipkin, "Poor Laws," *Encyclopaedia of the Social Sciences* (1934), Vol. 12, p. 231.

³ In the early eighteenth century the "work-house" system was made general in England, all classes of paupers being cared for in single institutions. In 1782, when chronic unemployment was increasing because of great economic dislocations, outdoor relief for the able-bodied was provided, and in 1795 the Speenhamland

in the United States has until recent years been relatively slight and its relief has been placed almost wholly on a local basis and to a considerable degree on a basis of private charity. In public relief measures, the penalization of vagrants and the "work-house test," which have commonly been followed until quite recent years, reflect the early English origins of American policy. In most American communities, outdoor (non-institutional) relief has been granted very charily by public authorities. Public institutional relief until the present century consisted mainly of the almshouse or "poor-farm" where were gathered a miscellaneous company composed of old people, cripples, and mental incompetents. The poor-farm declined in importance as state governments took over greater responsibility for defectives, caring for them in state institutions.

In most American communities, institutionalized relief has been anathema to all but the most helpless or depraved. Going to the poor-farm has been the last step downward, resisted to the end by all persons affected by prevailing canons of self-respect.⁴ Even non-institutional relief has been almost equally resisted. There has been a general attitude that in this "land of opportunity" only the incompetent and the degraded could be without personal means of livelihood—an attitude held not merely by the well-to-do but by all classes of society.

During the past century there has been an extensive development of so-called categorical relief—that is, aid to certain classes or categories of needy persons as distinguished from those who would receive assistance under the general relief laws. The federal government and many states made provision for dependent veterans

Act introduced the highly questionable policy of supplementing private wage payments below a certain level, which is said by some historians to have had the effect of making semi-paupers of a considerable fraction of workers. In 1834 the work-house system was resumed, with greatly improved administration, but expressing on the whole a punitive policy of penalizing vagrancy and a negative philosophy concerning the hazards of economic insecurity. In the present century, institutional care of dependents has continued, with a more humanitarian attention to isolating them into categories; but the more striking efforts have been the development of unemployment insurance and minimum "outdoor" relief for the unemployed. See Sidney and Beatrice Webb, *English Local Government: English Poor Law History*, Part I (1927), Part II (1929).

⁴In some jurisdictions the names of paupers are still posted. In the past their rights of citizenship and the right to marry were sometimes suspended.

of wars. The first state assistance to the blind was provided by Indiana in 1857, and by 1932 aid was being given in 21 states to approximately 15,000 blind persons.⁵ Attention was focused on the problem of dependent children by the White House Conference on Child Health and Protection in 1909.⁶ Missouri and Illinois passed laws in 1911 to aid children in their own homes by payments to mothers. By 1932, 45 states were granting yearly aid to mothers to provide for about 220,000 children.⁷ In recent years many states have inaugurated categorical assistance to the aged especially in the form of pensions. The first state law providing this was enacted in 1923. By 1932 there were 17 states granting aid to about 82,000 old persons. Except for aid to veterans, federal participation in categorical assistance did not begin until the Social Security Act of 1935. To sum up the status of categorical relief, before the recent depression there was a trend toward state legislation providing relief of certain special categories of dependents, but the numbers reached and the amount of aid rendered were small.

The actual measures for relief of indigency, and the relative amounts spent upon it, varied so greatly from locality to locality that little of a general nature can be said about it. The special problem of relief for those overtaken by industrial unemployment was, perhaps, the part of the relief problem which was given the least attention. In some urban communities the effects of periodic unemployment were cushioned primarily by personal savings, family connections, and private charity.⁸ In others, while considerable sums of public money were spent on public relief, administrative attention to relief of the unemployed was sketchy and marked by much neglect.

⁵ Family Welfare Association of America, *Governmental Relief* (1932), p. 43.

⁶ Russell H. Kurtz, ed., *The Public Assistance Worker* (1938), p. 12.

⁷ Family Welfare Association, *Governmental Relief*, p. 43.

⁸ As late as 1910, 76.4 per cent of relief in New York City was provided from private sources. Ten years later, largely as the result of categorical assistance, public relief had risen to nearly 63 per cent of the total (A. E. Geddes, *Trends in Relief Expenditures 1910-1935*, Works Progress Administration, Research Monograph X (1937), p. 21 ff.). Public relief in general tended to overshadow private, and by 1929 it has been estimated that 76.5 per cent of the relief in 120 urban areas was public. The same, p. 31.

No change of public attitude in the history of the United States has been more spectacular than the change toward relief during the years since 1929. The long continuance of the depression broke down the inhibitions against seeking public relief among the mounting numbers of unemployed. The ordinary resources of local relief agencies were swamped under the new demands upon them. Efforts were made to supplement available funds so that relief could be continued on a local basis. Campaigns were inaugurated to "spread the work," "spruce up," "give a job." Staggered employment with a double force, each on half time, was tried in some cities. Buffalo arranged for each block to hire one man.⁹ Apples and other products to be sold on the streets were furnished to the unemployed and people were urged to buy these products. Some communities furnished restaurants with sanitary containers for food scraps which were then distributed among the unemployed. But none of these plans made any appreciable diminution in the flood of need which the winter of 1930-31 brought forth.

The system of local responsibility clearly was not geared to large-scale relief. In Ohio alone, there were 1,525 local units administering relief, most of which could not afford adequate grants or provide effective administration. Most local governments had relatively inflexible tax systems and declining revenues; many had strict limitations on debt and had exhausted their legal or actual credit. Moreover, the principle of requiring state citizenship and local residence for a minimum period was ill adapted to this day of great mobility of population.¹⁰

Under these conditions local communities turned increasingly to the state governments. The first state to respond was New York with a law enacted in September 1931. New Jersey followed in October of the same year, and thereafter a number of states began extending aid. But the states themselves were not in a position to undertake a rapid expansion of public relief. State tax revenues, after reaching their peak in 1931, declined for the next three years, until increased by the broad extension of liquor, sales, and other taxes. Only ten states could incur debt for relief purposes without

⁹ Joanna C. Colcord and others, *Emergency Work Relief* (1932), p. 247.

¹⁰ Kurtz, *Public Assistance Worker*, p. 25.

submitting the proposal to a referendum or amending their constitutions, always a lengthy process. Moreover, the bond market was decidedly weak; the banks were contracting loans and trying to liquefy their assets, and because of the decline in revenues states could sell their bonds on the open market only at high rates.¹¹ Had the will existed, these fiscal difficulties could no doubt have been overcome more fully than they were. In fact, however, the proportions of the problem grew increasingly ominous and drew the attention of the federal administration.

In October 1930 President Hoover appointed "The President's Emergency Committee for Employment." The purpose of this committee was merely to furnish states with information concerning the experience of other states dealing with unemployment. In August 1931 a new committee, "The President's Organization on Unemployment Relief," was formed to encourage local and state action without committing the federal government to financial aid.¹²

The first actual federal aid came when in March 1932 the President authorized the Grain and Cotton Stabilization Corporation¹³ to distribute government-owned wheat to the American Red Cross for distribution to the needy. On July 5 the distribution of cotton was authorized. In July 1932 the Emergency Relief and Construction Act appropriated 300 million dollars to be advanced by the Reconstruction Finance Corporation to state and local governments, of which the advances to the states were to be recovered by deductions from future federal-aid highway grants. Municipalities receiving advances made separate provision for repayment. In 1934 all repayments were waived, making them in fact outright grants.¹⁴

Up to the end of his administration, in 1933, President Hoover insisted that responsibility for administering a relief program lay entirely with state and local governments and voluntary agencies, and he opposed the outright grant of funds by the federal govern-

¹¹ H. J. Bittermann, *State and Federal Grants-in-Aid* (1938), pp. 150-52.

¹² Harry L. Hopkins, *Spending to Save* (1936), pp. 18, 43 ff.

¹³ This body had been set up in 1929 to remove "surplus" quantities of wheat and cotton from the market pending a readjustment of market prices. Compare Chap. XXIII.

¹⁴ D. S. Watson, "Reconstruction Finance Corporation," in Laszlo Ecker-R, ed., *Financing Relief and Recovery* (1937), p. 375 ff. It is somewhat uncertain to what extent the original advances were regarded as loans.

ment for relief purposes, no matter how administered. The Roosevelt administration took a broader view of federal responsibility. By 1933 conventional attitudes toward the relief problem were rather thoroughly dissolved, so that there was little opposition to the program of action upon which the federal government entered.

With the Federal Emergency Relief Act of May 1933 the federal government accepted a large share of financial responsibility for direct relief.¹⁵ In entering this field it utilized the device of grants-in-aid for which there were well-established precedents, particularly in education and highway construction. The act set aside 500 million dollars to be expended through the states. Half of this was to be made available to the states on a matching basis of one federal dollar to three from all other sources. The rest was a discretionary fund to be granted to those states whose relief needs were so heavy or whose finances so depleted that they could not meet the matching provisions.¹⁶

In apportioning the 500 million dollars, the Relief Administrator at first accepted the *status quo* inherited from the R.F.C. of very unequal payments per capita to various states. This was in some degree justified by the fact that the percentage of families eligible for relief varied from less than 5 per cent in some states to more than 29 per cent in others. In attempting to remedy inequalities the Administration took some account, in addition to relief population, of per capita wealth, income, and tax-paying ability.¹⁷

Though not granted direct control over state and local policies, the Relief Administrator was empowered to take charge in those states where for political or other reasons relief was being administered in an unacceptable manner.¹⁸ Because of this power and the power to withhold grants, month by month, the Federal Emergency Relief Administration came to exercise a very real authority

¹⁵ The first federal relief organization actually to be set up was the Civilian Conservation Corps, formed in April 1933 to give employment to young men from relief families.

¹⁶ 48 Stat. L. 57.

¹⁷ E. A. Williams, "Intergovernmental Relationships under the Emergency Relief Program," *Monthly Report of the Federal Emergency Relief Administration, May 1936*, p. 4.

¹⁸ This was actually done in six states. See "The Assumption of Federal Control of Relief in Certain States," *Monthly Report of the F.E.R.A., April 1935*, p. 27.

over the whole program. Funds were made available for both direct relief and work relief and for various special groups, as is noted below.

In June 1933 came the inauguration of the Public Works Administration. It was not a relief organization in the narrow sense, since employment on construction projects set up under the program was not restricted to workers certified as needing public assistance, and in the consideration of projects attention was given to the probability of their yielding revenue. In a broad sense, however, it was a relief agency, since its objective was the provision of livelihood through the expansion of regular employment, both directly on public works projects and indirectly in the fabrication of materials and equipment. Launched with an original appropriation of \$3,300,000,000, the program provided for the support of state and local projects on a loan and grant basis as well as for federal projects operated by the regular government departments.

The next step in the federal program was the organization of the Federal Surplus Relief Corporation in October 1933 to purchase, process, and distribute "surplus" agricultural and other products. It served at the same time as a part of the program to raise agricultural prices and as a part of the relief program.¹⁹ In November came the inauguration of the Civil Works Administration, the beginning of the large federal program of emergency or "relief" employment.²⁰ The C.W.A. was a wholly federal organization, separate from the F.E.R.A. which continued to operate in conjunction with state and local government agencies. It was liquidated in the spring of 1934. The year 1934 saw the rise of several measures in the interest of special groups, including aid to college students, camps for young women, and an agricultural "adjustment" program which, in the process of its growth, developed more and more relief features.

¹⁹ Doris Carothers, *Chronology of the Federal Emergency Relief Administration May 12, 1933 to December 31, 1935*, Works Progress Administration, Research Monograph VI (1937), p. 21. Compare pp. 1173-74.

²⁰ The first federal work relief projects were started on a small scale under various bureaus of the government during the summer of 1933; for example, mosquito control under the Bureau of Entomology and a building census under the Bureau of Foreign and Domestic Commerce.

In 1935 came the virtual end of the F.E.R.A. The federal government gradually withdrew from the field of direct relief; and grants to the states for this purpose tapered off. The new policy was for the federal administration to assume the primary responsibility for the relief of "employables" through the inauguration of a works program, and for state and local governments to re-assume the whole responsibility for relief of the "unemployables," except in so far as categorical assistance was made available under the Social Security Act of 1935.²¹

A new organization, the Works Progress Administration, was set up under the Emergency Relief Appropriation Act of April 1935 to operate a program of work relief principally under federal administration, though with some financial participation by state and local governments and a large degree of local responsibility for the planning of projects and the certifying of workers.

From this brief chronological display it will be seen that relief policy since the beginning of the depression falls into three phases. From 1929 to 1932 the responsibility was almost wholly state and local, with an increasing assumption of state responsibility for what had theretofore been local functions. From 1932 to 1935 the federal government undertook joint responsibility for most forms of outdoor relief in collaboration with state and local agencies. From 1935 onward the federal government has confined itself to providing employment, returning all responsibility for direct relief to state and local agencies, except for certain categories of assistance under the Social Security Act and the distribution of commodities by the Federal Surplus Commodities Corporation.

²¹ The reorientation of federal relief policy was forcibly stated by President Roosevelt in his message to Congress Jan. 4, 1935. Having said that "work must be found for able-bodied but destitute workers," he then pointed out that the unemployable classes who in the past were dependent on local welfare efforts should again become a local responsibility. "Local responsibility can and will be resumed. . . . There are, however, an additional three and a half million employable people who are on relief. With them the problem is different and the responsibility is different. This group was the victim of a nation-wide depression caused by conditions which were not local but national. The federal government is the only governmental agency with sufficient power and credit to meet this situation." (*The Public Addresses of Franklin D. Roosevelt* (1938), Vol. 4, pp. 20-21.) In practice the line between employables and unemployables has never been clearly defined or followed.

II. DETAILS OF THE RELIEF PROGRAM

Since public relief (excluding categorical relief) now falls largely into two sharply separated parts, direct relief and work relief, correlated with equally sharply separated spheres of public responsibility, the two parts may conveniently be described separately.

A. Direct Relief²³

Direct relief consists of contributions to family support—whether in cash, supplies, orders for goods, rent allowances, or otherwise—for which the recipient makes no return. This was almost the sole form in which non-institutional relief was given before the depression.²³ The actual amount of outdoor family relief by public agencies before that time was relatively small. General relief was almost as much a private as a public function. Many communities had no public agencies for general relief, though private agencies were frequently subsidized from public funds. The rapid transition to public relief during the depression, as well as the great increase in total relief expenditures, is shown in the accompanying table, which shows relief expenditures in 120 cities (in millions of dollars).²⁴

	Public Agencies		Private Agencies	
	Public Funds	Private Funds	Public Funds	Private Funds
1929	32.9	—	0.5	10.3
1930	53.9	—	0.9	16.6
1931	118.1	0.5	5.2	48.9
1932	223.3	6.6	27.8	50.5
1933	389.5	1.4	31.5	26.4

After 1933 the expenditure of public funds through private organizations was negligible.

A fairly sharp difference in the methods of distributing general relief had developed as between public and private agencies. The widely accepted practice among private agencies was to give relief in cash, on the grounds that it aided in the preservation of self-

²³ For data upon the numbers of persons receiving direct relief and upon the costs see the tables on pp. 1195, 1196, and 1198, below.

²⁴ Geddes, *Trends in Relief Expenditures*, p. 38. This report states that in 1929 99.9 per cent of general relief was direct.

²⁵ U. S. Children's Bureau, *Trends in Different Types of Public and Private Relief in Urban Areas, 1929-1935*, Publication No. 237 (1937), p. 9. The 389.5 million dollars of public funds in 1933 excludes C.W.A.

respect and protected a sense of responsibility on the part of the recipients. Public agencies, however, remained unwilling to entrust cash to persons on relief, and dispensed relief almost wholly in kind.²⁵

The latter system was generally adhered to throughout the early part of the depression and led to a great variety of arrangements centering either in a public commissary or in a system of orders on merchants, the latter being much the more common. When applied to large numbers of persons used to managing their own household affairs and resentful of the stigma of pauperism, it occasioned continuous resentment, which indeed was widely shared by the members of relief administrative staffs. Relief in kind not only created a sense of complete dependency, but often in its most distasteful form because it allowed little or no choice in the selection of household commodities. Worst of all, in many communities, was the handling of the housing problem, where failure to make any, or adequate, rent allowances either put relief clients through a series of evictions or placed a special share of the relief burden upon landlords of houses in which they lived.

The change from earlier standards and methods of pauper relief was slow, but in many communities even before F.E.R.A. there had developed a wider scope for the exercise of family responsibility.²⁶

When in 1933 the F.E.R.A. began to administer federal aid to state and local relief programs, the basis of relief, whether direct or work relief, was defined as "budgetary deficiency established after careful investigation."²⁷

Direct relief allowances were made for food, shelter, light, fuel, water, clothing, and medicine, medical supplies, and medical attendance. The shelter allowance was either rent to landlords or tax or mortgage payments for home owners up to the amount of the rent allowance if necessary to prevent foreclosure. Relief could be given directly in kind, or by orders for goods, or in cash. The of-

²⁵ Joanna C. Colcord, *Cash Relief* (1936), pp. 10, 11. The following text relies heavily upon this source.

²⁶ See Mary A. Nicol, "Family Relief Budgets," *Monthly Report of the F.E.R.A.*, June 1936, pp. 141-42.

²⁷ Marie Lane and Francis Steegmuller, *America on Relief* (1938), p. 14.

ficials of F.E.R.A. expressed a preference for cash relief but did not attempt to force it upon local agencies. A number of cities, however, began to experiment with it, and in due course a considerable part of urban relief was put partly or wholly on a cash basis. However, many cities and most smaller communities apparently failed to follow that trend.

A special relief problem arose in the case of transients. One of the conditions commonly imposed by local bodies in granting relief had been the requirement of a stated term of residence in the county. Under federal emergency relief, as the administration was still through state and local agencies, there were large numbers of unemployed who found themselves ineligible for aid because they had been in a community too short a time. The 1933 Emergency Relief Act made special provision for this class of unemployed. The grants earmarked for their care could be spent by the states for camps, shelters, or any sort of care which the officers saw fit to provide.²⁸ The Relief Administrator, however, warned state administrators against subsidizing seasonal industry by supplying migratory workers transportation to their legal residences out of relief funds.²⁹ By the end of 1934, in addition to other forms which transient relief took, over 250 camps for transient men had been established, including several camps with special facilities for tubercular transients and one for the treatment of venereal disease.³⁰ The transient program practically ceased with the end of federal relief grants to the states. The problem now ranks as a very pressing one in some areas, especially on the Pacific Coast, to which many persons have moved after successive droughts in the "dust-bowl" region of the Southwest.³¹

In the spring of 1934 it was decided that, because of special characteristics of the relief problems of rural areas,³² they should be

²⁸ Hopkins, *Spending to Save*, pp. 132-34.

²⁹ Carothers, *Chronology of the F.E.R.A.*, p. 19.

³⁰ Hopkins, *Spending to Save*, pp. 133-35.

³¹ See W. F. Baxter, "Migratory Labor Camps," *Quartermaster Review*, July-August 1937, p. 10 ff.; Paul Taylor, Address before the Commonwealth Club of California, April 15, 1938 (privately printed); and Carey McWilliams, *Factories in the Field* (1939).

³² "The Rural Rehabilitation Program," *Monthly Report of the F.E.R.A.*, August 1935, p. 15.

dealt with through a special rural rehabilitation program, designed to assist destitute farm families to become self-sustaining.⁸³ Activities in this field, which under F.E.R.A. were somewhat sketchy, were greatly expanded after the program was transferred to the newly created Resettlement Administration in 1935. It was later taken over by a successor agency, the Farm Security Administration in the Department of Agriculture. While this program included subsistence grants to some half a million distressed farm families,⁸⁴ especially during the drought year 1934, the farm rehabilitation program laid major emphasis on the granting of small loans to enable farmers to provide needed livestock, implements, and subsistence during the growing season. In so far as such loans were not ultimately repaid, they took on the character of relief. Similarly, a considerable extension of extra-hazardous loans through the Farm Credit Administration brought that agency into the field of relief activities. Relief aspects of the agricultural program (both A.A.A. and F.C.A.) are discussed in Chapter XXIII.

A period of confusion in state and local relief followed the withdrawal of federal support for direct relief in 1935. Some states continued state relief, while others handed the whole responsibility back to the local poor relief authorities.⁸⁵ The situation throughout the country continues to exhibit the most extreme differences of practice, from such highly organized and relatively generous systems of cash relief as exist in Philadelphia and New York, to some communities where no local relief is afforded.⁸⁶ In many states the largest cities are organized on a basis entirely different from the rest of the state.⁸⁷

⁸³ Farmers rendered destitute by natural disasters, such as drought, flood, livestock disease, or insect pests had on numerous occasions in the past been the beneficiaries of special relief acts.

⁸⁴ U. S. Department of Agriculture, "The Rural Relief Problem," Statement by the Secretary of Agriculture before the Special Senate Committee to Investigate Unemployment and Relief, Mar. 11, 1938. 75 Cong. 3 sess., *Unemployment and Relief*, Hearings before a Special (Senate) Committee to Investigate Employment and Relief, pursuant to S. res. 36 (1938), Vol. 2, p. 1128.

⁸⁵ Kutz, *Public Assistance Worker*, pp. 23, 24.

⁸⁶ "Unemployment in 1937," *Fortune Magazine*, October 1937, p. 188B; 76 Cong. 1 sess., *Some Aspects of the Relief Situation in Representative Areas in the United States* (summary of a report prepared by the American Association of Social Workers), S. doc. 80 (1939).

⁸⁷ For example, in June 1938 Chicago distributed 88 per cent of direct relief

Under the present distribution of responsibilities local relief agencies are responsible for certifying the "employables" who are eligible for employment on federal W.P.A. projects. There is little pretense, however, that federal projects really care for all employables on relief, so that the nominal spheres of federal responsibility on the one hand and state and local on the other are somewhat fictitious. There are some gaps between the two spheres of responsibility and in some degree, also, they overlap, employable persons moving back and forth between them. The interrelations are also such that in some cases persons on federal W.P.A. projects may secure extra aid from local relief authorities to complete the accepted budgetary standards.²⁸ Local agencies also in some cases supplement low wages paid by private employers.²⁹ Contrariwise, there are places where the whole provision for relief, if any, consists in federal work projects and "surplus commodities."³⁰

The federal government has not completely withdrawn from direct relief activities. As noted above, the free distribution of "surplus" agricultural commodities, begun in 1932, is still carried on by the Federal Surplus Commodities Corporation. The distribution of commodities is supposed to be based on the principle that the

in cash, while "downstate" the percentage was less than 10. Illinois Emergency Relief Commission, *Monthly Bulletin on Relief Statistics, July 1938*, p. 10.

²⁸ 75 Cong. 3 sess., *Unemployment and Relief*, Vol. 1, p. 624.

²⁹ The same.

³⁰ There never have existed comprehensive sources of information concerning the status of direct relief in states and local communities. Since the end of federal responsibility the subject is more veiled in darkness than before. Information consists of odds and ends from miscellaneous sources. See, for example, "Unemployment in 1937," *Fortune Magazine*, October 1937, p. 99 ff.; *National Municipal Review*, Vol. 27 (1938), pp. 5-38; Ellery Reed, "What Turning Relief Back to the Local Community Meant in Cincinnati," *Social Service Review*, Vol. 12 (1938), pp. 1-20; 75 Cong. 3 sess., *Unemployment and Relief*; American Association of Social Workers, *A Survey of the Current Relief Situation* (1938); the same, *Some Aspects of the Relief Situation in Representative Areas* (1939); *Social Security Bulletin*, November 1938; *Social Work Yearbook* (1939), Part II. Other useful periodicals are: *The Survey*; *Social Work Today*; *The Compass*; *Social Service Review*. See also Committee on Social Security of the Social Science Research Council, *A Selected Bibliography Relating to Suggestions for Research on Problems of Relief* (1939).

Only a few states publish relief statistics at regular intervals. Relatively accurate general statistics are compiled by the Social Security Board, especially the series on "General Relief Operations of Public Agencies in Selected Large Cities," in *Social Security Bulletin*.

commodities are in addition to regular relief grants and not a substitute for any part of the latter, a principle much honored in the breach. The primary purpose of this agency is not relief, but the raising of agricultural prices. Its activities have called for the maintenance of a commissary system and relief-in-kind, methods of relief which are not popular with most relief officials. An enlargement of its activities is forecast by current experiments in distribution through local grocery stores—the so-called stamp plan.⁴¹ Another sphere of federal responsibility is that mentioned above of so-called categorical relief for the aged, the blind, and dependent children. And, finally, there are subsistence grants to farmers through the Farm Security Administration.

For the years 1933-39 it is estimated that general relief cases have averaged about 3 million annually, while the average for work relief was a little over 2½ million.⁴² Since 1937 there has been an extension of categorical relief, mainly to the aged. For the years 1933-39 total payments of relief to general relief clients are estimated at approximately 5.2 billions of dollars, and for categorical relief about 2 billions.⁴³

As should be obvious from the showing above, direct general relief is the "stepchild" of the federal relief program. Except in a limited number of states and localities, those who fall outside the sphere of federal support are least well cared for, if they are cared for at all. This introduces into the whole relief picture a highly discriminatory feature.

B. Work Relief

Early phases. From the beginning of the depression in 1929 the expansion of local relief activities almost always included some measure of emergency employment on the highways, parks, and other public properties. Out of this experience, also, there began to emerge some large well-planned projects. When state aid began to be forthcoming, added funds were made available for work relief as well as for direct relief.

⁴¹ See p. 927.

⁴² See table on p. 1195 below.

⁴³ See table, p. 1198.

The increasing relative importance of work relief may be illustrated by the experience of 120 cities for which data are available. The percentages of total relief expenditures going for this purpose in the years 1929-33 are as follows:⁴⁴

1929	0.1
1930	5.3
1931	21.5
1932	21.4
1933	25.0

When the federal government entered the relief field in 1933, the influence of the F.E.R.A. was used to expand the amount of work relief in local programs.

With the setting up of the C.W.A. in November 1933 the federal government took over for a brief period the primary responsibility for work relief. The plan was to take half those to be employed on these projects (a total of 4 million being planned) from the relief rolls and to draw the other half from the "self-supporting unemployed" not on relief, without applying the means test.⁴⁵ Actually, well over half the employment appears to have been given to persons certified as in need of relief.⁴⁶ In broad outline, the policy of the C.W.A. was to undertake projects only on public property, and to employ day labor rather than workers on contract.⁴⁷ Having been very hastily devised, C.W.A. was marked by rather haphazard planning. The degree of public usefulness of its projects varied largely in accordance with the quality of the advance planning in the various communities where it operated.

After the demise of the short-lived C.W.A., the F.E.R.A. instituted a new emergency work relief program in co-operation with the states, administrative responsibility being largely returned to

⁴⁴ U. S. Children's Bureau, *Trends in Different Types of Public and Private Relief*, p. 10. The percentage for 1933 does not include C.W.A. expenditures, which began in November of that year.

⁴⁵ Geddes, *Trends in Relief Expenditures*, p. 72. The "means test" is proof of a state of destitution as defined for eligibility for public poor relief.

⁴⁶ Hopkins, *Spending to Save*, p. 116.

⁴⁷ Carothers, *Chronology of the F.E.R.A.* The idea of government using force account rather than contract was forwarded by John R. Commons in "A Comparison of Day Labor and Contract System on Municipal Works," *American Federationist*, Vols. 3, 4 (1897-98), *passim*. Compare Hopkins, *Spending to Save*, p. 115.

state and local agencies. The types of projects were of much the same sort as under the C.W.A., but with an increasing diversification to reach various special classes of unemployed. Work relief continued on this basis until the summer of 1935.

The Emergency Relief Appropriation Act was approved in April 1935 to "provide relief, work relief and to increase employment by providing for useful projects."⁴⁸ The appropriation (\$4,880,000,000) thus was used to cover grants for the P.W.A.; for emergency work projects under the Bureau of Public Roads and other federal agencies; and for two new agencies, the Rural Electrification Administration and the Rural Resettlement Administration. Ultimately about fifty federal agencies and bureaus assisted in carrying out the program. Appropriations were not made to specific agencies (with one or two exceptions) but for broad general purposes. Maximum amounts were allocated to each of eight categories, as follows (in millions of dollars):⁴⁹

Highways, roads, streets, and grade crossing elimination	800
Rural rehabilitation and relief in stricken agricultural areas, water conservation and diversion, irrigation and reclamation	500
Rural electrification	100
Housing	450
Assistance for educational, professional, and clerical persons	300
Civilian Conservation Corps	600
Loans and/or grants for self-liquidating projects of public bodies (only 25 per cent of the grant could be used on any one project)	900
Sanitation, prevention of soil erosion or stream pollution, seacoast erosion, reforestation, forestation, flood control, rivers and harbors, and miscellaneous	350

The President was given authority to alter the allocations and to determine the extent to which emergency work was to be organized on a relief or non-relief basis. These same general features have appeared in relief and public works acts of later years.

General aspects of W.P.A. The W.P.A., originally set up without definite scope of activities, quickly evolved into the agency for administering the central program of work relief.⁵⁰ Under this program administrative authority was centered in a federal administra-

⁴⁸ 49 Stat. L. 115.

⁴⁹ The same.

⁵⁰ The expenditures of the W.P.A. for the fiscal years 1935, 1936, and 1937 totalled \$3,204,871,000. See 75 Cong. 3 sess., *Emergency Relief Appropriations Act of 1938 and Public Works Appropriation Act of 1938*, Hearings before the (House) Sub-committee on Appropriations (1938), p. 15.

tor with subordinate officials in states and localities. The states and local government units, though lacking administrative control, were made participants, since they were expected to suggest projects and to participate in the financial support. The W.P.A. could originate projects and carry them out wholly at federal expense, but in practice it has done this only in caring for special classes of workers.⁵¹

The actual work program carried out under the W.P.A. has been designed mainly to provide employment for unskilled labor, and the work has been largely on public property. For the period of the W.P.A. program through June 1939, road work accounted for 38.3 per cent of the total expenditures on all projects. Work on public buildings, recreation grounds, conservation projects, health and sanitation projects, and public utility and transportation plants made up a further 39.3 per cent of the expenditure. "White collar" projects accounted for 12.8 per cent of the expenditure and "goods" projects for 8.0 per cent. Miscellaneous items made up the remaining 1.7 per cent.⁵²

EMPLOYMENT ON PROJECTS OPERATED BY THE W.P.A., CONTINENTAL UNITED STATES, DECEMBER 27, 1939^a

Type of Project	Number of Persons	Percentage of Total
Highways, roads, and streets	903,613	43.7
Public buildings	164,411	7.9
Recreational facilities	125,893	6.1
Publicly owned or operated facilities	208,992	10.1
Airports and airways	23,543	1.1
Conservation	61,672	3.0
Sanitation	36,229	1.8
White-collar—Total	185,516	9.0
Education	29,391	1.4
Recreation	34,646	1.7
State arts program	18,495	0.9
Other white-collar	102,984	5.0
Sewing	169,528	8.2
All other	190,357	9.1
Total	2,069,754	100.0

^a W.P.A., *Statistical Bulletin*, January 1940.

The accompanying table shows the numbers of persons employed by W.P.A. as of December 27, 1939, classified according to types of projects.

⁵¹ Such as actors, musicians, and teachers.

⁵² Information from Work Projects Administration, Division of Statistics, Feb. 28, 1940. Federal funds constituted about 83 per cent of total funds.

In April 1939 a broad administrative reorganization of federal agencies was made by the President. Under this reorganization the Works Progress Administration (with the new title of Work Projects Administration) was made a constituent unit in a new Federal Works Agency.⁵³ At the same time the units of the work relief program relating to youths (the Civilian Conservation Corps and the National Youth Administration) were made units in a new Federal Security Agency.⁵⁴ These administrative changes did not change the nature of the work relief program. The relief act of 1939 did, however, somewhat modify the program in relation to certain special groups, as noted below.

In addition to work relief carried on under federal agencies, the last two or three years have seen the rise of a considerable number of local work relief projects as part of the adjustment to local responsibilities under the legislation of 1935. The evidence is very fragmentary so that it is impossible to give any indication of the magnitude of the development.⁵⁵

Work relief for special groups. Though the great bulk of work relief has been organized for the benefit of ordinary manual workers, the program includes a variety of measures to assist special classes. Some of these can be treated under the headings of (1) white-collar projects, (2) special aid to youths, and (3) goods projects.

1. The so-called white-collar projects have been sponsored by the W.P.A. itself, rather than by state and local agencies, and solely supported from federal funds. In general their purpose has been to provide work of a non-manual character which would permit persons to make use of their prior knowledge and training; and in general the rates of compensation have been well above ordinary

⁵³ Other units brought together under this agency are the Public Roads Administration, the Public Buildings Administration, the United States Housing Authority, and the Public Works Administration. See 76 Cong. 1 sess., *Message from the President Transmitting the First Plan on Government Reorganization*, H. doc. 262 (1939).

⁵⁴ Other units in this agency are the Social Security Board, Office of Education, and Public Health Service.

⁵⁵ See Reed, *Social Service Review*, Vol. 12, pp. 1-20; C. O. Sherrill, "Solving the Relief Problem," *Harvard Business Review*, Vol. 18 (1939), pp. 44-49; "What 'Economy' Means in Pennsylvania," *Social Work Today*, January 1940, pp. 11-14.

relief wages. The variety of such projects is so great that it is not possible to list them, but a few types will be mentioned.

One widely developed type is the research project. Examples are: collection and organization of information relating to assessment for taxation; inventories of real property to improve housing conditions; traffic surveys to reduce accidents; indexing and modernization of vital statistics; health and other scientific research; researches into farm tenantry and co-operatives; and a survey of state trade practice laws. Notable among the research activities has been the National Research Project, which has made a study of recent changes in industrial techniques with a view to discovering what the future employment opportunities are going to be in industry.⁶⁶

A second type consists of projects for artists. This was first begun for painters under the C.W.A. The W.P.A. painters' project is best known for the large number of murals painted for public buildings. The music project has supported many thousands of concerts and undertaken the collection of folk, regional, and other types of native music. The theater project has produced many shows at popular prices, a few of them notably successful. The writers' project has specialized on guide books and historical records.⁶⁷

A third type consists of projects for unemployed teachers. A program of this sort was begun under the F.E.R.A. as early as 1933, and was used to open closed rural schools, conduct adult education classes, operate nursery schools, and so on. Under the W.P.A. since 1935 the educational program has centered on adult education. Special classes for women have covered instruction in cooking, sewing, nutrition, home management, and child care. In effect the W.P.A. stands ready to provide, for almost any organized group which appeals to it, a teacher for almost any subject. Hundreds of thousands of persons have been taught to read and write, and similarly

⁶⁶ A number of agencies co-operated in this project including the National Bureau of Economic Research, the Bureau of Mines, the Department of Agriculture, the Railroad Retirement Board, and the National Resources Committee. (Works Progress Administration, *Report on Progress of the Works Program*, December 1937, pp. 69-74.) This project has published a general study, W.P.A., National Research Project, *Unemployment and Increasing Productivity* (1937), and a number of special studies upon various areas of industry.

⁶⁷ "The Unemployed Arts," *Fortune Magazine*, May 1937, p. 109 ff.

large numbers have had vocational training. Many of the classes have been initiated by organized labor groups.

It was thought that projects of the white-collar type would be much curtailed under the terms of the relief act of June 1939, since all projects had to be sponsored by state or local agencies, which must meet 25 per cent of their cost. But, though good evidence is lacking, it is not clear that this has happened. Local governments have shown more interest in maintaining the white-collar type of project than had been expected. The act specifically brings theater projects to an end.

2. From the beginning the federal relief program gave special attention to the plight of unemployed youths. In fact the first step was the formation of the Civilian Conservation Corps in April 1933, primarily to create work for 250,000 boys and young men (though war veterans were also eligible). The peak of enrollment was 506,000 in August 1935. From 1933 to June 30, 1939 the Corps has given employment to an average of 300,000 men.⁵⁸

Enrollment is for six-month periods and is limited, except for veterans, to those between the ages of 18 and 25. Of the \$30 a month pay, most must be sent to the families of the enrollees, thus lightening the local relief load. The work undertaken has included national and state park development, forest-fire reduction, erosion control, water and wild-life conservation, coal-bed fire suppression, and such emergency work as dikes. The program also has educational features, especially in elementary and vocational subjects. The cost to the end of 1937 was somewhat under 1.9 billions of dollars.⁵⁹

In the summer of 1934, a series of camps for unemployed young women were set up by F.E.R.A., intended to be roughly comparable to C.C.C. camps. A general educational curriculum was offered, including workers' education in social sciences, vocational guidance, training in household management, health education, arts and crafts, and recreation.⁶⁰ The program was continued under the N.Y.A., with work projects for the making of hospital supplies,

⁵⁸ Civilian Conservation Corps, *Annual Report, 1939*, p. 9, and information from the C.C.C.

⁵⁹ 75 Cong. 3 sess., *Unemployment and Relief*, p. 1402.

⁶⁰ Hilda Smith, "Educational Camps for Unemployed Women," *Monthly Report of the F.E.R.A.*, May 1936, pp. 27-33.

Braille materials, and equipment for recreation centers. After its discontinuance in October 1937 resident centers with similar work programs were substituted.⁶¹

Aid to college students was begun in February 1934, with work allotted to give earnings of around \$15 per month. In August 1935, the student aid program was transferred to the new N.Y.A.⁶² Student aid was expanded to include high school students who were members of relief families or who could not otherwise continue in school. Earnings of high school students were limited to \$6 per month. University graduate students were also included, limited to \$40 a month or \$30 on the average during three months.⁶³

The N.Y.A. also provided funds for part-time employment on work projects of young persons between the ages of 18 and 25 years who were not in school. About 96 per cent of the jobs went to persons certified as being in need of relief. Monthly earnings were limited to approximately one-third of the wage schedule on W.P.A. projects.⁶⁴

Other activities of the N.Y.A. are directed toward general assistance to the young. One of these is the vocational guidance and junior placement program, which co-operates with the United States Employment Service. Junior employment services have been set up in many states and cities.⁶⁵ In August 1935 a Federal Committee on Apprentice Training was set up. Several thousand indenture agreements were arranged providing for board, training, and satisfactory wages. Another form of training supported by the N.Y.A. was agriculture and home-making courses, conducted in co-operation with agricultural schools.

3. In the summer of 1934 a considerable number of projects were started with the purpose of putting clients to work producing goods either for themselves or for other relief clients or producing supplies for other work projects. At the outset these were confined principally to gardening and food-canning projects, and to projects

⁶¹ W.P.A., *Report on Progress of the Works Program*, June 1937, p. 67. N.Y.A. Press Release No. 1751, August 1939.

⁶² Carothers, *Chronology of the F.E.R.A.*, pp. 42, 87.

⁶³ W.P.A., *Report on Progress of the Works Program*, June 1937, p. 63.

⁶⁴ The same, p. 64.

⁶⁵ Lane and Steegmuller, *America on Relief*, p. 153.

for the processing of cattle bought from drought areas. Other projects included the manufacture of household equipment, bedding, and clothing, and a wide range of miscellaneous production.⁶⁶ In 1935 these projects were taken over by the W.P.A., but, while many of them have been continued, development in this direction has been very limited. Since late 1935 goods projects have been developed mainly for the employment of women. While there have been many miscellaneous projects such as nursing, serving school lunches, and conducting nursery schools, the activities have centered in sewing rooms, in which over 162,000 women were employed in December 1939,⁶⁷ mainly upon the making of articles of clothing.⁶⁸

Goods projects and private enterprise. Given the existence of a large-scale work relief program, no question is more critical than its relation to the range of activities commonly carried on for profit by private enterprises. During the depression controversy has been raised especially by the so-called goods projects discussed above. The extension of the plan has been urged on the ground that more

⁶⁶ See P. A. Kerr, "Production-for-Use and Distribution in Work Relief Activities," *Monthly Report of the F.E.R.A.*, September 1935, pp. 1-17, and "Industrial and Agricultural Work Relief Projects," *Monthly Labor Review*, Vol. 41 (1935), p. 1497.

⁶⁷ Information from W.P.A.

⁶⁸ In addition to the special work projects described above, the F.E.R.A. in its early days made grants for working capital to so-called self-help co-operatives, under specific authorization of the Emergency Relief Act of 1933. These co-operatives were private voluntary associations for mutual aid. The activities common to most groups were: growing of foodstuffs, canning, fuel-wood cutting, and making of clothing. Other activities included: dairying, butchering, poultry-raising, plumbing, fishing, carpentry; operating bakeries, beauty shops, and cafeterias; making soaps and cosmetics; and doing repair work on such things as automobiles, shoes, and radios. Relief budgets were reduced through these activities. (See Kerr, *Monthly Report of the F.E.R.A.*, September 1935, pp. 13-15.) While receiving federal aid they were not permitted to produce for sale on the open market, a rule which led to much ingenuity in arranging barter deals. (See Carothers, *Chronology of the F.E.R.A.*, pp. 10, 16.) Federal aid to self-help co-operatives ceased with the inauguration of the works program in 1935. The program was, therefore, in effect only from August 1933 to July 1, 1935. During this period, the formation of a total of 176 active associations was reported, with a membership of 14,068. A considerable number of such groups continue to exist without government aid, especially on the West Coast (see "Self-Help Activities of the Unemployed," *Monthly Labor Review*, Vol. 47 (1938), p. 9), but they have not achieved the large place as a substitute for public relief which many persons expected of them a few years ago.

adequate relief could be achieved at lower cost. The basic contention is that it is socially wasteful to use relief labor so largely on projects of a public character when the pressing need is for more and better provisions, clothing, supplies, and housing for the unemployed. This idea is naturally opposed by private enterprises engaged in producing the things which relief labor could be turned to producing. Even though in practice goods projects have been very restricted in scope, the issue raised is important enough to justify a little further discussion.

If the profit interest of private enterprisers were the only objection to what its proponents like to call "production for use," the positive case for such a plan would be very strong. The fact is, however, that there is a whole series of social dangers and limiting factors which dictate an attitude of caution in extending the system. The problem is partly that relief enterprises competing with private enterprises might seriously undermine various areas of the latter, with consequences in temporarily widening the ring of unemployment.

Aside from such dangers, the fact seems to be well established that the primary needs of relief clients—for agricultural products, shelter, and miscellaneous supplies—are, many of them, of a sort which could not be transferred to production by relief workers without an increase in costs. Moreover, the plan, if widely extended, would incite all the strong objections generally raised against the so-called "commissary system" of direct relief, which takes away from relief families almost all responsibility for ordering their family affairs. And it would appear seriously to impair the collateral relief objective of restoring relief clients to private employment. Relief clients do not make up a permanent group which can be effectively organized into a sort of self-supporting communistic relief economy imbedded within the larger private enterprise economy. It is problematical whether competent managers could be induced to stay on such projects. The available equipment would almost necessarily be of relatively obsolete or inefficient types. Moreover, since relief clients are the left-overs from the labor market, it is problematical whether they possess the necessary skills to be assembled entirely by themselves into an efficient working force.

With due regard for these limiting factors, it appears quite possible that a more extensive use of relief labor to supply relief needs might prove desirable if plans were carefully drawn to produce a minimum disturbance to private employment.

If emergency employment is limited by the general rule of minimizing competition with private enterprise, work projects must obviously consist, in the main, of improvements on public property or the expansion of that broad range of services which are typically produced by public agencies. It may properly be assumed that there is an almost unlimited amount of such work which would have some social usefulness; but the longer large-scale work relief is maintained, the more difficult it will become to find non-competitive projects of high grade from the standpoint of need and utility, and the greater will be the temptation to encroach upon the traditional preserves of private production. The temptation may be resisted, but there can be no denying that its existence constitutes a hazard for private industry.

III. EMPLOYMENT CONDITIONS ON WORK RELIEF PROJECTS

A considerable interest attaches to the employment conditions laid down under a work relief program. In the present section, therefore, their development in federal programs will be reviewed and brief comment will be made upon their relation to the private market for labor.

Review of the facts. When the federal government embarked upon a broad program of work relief, it became necessary to define wage and hour policies. It has already been noted that relief payments, both direct and work, under the act of 1933, were based on the principle of "budgetary deficiency." As applied to work relief, this meant that after rates of wages had been set employment was to be given for a sufficient number of hours per week to bring the earnings of individuals up to the amount of money relief they were entitled to.

The policy announced in July 1933 provided: (1) that all work relief wages were to be based on relief needs; (2) that the wage rate was to be a fair rate for the work performed but that the total

compensation was only to cover the budgetary need; (3) allowances were to be on the basis of a day's wages or their equivalent for the hours worked; (4) no discrimination as to race, color, or religion was to operate; and (5) skilled wages were to be paid for skilled work.⁶⁹ No one under 16 years of age could be employed. The minimum wage was set at 30 cents an hour but if the local prevailing wage rate was higher, then that was to be paid. Hours of work were limited to eight per day, 35 per week, and 150 per month for physical labor and eight per day and 40 per week for clerical workers, but in no case was the number of hours' work given to exceed provision for the budgetary needs of the family. It is impossible to give accurate figures on monthly earnings on work relief projects during 1933, though one very rough estimate places the average at about \$15.00.⁷⁰

Under the C.W.A. program in the winter of 1933-34, the regulations governing wage policy provided for a 30-hour week. However, certain exceptions were allowed.⁷¹ Wages were established on the basis of three zones, the minima being:

Zone	Skilled	Unskilled
Southern	\$1.00	\$0.40
Central	1.10	0.45
Northern	1.30	0.50

Exceptions were made for any rates which might be agreed upon by the Bureau of Public Roads and the various state highway de-

⁶⁹ Carothers, *Chronology of the F.E.R.A.*, pp. 6-7.

⁷⁰ Compare Arthur E. Burns, "Work Relief Wage Policies, 1930-1936," *Monthly Report of the F.E.R.A.*, June 1936, pp. 32, 33.

The need was sometimes so great that a worker was given relief and then allowed to work it out on one of the projects. In other cases it would have taken so long to work out the amount which had been received that the relief client was kept on straight relief rather than assigned to a job (Lane and Steegmuller, *America on Relief*, p. 22). But, in general, work relief was an important method of bringing the budgets of the unemployed up to a subsistence level.

⁷¹ One hundred and thirty hours in any one calendar month could be substituted for the 30-hour week requirement when a sufficient amount of labor was not available in the immediate vicinity of the work; work up to eight hours a day or 40 hours a week could be permitted on projects located at points so remote that it was necessary to house laborers in camps or floating plants; and, for the first time an element of security was introduced in the provision allowing time lost because of inclement weather or unavoidable delays in any one week to be made up in the succeeding 20 days.

partments. These rates were commonly 30 cents an hour for unskilled labor.⁷²

As the C.W.A. program developed, prevailing rates, or union rates if higher, were adopted when these exceeded the minimum prescribed. Finally, early in March 1934, the zone system of minimum rates was abandoned entirely, with the substitution of prevailing rates throughout, except for a flat nation-wide minimum of 30 cents an hour.⁷³ Under the regulations existing up to the middle of January 1934, average weekly earnings ranged generally between \$13 and \$15. Thereafter, owing to a prospective exhaustion of funds, the average was cut to between \$11 and \$13.

Relief status was not necessary to secure employment under the C.W.A. program; nor were earnings adjusted by the "budgetary deficiency" principle. When, at the end of C.W.A., the emergency work program was returned to F.E.R.A., relief status was re-established as the basis of employment and budgetary deficiency as the measure of earnings, and the earlier "family wage" was re-established.⁷⁴ From April 1934 through December 1935 the average monthly earnings were \$27.44.⁷⁵

Under the W.P.A., as set up in 1935, the idea of a "security wage" was adopted.⁷⁶ This was a predetermined monthly salary varying in accordance with broad occupational groups, geographic regions, and urban-rural areas within each region. Monthly earnings were to be substantially higher than relief benefits, although for

⁷² Since the initial 400 million dollars of C.W.A. funds was allotted from P.W.A. balances, the payment of P.W.A. minimum wage rates was mandatory while these funds were being used. Burns, *Monthly Report of the F.E.R.A.*, June 1936, p. 32 ff.

⁷³ Special treatment was given "white-collar" labor, which we need not detail.

⁷⁴ The wage policy provided for the prevailing rate in each community for the type of work performed, with a minimum of 30 cents an hour. This minimum was dropped in November 1934 because of the disparity between it and prevailing local rates. Rates in the South were reduced in some cases to as low as 10 cents an hour, with 12½, 15, and 20 cents an hour common. Maximum hours were set at 30 per week and 128 per month with some exceptions to special groups. The average number of hours worked was about 60 per month. Burns, *Monthly Report of the F.E.R.A.*, June 1936, p. 42.

⁷⁵ Computed from Table B-4, the same, p. 43.

⁷⁶ At the outset 90 per cent of all workers were to be certified from the relief rolls and only one member of a family could be employed. (Executive Order No. 7046, May 20, 1935.) Subsequently the percentage was increased to 95 per cent. W.P.A. Administrative Order No. 52, Feb. 20, 1937.

unskilled laborers with large families this was not always the case. In such instances the Administrator was given authority to vary the basic rates within 10 per cent.⁷⁷ There were different rates for each of four occupational groups within four (later three) regions. The variations ran from \$19 to \$55 a month for the unskilled; from \$27 to \$65 for the semi-skilled; from \$35 to \$85 for the skilled; and from \$39 to \$94 for professional and clerical workers.⁷⁸ The yearly average for the country as a whole was to approximate \$600.

The schedule of actual earnings under the W.P.A. went well above the minima, and above the average of former relief benefits.⁷⁹ In June 1936 the average wages on works projects were: unskilled, \$47.00 per month; semi-skilled, \$57.10; skilled, \$76.24; professional, \$85.48. The percentage distribution of workers among the four classes was: 65 per cent, 11 per cent, 12.3 per cent, and 4.4 per cent.⁸⁰ Actual earnings for the first year of W.P.A. averaged very nearly the same as the C.W.A. monthly average and twice the amounts paid for emergency work relief in 1934-35.⁸¹

The original intention of the "security wage" scheme was to get away from the question of hourly wage rates, and to permit an increase in the hours of relief labor without an increase in pay. The early regulations under the W.P.A. simply required a worker to be employed from 120 to 140 hours per month, at the monthly stipend set for his classification and region. The program had barely begun, however, when the clamor from organized labor and others against paying less than prevailing wages on an hourly basis led to a retreat, which soon became a rout. As early as September 1935 the 120-hour monthly minimum was dropped.⁸² In July 1936, all

⁷⁷ "Wages, Hours and Conditions of Employment under the New Works Program," *Monthly Report of the F.E.R.A.*, May 1935, p. 3.

⁷⁸ Subsequently, the minimum was raised by \$7 for the unskilled, and \$3 for other groups. W.P.A., Regulations Relating to Monthly Earnings, Administrative Order No. 62, June 27, 1938.

⁷⁹ In some communities persons with numerous dependents had received local relief higher than the W.P.A. average earnings for unskilled labor.

⁸⁰ "The Works Program at the Beginning of 1937," *Monthly Labor Review*, Vol. 44 (1937), p. 1425. The 7.3 per cent of employees not covered by this distribution were non-security-wage workers.

⁸¹ Burns in *Monthly Report of the F.E.R.A.*, June 1936, p. 53.

⁸² State administrators were authorized to determine hours "as conditions require," still continuing, of course, the same monthly wage. In November an order per-

W.P.A. work was put on an hourly rate basis, as required in the appropriation act of that year, though the schedule of monthly earnings and of maximum hours of work was substantially retained.⁸³

The disinclination of federal authorities to accept even prevailing wage rates where they were exceptionally low, especially for unskilled labor in the rural areas of the South, may be seen in their efforts during the first year and a half of relief activity to maintain a minimum wage. Grants to the states under the first F.E.R.A. program were conditioned on the payment of not less than 30 cents an hour. The C.W.A. operated during most of its life on a 40-cent minimum in the South (45 and 50 cents elsewhere), and during its last few weeks on a flat 30-cent minimum. The emergency work relief program, which followed C.W.A., maintained the 30-cent minimum until November 1934. The security wage set up by the W.P.A. in 1935, while nominally on a monthly basis, had the effect of setting low hourly minima, differentiated by regions and vocational classifications, the lowest, for unskilled labor in the rural South, being about 13.5 cents an hour. This was later increased to 18.5 cents,⁸⁴ and was higher, in many instances, than private wages for the same grade of labor in the same communities.⁸⁵

The relief act passed by Congress in June 1939 ended the practice of paying prevailing wages and reverted to an earlier policy by requiring that workers on relief projects work 130 hours per month for their "security wage." Skilled and semi-skilled workers will thus have to work longer hours for their monthly earnings, and in some cases rates of pay computed on an hourly basis will be cut by more than half.⁸⁶

mitted the exemption of 10 per cent of W.P.A. workers even from the schedule of monthly earnings, if paid prevailing hourly rates. In December this was broadened to cover workers on any project at the discretion of an assistant administrator.

⁸³ Burns, article cited above, p. 52.

⁸⁴ The monthly minimum wage, originally \$19, was raised to \$26. The maximum of working time per month was 140 hours; hence the lowest hourly rate possible was the monthly rate divided by 140.

⁸⁵ The fact that the federal officials attempted to use relief employment as a means of raising private wage standards in the low-wage areas is explicitly stated in Burns, article cited above, p. 55.

⁸⁶ It was against this feature of the act that a number of strikes among skilled trade union W.P.A. workers occurred in July 1939.

The act specified that no distinctions were to be made between regions, except such as were based upon differences in the cost of living. Under the new law the division into three regional areas was continued, but the classification of workers was increased from four to five. The range of monthly compensation for the various groups was set by the Administrator as follows: for unskilled "B," from \$31.20 to \$52.00; for unskilled "A," from \$35.10 to \$57.20; for intermediate, from \$42.90 to \$68.90; for skilled, from \$54.60 to \$89.70; for professional and technical, from \$55.90 to \$94.90.⁸⁷ There is as yet no evidence of what the effect has been on actual earnings in different regions.

Work relief in relation to private employment conditions. There is always danger, in work relief operations, that relief employment will prove sufficiently attractive to certain classes of labor, especially in some geographical areas, to lead them to prefer it to such private employment as is available. This danger is by no means non-existent even in the case of direct relief. Where the allowance is high enough in comparison with the amount that relief clients can earn in private employment, the development of a class of relief "careerists" is inevitable, especially when there exists no adequate machinery for seeing to it that relief is discontinued when suitable employment opportunities are refused.

The attractiveness of relief work as compared with private employment is not shown by a simple comparison of hourly wage rates. Many other factors enter, such as the number of hours of work available, the security and continuity of employment, the character of the work, the character of one's fellow-workers, and the stigma of being on relief. Only a detailed study of local situations would permit an informed opinion upon the numbers of those on work relief who prefer their present employment to private employment at the going local rates for their kinds of skill. Certain general observations may, however, be made.

So long as there are on relief work many workers who prefer private employment at prevailing rates, the existence of some work relief careerists has small effect upon the private labor market,

⁸⁷ W.P.A., General Order No. 1, Aug. 15, 1939. For comparison with earlier schedules, see p. 1187.

but there may be important effects on the supply of specific types of workers, particularly seasonal and casual laborers and odd-job men. The possible consequences would become more important if private employment were to reabsorb large numbers of workers. Unless the would-be work relief careerists were then forced into private employment, either by removal from the rolls or by a reduction of the relative attractiveness of relief work, the private labor market would suffer from artificial scarcity at a time when there was really a surplus. Moreover, it is likely that as re-employment progresses the work relief rolls will accumulate a residuum of less and less competent and desirable workers, for whom the "prevailing wage," if it were to be restored, would be well above what private employers would be able or willing to pay them. In these circumstances, the existence of work relief may constitute a real bar to the absorption of unemployed labor in private industry.

The attempt to employ work relief wages as a means of creating an artificial scarcity in the private labor market, in order to force up private wage rates, must be regarded in any circumstances as a doubtful proceeding. If the country is to follow a general minimum wage policy it would seem better to do so directly, rather than through controlling the competition of the unemployed at the administrative discretion of relief officials. Even when minimum wages are adopted for private industry, it need not follow that they should invariably be paid for relief work. In fact they should as a rule not be paid when they effectively restrict the amount of labor available for private employment.

The relation of work relief to the private labor market would be much clearer if it could be determined how long relief workers remained on the relief rolls. Unfortunately there are almost no data on this point, nor on the rate of re-absorption in private employment. During 1935 it is reported that the rate of separations from W.P.A. to return to private employment was about 3 per cent per month.⁸⁸ Such a figure, which is not available for later

⁸⁸ A. R. Eckler and Lincoln Fairley, "Relief and Reemployment," *Harvard Business Review*, Vol. 16 (1938), pp. 141, 147. The rate of total accessions to all relief rolls is reported as 7 per cent per month, the rate of separations as 8 per cent per month during 1935. The latter figure does not, however, express a rate of re-employment. References to other data may be found in Committee on Social Secur-

years, shows that some shifts take place in the clientele of the work program. It gives no indication, however, of the length of time individuals typically remain on the relief rolls. Some indirect evidence on the latter point is furnished by the accompanying table which, however, relates to length of time individuals were unemployed, not to length of time they were on the relief rolls.

RE-EMPLOYMENT RATES OF RELIEF WORKERS IN THIRTEEN CITIES, BY DURATION OF UNEMPLOYMENT, OCTOBER-DECEMBER 1935^a

Duration of Unemployment (Number of weeks)	Number of Unemployed Workers on Relief ^b	Workers Leaving Relief for Private Employment (Monthly average)	
		Number	As Percentage of Unemployed Workers on Relief
Less than 9.5...	10,784	1,375	12.75 ^c
9.6 to 17.5...	14,630	2,262	15.46
17.6 to 26.5...	21,030	1,914	9.10
26.6 to 52.5...	47,315	1,623	3.43
52.6 to 104.5...	83,629	1,443	1.72
104.6 to 156.5...	53,378	544	1.02
156.6 to 208.5...	41,453	468	1.13
208.6 to 520.0...	79,523	487	0.61
All workers	351,742	10,116	2.88

^a Eckler and Fairley, *Harvard Business Review*, Vol. 16, p. 150.

^b Monthly average of total number of cases on rolls at any time during month.

^c Not on a full month basis, since some were on relief rolls less than one month.

This table reveals the fact that 22.6 per cent of the whole number of relief clients had been unemployed from four to ten years, and 73 per cent more than one year. On the other hand 55 per cent of those returning to private employment were from the group who had been unemployed only up to six months. The bulk of the separations, in other words, was among those unemployed only a short period. The significance of this table is affected by the probable inclusion of a large number of persons who are among the more or less "unemployable" class of chronic dependents.

In a study made by the W.P.A. the median period of continuous employment on W.P.A. projects was found to be 12.4 months. The proportion of workers employed continuously for various periods

ity of the Social Science Research Council, *A Selected Bibliography . . . on Problems of Relief*, under the headings: "Job Refusals" and "Turnover on Relief and Work Relief."

was analyzed as follows:⁸⁹

Length of Continuous Employment	Percentage of Total
6 months or more	80.1
1 year or more	51.6
1½ years or more	30.0
2 years or more	25.6
2½ years or more	20.1
3 years or more	16.9

Concerning re-employment of W.P.A. workers, evidence is slight and conflicting. The Administrator of the W.P.A. in New York City has stated that 75 to 80 per cent of the W.P.A. workers in New York City were continuously on the rolls from 1935 to January 1938.⁹⁰ This is presumably a percentage of those working at the latter date, when the number was much lower than at the peak (in 1936). Stated as a percentage of peak employment, the figures would have been much smaller, and still smaller if stated as a percentage of the number of different individuals who had been on the rolls. The latter form of calculation was adopted in a statement by the Works Progress Administrator⁹¹ that the number of persons continuously on the W.P.A. rolls from February 1936 to November 1937 was only 15.4 per cent of the 4,900,000 different persons who had been on the rolls since the inception of W.P.A. Since W.P.A. employment was about 1.4 million in November 1937 the Administration's figures show that about 50 per cent of those then employed had been continuously on the rolls for the period stated.⁹²

For many persons who do not work in the W.P.A. continuously, it is an intermittent source of work. Some evidence of this is seen in an analysis of accessions to the rolls from May to September 1937.⁹³ During that period 48.9 per cent of accessions had previously

⁸⁹ Information from W.P.A. The figures are as of February 1939 and hence reflect conditions prior to application of the new rule, noted later, requiring the lay-off of persons employed for more than 18 months.

⁹⁰ 75 Cong. 3 sess., *Unemployment and Relief*, Vol. 1, p. 640.

⁹¹ W.P.A. Press Release, Aug. 5, 1938.

⁹² Unfortunately the W.P.A. has not published statistics showing the proportion of workers who have depended on the W.P.A. as the main or sole source of work over given periods of unemployment. The difficulty of assembling and presenting such figures in a form not subject to misinterpretation is no doubt very great, but in their absence no one can judge the significance or propriety of official statements relating to continuity of employment on relief work.

⁹³ W.P.A., *Report on Progress of the Works Program*, December 1937, p. 44.

worked on W.P.A. projects, and of these 63.5 per cent had been on the rolls within the preceding three months. It is evident therefore that work relief has in recent years furnished a continuous support for a substantial number of people, as well as intermittent support for many more.

The whole situation will be changed by the rule written into the relief act of 1939 that persons who have been on the rolls for 18 months (with certain exceptions) are to be laid off for a period. During the first two months of its application this rule led to the discharge of 782,807 persons. During the next four months the average monthly rate of discharge was approximately 64,000.⁸⁴

Benefits under work relief and direct relief. A final point of considerable interest is the difference in practice between the fixing of work relief wages and the fixing of direct relief benefits. Direct relief is given to the families of the skilled and unskilled alike on the basis of need, without any reference to what the breadwinner ordinarily earns when employed. The question arises whether there is any compelling reason why the compensation of relief labor should not likewise be determined by need. It is not easy to see why on a work relief project, the primary purpose of which is to take the place of direct relief for those employed, a skilled artisan with one dependent should get two or three times the wage of an unskilled worker with six. Yet this is one of the results of the present W.P.A. policy, which makes the monthly "security" wage a matter of skill rather than of "budgetary deficiency." There is no doubt a basis for the opinion that some recognition should be given to habitual standards of living, and strong pressures in favor of this policy operate from the side of organized labor groups. The system nevertheless involves a departure from the primary purpose of relief, which is to take care of human need in an equitable way.

Since rates of compensation are not related to number of dependents, if maximum needs are to be met the scale has to be set at a level so high as to yield the unskilled with few dependents, and the semi-skilled and skilled generally, a larger income than would be accorded them on the basis of comparative need. This makes the

⁸⁴ W.P.A. *Statistical Bulletin*, January 1940, p. 4. A further study of the effects is being made by the Work Projects Administration.

cost of work relief substantially greater than that of direct relief based on degree of need. This means moreover that those not lucky enough to be selected for work relief are left perforce on what, in most communities, is the much lower standard of local direct relief.

If work relief is to be continued, careful consideration should be given to the possibility of removing this discrimination by putting work relief compensation more largely on the basis of need, as it was under the emergency work relief program of 1934-35, and thus permitting some diminution in the cost of assistance of employables. The possibilities of reducing costs in this way should not be exaggerated, since it might work out so that higher compensation would be paid to workers with numerous dependents.⁹⁵ In view, however, of the great fiscal burden of relief activities, the possibility of reducing the existing scale of expenditures without abandoning work relief—indeed with its actual expansion—is obviously deserving of the most serious attention.

IV. THE MAGNITUDE OF THE RELIEF LOAD

Statistical statements of the magnitude of relief give quite different results according to the inclusion or exclusion of certain categories. The definition of relief upon which the figures presented below are based is a broad one, intended to include so far as possible all programs of direct assistance and emergency employment. Emergency work programs are included even though, as in the case of C.W.A. or P.W.A. for example, employment was not restricted to those certified as in need of relief. Considerable differences of opinion exist as to just what should be included under relief for this or that purpose. The broad definition used here is one of several, but is the one most useful for showing the full load of providing emergency employment, and is the one utilized in the compilation of the official figures from which the table on page 1195 is derived.

From this table it will be seen that the average number of families aided by relief and emergency employment for the 7-year

⁹⁵ In *The Survey* for March 1936, Gertrude Springer estimated that 20 to 25 per cent of W.P.A. workers needed supplementary relief. "You Can't Eat Morale," *The Survey*, Vol. 72 (1936), p. 76 ff.

PUBLIC RELIEF

1195

EMPLOYMENT ON FEDERAL WORK AND CONSTRUCTION PROJECTS AND NUMBER OF
RECIPIENTS ON RELIEF IN CONTINENTAL UNITED STATES—1933-39^a
(In thousands)

Period	Unduplicated Total		Work Relief ^c	General Relief ^d	Categorical Assistance ^e		
	Households ^b	Persons in These Households			Old-Age Assistance	Aid to Dependent Children	Aid to the Blind
1933							
Jan.-June	5,195	20,189	244	4,770	112	110	24
July-Dec.	5,157	19,165	1,385	3,825	105	111	24
1934							
Jan.-June	6,903	24,692	2,718	4,116	126	110	27
July-Dec.	6,363	22,999	931	5,183	157	111	32
1935							
Jan.-June	6,773	24,007	812	5,672	268	108	32
July-Dec.	5,966	20,700	2,048	4,213	338	112	34
1936							
Jan.-June	5,939	20,270	4,172	2,041	539	139	42
July-Dec.	5,795	18,831	3,896	1,523	935	153	44
1937							
Jan.-June	5,812	18,254	3,486	1,816	1,253	180	48
July-Dec.	4,922	14,671	2,577	1,420	1,485	212	53
1938							
Jan.-June	6,381	19,654	3,479	1,953	1,644	248	60
July-Dec.	6,935	21,450	4,256	1,641	1,740	270	65
1939							
Jan.-June	6,980	20,991	4,102	1,842	1,818	298	79
July-Dec.	6,055	17,425	3,181	1,656	1,887	314	69
Average for 1933-39	6,084	20,236	2,663	2,976	886	177	45

^a Work Projects Administration, *Federal Work Programs and Public Assistance*, December 1939, pp. 6-7.

^b Number of cases is reduced to a basis of families receiving assistance in order to remove duplications among sources of family relief.

^c Work relief includes employment on C.W.A., W.P.A., C.C.C., N.Y.A. and prior student aid, P.W.A., and other federal work and construction projects. The employment under P.W.A. and under some other federal work and construction projects is not, strictly speaking, of a relief character. The figures for work relief do not include cases receiving work relief under the general relief program. See footnote d.

^d The figures for general relief consist mainly of direct relief but contain some work relief cases. From July through November 1933 these cases averaged 1,382,000 a month, and from April 1934 through August 1935 they averaged 1,315,000. Except for these periods the amount of work relief under this heading is relatively unimportant.

The figures for general relief also include F.E.R.A. grants for transients and rural rehabilitation grants of F.E.R.A. and F.S.A.

^e Each case of old-age assistance and of aid to the blind may represent a family, a couple, or a single unattached individual. For aid to dependent children, data represent the number of families for whom aid is granted.

period is approximately 6.1 million, with decided peaks at the beginning of 1934 and at the turn of 1938-39. The average for 1939 was 6.5 million. For the whole period the number of persons in relief households averages about 20 million. Without allowing for duplicating figures the average numbers of cases for the two main categories are: for general relief 3.0 million for the whole period,

COST OF RELIEF AND EMERGENCY WORK, 1933-37*
(In millions of dollars)

Period	Federal	State and Local	Total
1933			
Jan.-June	390	220	610
July-Dec.	744	250	994
1934			
Jan.-June	1,556	375	1,931
July-Dec.	1,597	416	2,013
1935			
Jan.-June	1,530	447	1,977
July-Dec.	1,525	491	2,016
1936			
Jan.-June	1,932	695	2,627
July-Dec.	1,929	748	2,677
1937			
Jan.-June	1,747	716	2,463
July-Dec.	1,269	726	1,995
1933-37	14,219	5,084	19,303

* The expenditure figures are from Dorothy Fahs Beck, "Problems in the Compilation of Data on Total Relief and Work Program Expenditures," *Journal of the American Statistical Association*, Vol. 33 (1938), p. 355. They include pay rolls of all types, materials, administration, and all other costs incident to the programs included in the series, with certain minor exceptions. The included programs by principal classes are (1) general relief, (2) federal work programs designed primarily to employ relief labor, (3) the Civilian Conservation Corps, (4) categorical assistance, (5) rehabilitation loans to destitute and low income farmers, (6) emergency public works, and (7) surplus commodities distributed for relief. For a full description see 75 Cong. 3 sess., *Unemployment and Relief*, pp. 1404-08.

and 1.7 million for 1939; for work relief 2.7 million for the whole period, and 3.6 million for 1939. Of the 1939 work relief cases, an average of 2.4 million persons were under W.P.A., 280 thousand in C.C.C., and 520 thousand under N.Y.A. The figures for categorical relief show that the numbers receiving old-age assistance averaged 886 thousand for the whole period, but reached a peak of 1.9 million in the second half of 1939. For aid to the blind the

average was 45 thousand cases, and for aid to dependent children, 177 thousand.

It is possible to show the cost of the relief and emergency work programs in continuous comparable series only for the years 1933-37. This is done in the table on page 1196.

On the broad definition of emergency work and relief, there was a total expenditure of over 19 billion dollars, in the 5-year period, nearly three-quarters of it from federal funds. If one deducts projects financed by the P.W.A. and R.F.C., the total is reduced to almost exactly 17 billions, of which approximately 5 billions was for direct relief and 12 billions for work projects. The larger total may be distributed roughly as follows (in millions):

General relief (excluding all work projects)	\$4,000
Work programs primarily of a relief character	8,700
Emergency public works not primarily of a relief character	5,400
Categorical relief	960
Rehabilitation loans to farmers (F.E.R.A. and F.S.A.)	230

Of the total, W.P.A. expended less than 4.5 billions, or about 23 per cent.⁹⁶

As was noted above, information on the total cost of the relief program is available only through 1937. The portion of cost which represents payments to recipients of relief, however, can be shown through 1939. This information is presented in the table on page 1198.

It will be seen that the payments to recipients under public programs providing assistance and employment totaled 19.5 billion dollars from January 1933 through December 1939. Of this total the earnings under the federal work programs were about 12.1 billion and the payments under assistance programs about 7.5 billion.⁹⁷ Since 1933 there has been a noticeable growth both in earnings under federal work programs and in payments for public assistance. Total annual expenditures for assistance and earnings increased from 1.4 billion in 1933 to 3.5 billion dollars in 1938 and 1939.⁹⁸

⁹⁶ The preceding calculations are based on an analysis of data presented in 75 Cong. 3 sess., *Unemployment and Relief*, Vol. 2, pp. 1404-08.

⁹⁷ Assistance programs include: special types of assistance for the needy aged, dependent children, needy blind, general relief, subsistence payments to farm families, and special programs of the F.E.R.A.

⁹⁸ *Social Security Bulletin*, February 1940, p. 51.

AMOUNT OF PUBLIC ASSISTANCE AND EARNINGS OF PERSONS EMPLOYED
UNDER FEDERAL WORK PROGRAMS, CONTINENTAL UNITED STATES,
JANUARY 1933-DECEMBER 1939^a
(In thousands of dollars)

Year	Total	Special Types of Public Assistance ^b	General Relief ^c	Special Pro- grams of F.E.R.A. ^d	Subsistence Payments by F.S.A.	Work Programs ^e
1933	1,358,159	72,414	758,752	5,753	—	521,240
1934	2,436,328	80,003	1,200,360	61,069	—	1,094,896
1935	2,594,765	114,663	1,433,180	114,996	2,541	929,385
1936	3,258,781	217,516	439,015	3,873	20,365	2,578,012
1937	2,869,379	397,866	406,881	467	35,894	2,028,272
1938	3,487,188	508,985	476,201	—	22,587	2,479,413
1939	3,493,882	566,060	481,723	—	19,050	2,427,049
Total	19,498,482	1,957,507	5,196,112	186,158	100,437	12,058,267

^a *Social Security Bulletin*, February 1940, p. 52. Figures exclude cost of administration and of materials, equipment, and other items incident to the operation of programs. Figures are partly estimated and subject to revision.

^b Figures for January 1933-January 1936 represent payments from state and local funds only. Figures thereafter represent payments from federal, state, and local funds in states administering the three special types of public assistance under the Social Security Act and from state and local funds in states not participating under the act.

^c Figures for 1933-35 include obligations incurred for direct relief and earnings of relief and non-relief persons (other than of administrative employees) employed under the general relief program of the F.E.R.A. They also include an estimated amount of obligations incurred for relief extended to cases by local authorities from public funds under the poor laws.

^d Figures include obligations incurred for relief extended under emergency education, student aid, rural rehabilitation, and transient programs of the emergency relief administrations largely financed from F.E.R.A.

^e Includes C.C.C., N.Y.A. and prior student aid, W.P.A., C.W.A., and other federal works and construction projects, including P.W.A.

V. SUMMARY AND CONCLUSION

The general picture of the relief situation, as it has developed to 1940, may be stated in brief summary. Work relief projects are almost wholly the responsibility of the federal government, mainly supported by federal funds and administered by federal officials. The projects, however, are largely planned and sponsored by state and local agencies, which also contribute a part of the cost. A number of projects for special groups of relief clients are wholly federal in initiation and support. In addition to the major part of the works program administered by the W.P.A., numerous federal agencies are carrying on relief projects. Some work relief is carried on wholly by state and local agencies. Outside the strictly relief program, emergency employment is being created under the construction program of the P.W.A. Categorical relief—old-age assistance, aid to

dependent children, aid to the blind—has become a joint federal-state-local responsibility, federal grants-in-aid being given to the states under the Social Security Act.⁹⁹ Responsibility for general direct relief has been returned to state and local authorities. This covers both the “unemployables” who do not qualify for categorical relief and all the “employables” who are not at any particular time employed on federal projects.

While federal intervention has placed the care of many of the unemployed upon a much higher plane than it could otherwise have been, present federal policy involves a very serious discrimination in the treatment of relief clients. The federal government, which still bears the major financial burden, provides the most adequate assistance through its work projects. It is also improving the aid to those categories for whom grants-in-aid are made. On the other hand, many of those for whose aid no federal funds are forthcoming are, comparatively speaking, neglected. The standards of state and local relief vary in the highest degree from one place to another.

Certain elements of inertia and local interest tend to perpetuate these discriminations. The federal works program has a going administrative organization which tends to be extended and perpetuated because of congressional inertia in attacking the difficult problem of devising a satisfactory alternative, and because of pressure from the benefited groups. The demand for its continuation also comes strongly from municipal officials who by this means secure for their cities a wide variety of public improvements at federal expense and are thereby enabled to lessen their local relief responsibilities. Beyond this, they can neglect local relief needs to whatever extent they wish except in those few states where state standards are effectually enforced in conjunction with state financial aid.

There is a considerable vagueness in and departure from the basis upon which responsibility is now nominally distributed, federal aid to “employables” and state and local aid to “unemployables.” No one has even a reasonably accurate idea to what extent

⁹⁹ Beginning to supplement the relief program are the permanent measures for unemployment compensation and old age insurance under the Social Security program, which are dealt with in the next chapter.

employables are on local relief or how many persons are excluded because they have been certified as employable.¹⁰⁰ The distinction is not maintained in the matter of federal grants to states for aid to selected categories of unemployables, in particular the aged.

As a by-product of the present division of responsibility, there has developed a very complex penetration of federally supported relief labor into the production of services of sorts which have heretofore been almost wholly, and are still mainly, supported out of state and local funds. This leads to the blurring of any distinct boundaries between relief objectives on the one hand and ordinary local programs of public services on the other, as well as between federal, state, and local functions. Federal participation gives local authorities the opportunity to unload local improvements on to the broad fiscal back of the federal government. Substantially similar types of work are done in the same communities by two different categories of workers under entirely different employment conditions and status, "ordinary" local public employees on the one hand and federally paid "emergency" employees on the other.

In a general view of the relief picture, what now exists is an empirical and haphazard growth providing no satisfactory basis for permanent co-operation of all levels of government upon the common problem. The continued existence of large numbers of persons without means of livelihood may be taken for granted, including a somewhat stable number of true "dependents," a vague but large class of semi-dependents, and a body of unemployed fluctuating with the state of private employment. No one can reasonably argue that the present means of caring for these classes operate equitably. There exists, therefore, the need for further consideration of the outline of a permanent program of public assistance to replace the jerry-built emergency structure which has developed.¹⁰¹

¹⁰⁰ A very large percentage of local relief rolls are made up of employables. In New York City, the Welfare Commissioner reports that from one-half to two-thirds of the households on local relief have one or more employable members (*New York Times*, June 26, 1939, p. 17). William Haber estimates that in September 1937 a third of general relief households contained employables, and that about half of the W.P.A. workers were of questionable eligibility. "Relief: A Paramount Program," *Survey Graphic*, Vol. 27 (1938), p. 591.

¹⁰¹ The governmental reorganization measures initiated by the President in April 1939 would appear in some degree to make the prospects of reconsideration even

Even if unemployment were to shrink to relatively minor proportions, the number receiving public assistance and the cost of assisting them would no doubt remain much higher than for a comparable situation before the depression. At least temporarily, an aftermath of the depression will probably be an increased number of persons more or less unfitted for private employment. Moreover, the activities of relief agencies in recent years have placed on the relief rolls a large number of individuals of types that were previously dependent on private charity or otherwise eked out an existence without benefit of public assistance. The claims of such persons to support are not likely wholly to lapse even in local general relief; while many of them are being covered into the federally aided system of categorical assistance.

The problem of relief therefore presents itself as a continuing one which has two phases: caring for immediate needs and devising a permanent structure. It is the former which still occupies the center of attention, and to it the brief remaining discussion will be mainly devoted; but it cannot be wholly dissociated from the second, since the latter is less likely to be separately conceived and executed than to crystallize gradually out of short-run practice. The continuing problem will be treated, first, in relation to the constituent nature of possible relief programs, and second, in relation to the respective responsibilities of the various levels of government—federal, state, and local—for such programs. The issues involved are controversial in the highest degree.¹⁰²

more remote. The general work relief program, renamed the Work Projects Administration, is absorbed into the Federal Works Agency, while work projects for the young (C.C.C. and N.Y.A.) are absorbed into the Federal Security Agency, which also includes the Social Security Board. The relations of federal relief agencies to state and local agencies are therefore more diffused than heretofore.

¹⁰² It will be impossible to cover various specific plans which have been drawn up. Some of these may be reviewed in the following sources: 75 Cong. 3 sess., *Unemployment and Relief*, preliminary majority and minority reports, pp. 1379-99; National Citizens' Committee of the Community Mobilization for Human Needs, *Program, 1938*, reproduced in the same, pp. 425-35; National Conference on Work and Security, *Program, 1938*, distributed by Workers' Alliance of America; Charles M. Bookman, "A Community Program for Reducing Unemployment and Relief," *Social Service Review*, Vol. 11 (1937), p. 360; American Association of Social Workers, *An Outline of the Position of the A.A.S.W. in Respect to Governmental Employment, Social Insurance and Assistance Programs (1938)*, and *An Outline of the Position of the A.A.S.W. in Respect to Federal Employment*

1. The content of a relief program cannot be considered without reference to the fact that the federal government is committed, in a way unlikely to be reversed, to a program of unemployment insurance and old-age insurance, and to assistance for the aged, the blind, and dependent children.¹⁰⁸ As these programs, administered under the Social Security Board, grow in coverage they should in some degree diminish the demand for emergency relief. For the time being, however, they are secondary sources of emergency livelihood, and are never likely to remove the need for a general relief program.

The next fact of importance is that the relief rolls are made up of two quite separate classes of persons, those unable to work and those able to work. The question is whether or not the two classes shall be treated as relief clients on the same basis. If they are, one possibility would be to make the whole of relief direct. This would be the cheapest method. How great the economy would be would depend simply on the standards of maintenance adopted. The principle of equivalent treatment for equivalent need could be worked out without the abandonment of work relief, by an adjustment of rates of pay and hours worked to correspond to demonstrated need.

If, however, the difference between the two classes is to be sharply recognized in practice, it is probable that they will have to be cared for under different administrative set-ups. In that case, problems of discrimination will arise, such as have been reviewed above under existing circumstances. The mere existence of different administrative responsibility does not, however, necessitate highly discriminatory treatment. The latter is the result of having responsibility allocated to entirely different political units.

The extent to which a relief program should embody work relief is a controversial question far too complex to discuss at any length in the present context. The major arguments for an extensive works program—the support of morale, the preservation of work habits, the avoidance of pauperization, and the securing of some

and Assistance Programs (1937); Buel Patch, "The Permanent Problem of Relief," *Editorial Research Reports* (1938), Vol. 1, pp. 119-31; Maxwell S. Stewart, *This Question of Relief*, Public Affairs Pamphlet No. 8 (1938).

¹⁰⁸ See Chap. XXXI.

valuable return for public expenditures—all have great force. The contrary argument emphasizes the doubtful capacity of work programs to achieve these laudable ends in practice. An extensive program is likely to include a very considerable element of “made work” with problematical consequences in private morale and public usefulness.

Another major point is that no system of work relief can pick up on a satisfactory administrative basis, nor with satisfactory social results, those “employables” who need relief for relatively brief periods and primarily for emergencies such as sickness. Moreover, the feasibility of an administrative structure and of a sufficiently flexible program of projects to handle more than a limited proportion of the “employables” at any given time is still debatable. To such considerations must be added the greater cost of work relief due not merely to extra materials and administrative costs, but also due to somewhat different criteria of eligibility. Their difference in cost is, of course, exaggerated when work relief benefits are typically higher than direct relief benefits, as has been the case in actual practice.

Consideration of such points makes it perfectly clear that work relief is by no means adequate as a system of relief for “employables” and that a much more clearly thought out and administratively articulated combination of work relief and direct relief than now exists is needed.

The federal concentration upon work relief has been strongly criticized by many local relief officials, not because of any distaste for work relief as such nor for its cost, but because it involves the withdrawal of federal funds from the support of direct local relief. These officials are the persons who see at first hand the discriminatory character of the existing allocation of funds, and are more impressed by immediate needs of direct relief clients than by arguments for a federal work program which provides relatively adequate care for some and leaves others cared for poorly, if at all. This point comes most strongly into view during the periodical financial crises which overtake local relief activities.¹⁰⁴

¹⁰⁴ While the preferences of local relief officers and welfare workers cannot be clearly determined, it appears that there is a widely held desire for a com-

2. The whole question of the relative adequacy of relief to various classes turns on the relationships between the various levels of government in the provision of relief.

The major arguments advanced in favor of the existing division of responsibilities have been that because local resources are inadequate the federal government should take some but cannot take the whole responsibility for providing relief; that it is already carrying its reasonable share financially; that it is providing the most socially valuable type of relief; that in so doing it is by example setting standards, but that in relation to the part not assumed it ought not to dictate local standards. Against this position there is the strongest immediate pressure from local sources to secure federal grants-in-aid for general relief, where the need is now greatest. The force of this position is that with the funds available it would be possible to provide a far more equitable distribution of relief, though at the expense of a revision of work relief compensation standards and possibly a considerable curtailment of work relief. In addition, there are some who favor the return of greater responsibility to state and local units, both in the provision of funds and in the administration of relief.

These issues lead to the much more fundamental question whether the federal government should assume primary administrative responsibility for a relief program. In actual practice there is a large degree of administration by local personnel whose primary loyalties and personal interests run in terms of their local situations. Indeed the actual administration of relief must always be highly localized, no matter to what headquarters the local officials report. It therefore becomes a reasonable question why the federal government should not divest itself of administrative responsibility, except for a few special classes of relief clients, and confine itself to making grants-in-aid to states for redistribution to localities on such conditions as the federal government wishes to lay down. In so doing it would, if desired, to earmark parts of the total for

bination of work relief and federal grants-in-aid for direct relief. Some of these officers and workers, however, would not object to dropping federal work relief entirely if compensated by grants-in-aid. Officials in localities faring relatively well with respect to W.P.A. grants may be willing to let well enough alone, or, on occasion to endorse the *status quo* strongly.

direct, work, and categorical relief, respectively; to require grants to be in some proportion matched by state and local funds; and to exercise some supervision over the state welfare agencies.

It is not at all impossible to draw up a plan of administrative responsibility, with federal, state, and local contributions to the program's support, and a higher degree of state and local responsibility, which on paper would appear to promise relief assistance on a less discriminatory basis.¹⁰⁸ If one may judge from available evidence, the responsible W.P.A. officials hesitate to advocate change in that direction for two reasons: a profound distrust of local government agencies, and a deep-seated distaste for the policy which those agencies follow of caring for needy persons on a direct relief basis. It is the first of these attitudes which dictates the continuance of federal responsibility for projects supported by federal funds, lest they be corrupted to the purposes of local political "machines."¹⁰⁹ The second dictates the aloofness of federal agencies from supporting local direct relief except where, by inclusion under some form of categorical assistance, it takes the form of a "right" to assistance without the stigma ordinarily attaching to "pauper relief."

The apparent aim of responsible federal officials¹⁰⁷ at the present time is, by the withholding of federal funds, to reduce direct relief to an absolute minimum, on the grounds that it is degrading. Alternatively, it appears to be their purpose to promote the "right to work" by generously supporting work projects, and to establish the "right" of the non-working poor to an unstigmatized livelihood through expansion of aid to dependent children, pensions to the

¹⁰⁸ If the mere elimination of discrimination is the purpose, it should be said, this could be accomplished as well by centering more rather than less responsibility in the federal government.

¹⁰⁹ The charges of "politics" in relief administration which have most frequently been made have been mainly directed at the federal administration of the W.P.A. The statement in the text reflects a different point of view, that of federal officials, who may be credited with attempting to minimize political influences in the carrying on of projects and who are undoubtedly of the opinion that political abuses—"making political capital out of human misery"—would be much greater if the controlling hand of the federal government were removed.

¹⁰⁷ Judgments of the sort expressed in this and the preceding paragraph cannot be properly documented since they depend upon reading between the lines of official statements, upon inferences from the development of policy, and upon personal knowledge of the opinions of some officials.

aged, unemployment insurance, and many other devices for ending traditional forms of poor relief and traditional attitudes toward it.

It is not to be doubted that federal policy has led to a vast change in public attitudes concerning relief. But it now faces the strongest criticism from those who stand closest to the local problems. There appear to be remediable defects which are continued for less than adequate reasons. Moreover, as time goes on the incentive to fiscal economy must necessarily become more pressing.¹⁰⁸

The preceding discussion has picked out only a few of the more fundamental questions of relief policy. Space does not permit entrance into further details. In conclusion, however, it will be well to note that there are problems of infinite complexity in detail relating to eligibility for relief, standards of relief, the scope and character of work relief, the financing of relief, methods of disbursing relief, the character of local poor laws, the differentiation of types of relief, the treatment of transients, and the personal status of relief clients. Into these matters we cannot go further. But the preceding general picture indicates very clearly that the relief problem is as important and as difficult as any of the new problems with which government is currently concerned in the United States.

The basic issues of future policy reach down into the depths of conflicting prejudices, interests, and principles. The traditional American regard for individual self-help is challenged by the emergent dogmas of the "right" of all persons to means of livelihood and the "duty" of government to provide when private means are lacking. Many private economic interests are in some degree inevitably ill affected by large public employment and large fiscal provision for the dependent. Traditional relations of local, state, and federal governments are involved in any programs for the public provision of livelihood; and the terms of such provision affect the power and selfish interests of political "machines" at the local, state, and federal levels. It is not, therefore, to be supposed, with due regard for the processes of practical politics, that a more per-

¹⁰⁸ So far as the federal government is concerned it is impossible to isolate fiscal aspects of relief from the general fiscal policy of the government. Compare Vol. 1, Chap. VII.

manent pattern of policy is going to emerge in an atmosphere of "sweet reasonableness." The subject is not one, however, which ought to be relegated to the political arena without carefully canvassing the possibilities of a more satisfactory system of alleviating economic distress in ways which avoid the degrading pauperization of large numbers of people, and without threat to democratic traditions.

It has not been the purpose of the preceding brief review of issues to present any definitive outlines of a revised relief policy—a task which would require a much more comprehensive examination of the problems in detail—but merely to suggest that the present organization of relief activities is highly heterogeneous and shot through with anomalous and discriminatory features which it might be politically feasible to eliminate in a considerable degree.

The present chapter has reviewed only those activities which in recent years have been placed on the basis of emergency relief. There have in the meantime been other developments directed toward a long-run program of diminishing the insecurity of economic livelihoods. These efforts which are commonly lumped together under the title of the "social security program" are the subject matter of the next chapter.

CHAPTER XXXI

SOCIAL SECURITY

The same set of influences, induced by the depression, which carried the relief program forward so rapidly after 1933, served also to further the development of more permanent social insurance measures. As was seen in the preceding chapter, the relief measures have been carried out almost wholly on an emergency basis. With the growing sense of public responsibility for security of livelihoods, however, attention was turned to the problem of supplementing private incomes by a long-run program of continuous public action. While this program makes provision for public assistance to particular classes of dependent persons on the basis of need, its most important feature is the accumulation of insurance funds in the course of ordinary employment to support persons during periods of unemployment and during their old age.

I. THE BACKGROUND OF SOCIAL INSURANCE LEGISLATION

The development of social insurance in the United States has proceeded along lines somewhat different from those followed in other countries. In Great Britain, for example, the Friendly Societies had been slowly building a comprehensive voluntary system of unemployment insurance which was so well developed by 1911 that the new act inaugurating a national system in that year simply incorporated the voluntary system as an integral part of the whole. So, too, unemployment insurance in Great Britain had its roots in the system of unemployment benefits paid by many trade unions over an extended period of time.

In the United States, on the contrary, there was no such background. Co-operative and trade union ventures in this field were not numerous or far-reaching enough to exert any great influence. The most significant related developments prior to 1929 were in fact of governmental origin—workmen's compensation for industrial accidents having been provided by all but four states.¹ Shortly

¹ Accident compensation was originally less a social insurance concept than a piece of regulatory legislation, which modified the old common law defenses of

before the entrance of the United States into the World War, considerable pressure developed for health insurance (perhaps as a result of the British legislation a few years earlier), but the movement died out during the war years and remained dormant for more than a decade.³ The short but sharp depression of 1921 witnessed several attempts in state legislatures to obtain passage of unemployment insurance legislation.⁴ The abounding prosperity of the twenties, however, was definitely unfavorable to the progress of social insurance legislation. It supported the opinion that the United States had developed a system of free enterprise which provided well-being for all the people. There was, indeed, some disposition to think that Europe's plight was in part the result of social insurance devices. In 1929 there was no immediate prospect of the enactment of any type of unemployment insurance in any state legislature in the country.

With the oncoming of the depression of the thirties there came a change in public sentiment which found expression first in emergency relief measures, and later in the development of interest in social insurance. In a number of states, commissions were appointed in the early thirties to study unemployment, but of the 16 states in which unemployment insurance bills were introduced, Wisconsin was the only one to enact one by 1932.⁵

The Wisconsin act was based as much upon the philosophy of

employers in exchange for the establishment of a more orderly system of compensation awards. Generally speaking, the legislation assigned a certain liability to the employer and left it to him to meet this liability as best he could. Some employers set up systems of self-insurance, while a great majority took out insurance with private insurance carriers. Even when state funds were established they were often only alternative to private accident insurance. Thus, important as workmen's compensation is in the history of American labor legislation, it was not a weighty influence in the development of social insurance.

³I. M. Rubinow, *Standards of Health Insurance* (1916), p. 197. The medical care problem received serious attention again during the activity of the Committee on the Cost of Medical Care, 1927-32 (financed by a number of philanthropic foundations), but this committee of itself was not so much interested in developing the idea of health insurance as in analyzing in a broad, general way the multitudinous problems of medical care on many fronts. Furthermore, the findings of the committee, when finally announced, were not acted upon by any governmental agency.

⁴Social Security Board, *Social Security in America*, Publication No. 20 (1937), p. 91.

⁵Social Security Board, *Third Annual Report, 1938*, p. 175; and Social Security Board, *Social Security in America*, p. 6.

prevention of unemployment through stabilization of employment as upon an insurance principle. Each employer had to establish unemployment reserves, but he was responsible for benefits only to his own unemployed workers. The rates of assessment were based upon relative stability of employment. Responsibility for unemployment was definitely placed on the employer; there were no employee contributions. Provision was made for plans under which employers guaranteed employment instead of providing unemployment reserves. The act was not to go into effect if, within a period of about a year, employers in the state were to adopt voluntary unemployment benefit plans covering at least 175,000 workers. This condition not being fulfilled, the act went into effect in 1934.

Apart from the mounting sentiment for insurance for the unemployed, influences were at work to support a program of care for other classes of persons, especially dependent children and the aged. As was noted in the preceding chapter, many states were already providing special assistance to these classes of persons, on the basis of need. This program was, however, widely criticized. Particularly censured was the use of a means test because it generally included an insistence upon family responsibility. Thus many old persons who did not receive from their children what seemed to them or to others to be adequate support, were denied assistance on the grounds that their children could support them. The assistance program was also criticized by some on the ground that the payments were too small.⁵ Further, because of the financial limitations of some localities in every state, and of some states as a whole, there was dissatisfaction with the existing state and local basis of the system. Moreover, state and local finances in the midst of the depression were getting worse, and the program faced the prospect of contraction rather than expansion. Finally, many of the "near-old" were bitterly critical of the minimum age limit required. In many states the limit was set at 70 years of age, although many persons were being dropped out of the labor market at the age of 65, or even at 60 years.⁶

⁵ In the 30 states in which old-age assistance payments were made in January 1936, they averaged around \$16 per month, with some states averaging as low as \$5 to \$10 per month. Information from Social Security Board.

⁶ Social Security Board, *Social Security in America*, p. 162.

It would be difficult to assay the real importance of all these criticisms, but it seems safe to hazard the opinion that the driving force which led to the rise of the widely discussed Townsend movement, followed by the General Welfare Federation, Ham and Eggs in California, and other variants, was among "middle-class" oldsters—those who had some resources or some children at intermediate wage-earning or salary levels, but who were unable to maintain their previous standards of living either by relying on their children or their private sources of income, or through state old-age assistance. In many cases the parents had lost the income which they had been accustomed to receive from real property or other investments, and the earning power of their children had been seriously undermined by the depression. It is not surprising that nearly all of the extremist pension movements have originated in California, where there is probably a heavier concentration of middle class "near-old" persons than anywhere else in the country.

The Townsend plan¹ owed its popularity to the fact that it embodied ample remedies for the dissatisfactions people felt toward the existing pension system. It promised generous payments, abolition of the means test, support from the federal treasury, and independence from reliance on children. In their economic aspects the Townsend plan and its variants were of the "crackpot" variety, but the strength of the support they received made them politically important and no doubt hastened action on alternative measures for caring for the aged.

II. THE EMERGENCE OF A FEDERAL PROGRAM

The first step in the formation of a federal program of social insurance came on June 8, 1934 when President Roosevelt in a message to Congress outlined a long-range program for the reconstruction of the economic life of the nation. Referring to social insurance as an important part of this program, he said:

... I am looking for a sound means which I can recommend to provide at once security against several of the great disturbing factors in life—especially those which relate to unemployment and old age. I believe

¹ H.R. 2. Discussed in 76 Cong. 1 sess., *The Social Security Act Amendments of 1939*, Hearings before (House) Committee on Ways and Means (1939).

there should be a maximum of cooperation between States and the Federal Government. I believe that the funds necessary to provide this insurance should be raised by contribution rather than by an increase in general taxation. Above all, I am convinced that social insurance should be national in scope, although the several states should meet at least a large portion of the cost of management, leaving to the Federal Government the responsibility of investing, maintaining, and safeguarding the funds constituting the necessary insurance reserves.⁸

The President followed this message by making provision for studies and the formulation of plans which he proposed to submit to the next Congress. He created⁹ a policy-making Committee on Economic Security consisting of the Secretary of Labor as chairman, the Secretary of the Treasury, the Attorney General, the Secretary of Agriculture, and the Federal Emergency Relief Administrator. This committee appointed a Technical Board on Economic Security composed of a number of officials in the government service.¹⁰ The committee hired a small staff of outside experts, and thereafter the Technical Board and the staff carried on statistical studies and actuarial analyses as a basis for the formulation of a program.¹¹

The findings of the committee were presented to President Roosevelt on January 15, 1935. The basic recommendations made by this committee will be discussed later in connection with each of the specific social insurance programs, but it will be helpful to list the major items at this point. There were recommended:¹²

1. Employment assurance: the stimulation of private employment and the provision of public employment for those able-bodied workers whom industry does not employ at a given time.
2. Unemployment compensation: payment in cash for limited

⁸ *The Public Papers and Addresses of Franklin D. Roosevelt*, Vol. 3 (1938), p. 291.

⁹ Executive Order No. 6757, June 29, 1934.

¹⁰ *Report to the President of the Committee on Economic Security*, Letter of Transmittal (1935), pp. v-vii.

¹¹ There was also created an Advisory Council on Economic Security consisting of citizens outside the government service, representing employers, employees, and the general public, and certain other advisory groups: a committee of actuarial consultants, a medical advisory board, a dental advisory committee, a hospital advisory committee, a public-health advisory committee, a child welfare committee, and an advisory committee on employment and relief.

¹² *Report of the Committee on Economic Security*, pp. 3-7.

periods on a contractual basis to those unemployed who are ordinarily steadily employed.

3. Old-age security: non-contributory old-age assistance on a needs basis for those who are now old and have no means of support, with federal aid to existing state systems; compulsory contributory old-age annuities without a means test for younger workers now employed; voluntary contributory annuities administered by the federal government and designed particularly for professional and self-employed small-income groups which were not to be brought under the compulsory system.

4. Security for children: federal grants-in-aid to the states having systems of assistance to the children of fatherless and other "young" families; federal assistance to states in providing local services for the protection and care of homeless, neglected, and delinquent children, and for child and maternal health services, especially in rural areas.

5. Security against risks arising out of ill health: nation-wide preventive health program largely financed by state and local governments and administered by state and local health departments with federal financial and technical aid; application of the principles of insurance to the problem of ill health, but without specific recommendation at that time.¹⁸

6. Residual relief: for the care of those people not segregated nor given differentiated treatment, primary responsibility to be returned to state and local governments with the recommendation "that the States substitute for their ancient, out-moded poor laws modernized public-assistance laws, and replace their traditional poor-law administrations by unified and efficient State and local public welfare departments."

7. Administration: (a) creation of a social insurance board within the Department of Labor to administer the federal unemployment compensation act and the system of federal contributory old-age

¹⁸ The final outcome of this aspect of the social security recommendations was set forth in the Interdepartmental Committee to Coordinate Health and Welfare Activities, *Proceedings of the National Health Conference (1938)*. For further analysis of this problem, see "Medical Care," *Law and Contemporary Problems*, Vol. 6 (1939), pp. 495-680.

annuities; (b) full responsibility for the safeguarding and investment of all social insurance funds to be vested in the Secretary of the Treasury; (c) non-contributory old-age pensions and grants-in-aid to dependent children to be administered by the Federal Emergency Relief Administration, or if this agency should be abolished, the President to designate the distribution of its work.

The President transmitted the report to Congress together with a special message recommending immediate action. After extensive hearings¹⁴ and debate, an act was finally passed in August 1935.¹⁵ A new agency—the Social Security Board—was created and charged with the administration of the three public assistance titles of the act—old-age assistance, aid to the blind, and aid to dependent children—as well as the two insurance titles dealing with unemployment compensation and old-age benefits (except that the specific pay-roll taxes for insurance purposes were to be collected by the Treasury Department).¹⁶ An analysis of the various specific phases of this act, and of its amendments, constitutes the subject matter of the sections to follow.

III. SECURITY FOR OLD AGE

A. Nature of the Problem

It has long been recognized that a financially secure and independent old age has never been attained by more than a small proportion of the aged population of any country or community. Several factors have made this problem especially serious in recent

¹⁴ 74 Cong. 1 sess., *Economic Security Act*, Hearings before (House) Committee on Ways and Means on H.R. 4120 (1935); 74 Cong. 1 sess., *Economic Security Act*, Hearings before (Senate) Committee on Finance on S. 1130 (1935).

¹⁵ 49 Stat. L. 620.

¹⁶ Other titles of the act are administered by other agencies. Title VI, providing for research in public health and for federal grants-in-aid to the state health services, is administered by the Public Health Service; Title V, parts 1, 2, and 3, providing for services to promote the health of mothers and children, for locating crippled children and furnishing certain medical care, and for the development of public welfare services for the care of homeless, dependent, and neglected children, are administered by the Children's Bureau of the Department of Labor; and Title V, part 4, providing for vocational rehabilitation of the physically disabled, is administered by the Office of Education of the Department of Interior. The social security programs of all these agencies began functioning in the first months of 1936.

years in the United States. One is the shift to industrial employment and urban living, since under conditions of farm life it is much easier to make a place for the older members of the family. A second factor is a diminution in the size of families. In the days of larger families the burden of parents could be more widely divided. A third factor has been the geographical dispersion of families and the consequent undermining of their solidarity and sense of unity.

The problem of old-age security is also greatly influenced by the changing age distribution of the population. In 1850 over one-half of all persons living in the continental United States were under 20 years of age; only 2.6 per cent were over 65 years of age.¹⁷ In 1930 the proportion of persons under 20 years of age had fallen to 38.8 per cent of the total population; the proportion of those 65 years and over had more than doubled. In 1980, which is estimated to be the date of culmination of this movement, scarcely more than one-half of the whole population will be under 40 years of age.¹⁸ About one-third of the entire population will be 50 years of age and over and about one-seventh will be 65 years and over.

B. Alternative Approaches to the Problem

At least three clearly differentiated principles for the establishment of a governmental system of old-age security have been suggested. These are: (1) non-contributory pensions of uniform amount to all persons over a given age; (2) public assistance to such persons varying with their need; (3) old-age insurance based upon contributions made by prospective beneficiaries.

The first of these principles has been widely approved because of its simplicity. Such difficult questions as coverage, eligibility, and need are resolved in a way that is generally understandable. The specific plans following this principle which have been advanced, however, have been criticized because of their cost. The Townsend plan, for example, with its proposal of \$200 per month for all persons 60 years of age and over, would involve at the present

¹⁷ W. S. Thompson and P. K. Whelpton, *Population Trends in the United States* (1933), p. 109.

¹⁸ National Resources Committee, *Population Statistics, Part I, National Data* (1937), p. 9.

time an annual expenditure of around 29 billion dollars per year¹⁹—an amount which in 1938 would have exceeded 40 per cent of the entire national income. Even a pension of \$30 a month for the single and \$50 a month for the married persons in that whole group would involve an annual expenditure of about 3.7 billion dollars.²⁰

A second criticism of the non-contributory pension system, and one that is urged also against public assistance based on need, is that if financed out of general taxation they divorce benefits from cost. For this reason there is certain to be constant pressure from the benefited groups to increase the benefits. In the third place, a uniform non-contributory system is criticized on the ground that it is desirable to differentiate in respect to previous standards of living of beneficiaries, differences in cost of living between different sections of the country or between urban and rural districts, and differences in the degree of need among the beneficiaries.

A system of public assistance based on need, it is contended, can be made no more costly than is necessary to make sure that minimum essentials are provided for all aged persons, since the needs of the individual and his other income and resources are taken into account. Moreover, public assistance of this type, it is held, is based upon well-tried methods of selecting cases, determining need, and otherwise adapting the benefit payments to the individual.

Both public pensions and public assistance will to some extent lessen the incentives to thrift, and may reduce saving. Moreover, if the means test is employed in granting public assistance, since the private income of a beneficiary will correspondingly diminish his assistance payments, he has no financial incentive to make any provision for his old age unless he believes he can succeed in getting beyond dependency.

The third suggested alternative is an insurance system based upon a contributory principle. Under such a system there is a direct relationship between the individual benefits received and the contributions made, though not necessarily an exact one such as exists in private insurance or savings.²¹

¹⁹ 76 Cong. 1 sess., *The Social Security Act Amendments of 1939*, p. 863.

²⁰ The same, pp. 827-28.

²¹ In almost every old-age social insurance system there is a considerable amount

The importance of a relationship between contributions and benefits, in both its social and political consequences, can hardly be exaggerated. It enhances the feeling of personal responsibility in each member and thus discourages the appearance of wild proposals.²² The significance of this point is often misunderstood—some individuals interpreting the pay-roll tax now levied in the United States for old-age insurance as essentially similar to a sales tax, and arguing that it is a matter of complete indifference whether the money is raised in one way or another, so long as there is a broad base for the tax. A general sales tax does not, however, impress upon the beneficiaries the costs to them which are involved. Another advantage of the contributory system is that it can provide higher benefits for higher-wage classes or higher-standard areas, without the opposition that would arise if this were attempted on a tax basis.

The major criticism which has been levelled against the insurance system is that it cannot, at least in the beginning, satisfactorily cover the entire population. Two important groups must necessarily be eliminated: (1) those who are already past working age and cannot make the contributions necessary to a significant annuity, and (2) those who are engaged in pursuits in which the contributory system cannot be easily administered. Examples of the latter are farmers, agricultural workers, and the self-employed.²³

Considering these three types of systems, the Committee on Economic Security came to the conclusion that the non-contributory pension idea is untenable as a permanent system, that public old-age assistance based on need is the only practicable method of dealing with those who are already old and with those residual classes who

of "levelling" in favor of short-time or low-wage contributors, and against the long-time or higher-wage contributors.

²² An example of belief in the impelling force of the contributory system as a factor in political sanity is furnished by the Swedish system. Despite the fact that by far the larger share of the benefits received is based upon individual need and only a small share upon insurance rights, the Swedes consider it desirable to maintain this small insurance feature as a permanent part of the system, notwithstanding the increased cost of administration. Compare Helen Fisher Hohman, *Old-Age in Sweden; A Program of Social Security*, Social Security Board, In press.

²³ In the first year of contributions under the present national Social Security Act only about three-fifths of the gainfully occupied persons in this country earned wages which were taxable.

cannot be brought into an insurance system, but that for all the rest the preference should be given to contributory insurance. It therefore devised, and Congress finally approved,²⁴ a system of public old-age assistance to take effect immediately, and a comprehensive long-range system of old-age insurance under which annuities would become payable five years after contributions began. In the long run this latter plan was to provide old-age security for the bulk of the people on the basis of contractual rights set forth in the law. These two systems will be treated in the next two sections.

C. Old-Age Assistance

The provision for the establishment of a system of public old-age assistance was easily framed. For the past decade or more the various states had been experimenting with such systems. By 1935 there were twenty-eight states and two other jurisdictions with programs in operation or at least on the statute books.²⁵ This system was extended by providing for federal grants-in-aid to the states, subject to certain broad conditions. The federal government, it was provided, should match equally the amounts paid by the state to each qualified individual, with the proviso that the federal contribution should not exceed a maximum of \$15 per month per individual.²⁶ It is important to note two points which gave rise to much

²⁴ On Aug. 14, 1935 (49 Stat. L. 620).

²⁵ Social Security Board, *Social Security in America*, p. 161.

²⁶ The conditions of this grant are set forth in Title I, section 2 of the Social Security Act, as follows: "(a) A State plan for old-age assistance must (1) provide that it shall be in effect in all political subdivisions of the State, and, if administered by them, be mandatory upon them; (2) provide for financial participation by the State; (3) either provide for the establishment or designation of a single State agency to administer the plan, or provide for the establishment or designation of a single State agency to supervise the administration of the plan; (4) provide for granting to any individual, whose claim for old-age assistance is denied, an opportunity for a fair hearing before such State agency; (5) provide such methods of administration (other than those relating to selection, tenure of office, and compensation of personnel) as are found by the Board to be necessary for the efficient operation of the plan; (6) provide that the State agency will make such reports, in such form and containing such information as the Board may from time to time require, and comply with such provisions as the Board may from time to time find necessary to assure the correctness and verification of such reports; and (7) provide that, if the State or any of its political subdivisions collects from the estate of any recipient of old-age assistance any amount with respect to old-age assistance furnished him under the plan, one-half of the net amount so collected shall be promptly paid to the United States. Any payment so made shall be de-

criticism. These are the failure to provide for minimum standards of payment and for variable grants to the states.

Minimum standards of payment. In the original draft of the act there was a provision that payments to individuals in the states should be at a level sufficient for "minimum health and decency," but Congress eliminated this provision. In the absence of any standard, there have developed wide differences between states in the benefits paid²⁷ and these have been cited as an argument for uniform, direct, generous federal pensions.

Variable grants. The act provides for a system of matched, as distinct from variable, grants to the states by the federal government. The fact that the states differ widely in their basic economic capacity to provide welfare services to their inhabitants has led to proposals that the federal government should vary its grants-in-aid with a view to equalizing these differences. For the poorest states it is proposed that the federal matching ratio be increased, with intermediate gradations in the matching percentages for states ranking between the top and the bottom in economic capacity.²⁸

D. Old-Age Insurance

The system of old-age insurance as finally enacted by Congress was set forth in two titles of the Social Security Act of 1935: Title II—Federal Old-Age Benefits, and Title VIII—Taxes with Respect to Employment. The following summary²⁹ outlines the essential features of that system as originally enacted.

posited in the Treasury to the credit of the appropriation for the purposes of this title.

"(b) The Board shall approve any plan which fulfills the conditions specified in subsection (a), except that it shall not approve any plan which imposes, as a condition of eligibility for old-age assistance under the plan—(1) An age requirement of more than 65 years, except that the plan may impose, effective until January 1, 1940, an age requirement of as much as 70 years; or (2) Any residence requirement which excludes any resident of the State who has resided therein five years during the nine years immediately preceding the application for old-age assistance and has resided therein continuously for one year immediately preceding the application; or (3) Any citizenship requirement which excludes any citizen of the United States."

²⁷ For detailed statistics, see recent issues of the *Social Security Bulletin*.

²⁸ Bills establishing, directly or indirectly, variable federal matching percentages have been introduced in Congress, but thus far none has passed.

²⁹ Social Security Board, *Social Security in America*, p. 213 ff.

Coverage. Old-age benefits are to be based upon wages received in employments performed within the United States, Alaska, and Hawaii except for: agricultural labor; domestic service in a private home; casual labor not in the course of the employer's trade or business; service performed as an officer or member of the crew of a vessel, documented under the laws of the United States or of any foreign country; service performed in the employ of the United States government or of an instrumentality of the United States; service performed in the employ of a state, a political subdivision thereof, or an instrumentality of one or more states or political subdivisions; service performed in the employ of a corporation, community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; employment by a carrier as defined in Railroad Retirement Act of 1935.

Eligibility for benefits. To be eligible for old-age benefits an individual has to be: at least 65 years of age; have not less than \$2,000 total wages from employment in a covered industry after December 31, 1936, and before the age of 65; and be employed for wages on some day in each of 5 calendar years after December 31, 1936, and before the age of 65.

Monthly old-age benefit payments. Monthly benefits are first payable on January 1, 1942. The amount of the monthly benefits payable is determined as follows:

Total Wages from Included Employments after Dec. 31, 1936, and prior to Age 65 (Not counting wages from any one employer in excess of \$3,000 annually)	Proportion of Total Wages Paid as Monthly Benefits
First \$3,000	1/2 of 1 per cent
Next \$42,000	1/12 of 1 per cent
All over \$45,000	1/24 of 1 per cent

The maximum monthly benefit is \$85.

Lump-sum benefit payments. Individuals whose total wages or periods of service are insufficient for them to qualify for monthly benefits are paid, upon reaching 65, a lump sum equal to 3½ per cent of the total wages from included employment after December 31, 1936, and before the attainment of age 65. Upon death of individual before age 65, death benefits will be paid equal to 3½ per cent of his total wages from included employment after December 31, 1936. If a person dies without having received at least 3½ per cent of his wages in a lump sum or monthly payments, the difference between such 3½ per cent and federal payments previously made will be paid as a death benefit.

Reduction of benefits. An amount equal to one month's benefit will be deducted for each month in which a qualified individual who has attained age 65 receives wages for regular included employment.

Federal administration. Social Security Board determines the qualifications of the individual and the amount of benefits payable, and certifies to the Treasury persons entitled to payments.

Taxes.

Years	Excise Tax on Employers' Pay Rolls (Per cent)	Income Tax on Employees' Wages (Per cent)
1937-39	1	1
1940-42	1½	1½
1943-45	2	2
1946-48	2½	2½
1949-	3	3

In working out a system of contributory insurance, the staff of the Committee on Economic Security was faced with a series of fundamental issues on which there were marked differences of opinion. A review of these fundamental issues, and of the decisions which were made regarding them, is essential to an understanding of the old-age insurance provisions of the Social Security Act.

A federal or a state system? An issue which arose very early in the discussions was the question whether the old-age insurance program should be on a federal or a state basis. Some argued that both for administrative and for constitutional reasons the program should be established on a state basis. Others held that the high mobility of the American people made the problem of transferring insurance rights from state to state for millions of beneficiaries extremely difficult, and for this and other reasons urged that the system be placed on a national basis. The latter view prevailed and in the Social Security Act old-age insurance was made a purely federal system.

Constitutionality. A full-fledged federal contributory system, however desirable it might be from theoretical and practical points of view, involved certain constitutional difficulties. Precedent decisions indicated that the spending powers of Congress were little subject to attack in the courts; therefore the benefit program seemed to be legally safe. So, too, Congress was conceded to possess wide

latitude in levying taxes for general purposes. The difficulty came in the fact that a specific levy for the benefit of specific classes of persons might be held to be not a tax, and thus open to challenge. The Committee therefore decided to set up a benefit program and a tax system independent of and only vaguely related to each other.³⁰ The receipts were to be labelled as taxes, not as contributions.

When the Social Security cases came up to the Supreme Court, counsel for the government argued that the benefit structure was independent of the tax structure and could be administered quite apart from it. What part this argument played in the final determination of the constitutionality of the old-age insurance program no one can say with certainty, but it does appear as one of the points in the opinion declaring the old-age titles of the act constitutional.³¹

Extent of self-support. A third question concerned the extent to which the program should be self-supporting. In the British and some other European systems, provision is made for a government contribution to supplement the contributions of the workers and their employers. The opinion of the Committee on Economic Security was that the limitations of coverage, at least in the early years of the system, were so great that it was preferable that the program be financed for a considerable period of time solely by covered workers and their employers. The tax rates recommended were expected to finance the system on a self-supporting basis for approximately 25 years.³² However, when this question came before Congress, the Secretary of the Treasury urged that the tax rates established in the first draft of the bill should be stepped up so that the system would be self-supporting in perpetuity,³³ and Congress accepted the Treasury's recommendations.

Socialized or individualized benefits. The fourth issue of major importance was whether the benefits should be "socialized" or "indi-

³⁰ The same, p. 210.

³¹ 75 Cong. 1 sess., *Constitutionality of the Social Security Act*, S. doc. 74 (1937).

³² Social Security Board, *Social Security in America*, pp. 204-07.

³³ 74 Cong. 1 sess., *Economic Security Act*, pp. 897-900.

vidualized.” Some believed that the thinking of the American people was permeated with private life insurance concepts and that they would strongly support only a system which had those same characteristics—that is, a close tie-up between individual contributions and individual benefits. Others pointed out that in all European systems there was a considerable degree of levelling or socialization, and urged that the program might as well be put on this basis at the start. The result was a compromise. The act bore the imprint both of private life insurance concepts and of equalitarian sentiments.

An example of the former is found in the fact that the retirement benefits were based in part upon the accumulated lifetime earnings of the individual, thus carrying out the principle of contributions; while the latter point of view is exemplified in the provision that on the first \$3,000 of earnings the benefit rate be twelve times as high as on earnings above \$45,000.

The establishment of the reserve method of financing (discussed below) constituted further evidence of the influence of private life insurance concepts in the plan. Another illustration was the arrangement that the contributing employee (or his estate) would in every case receive from the system more than he himself had paid in. This was guaranteed in three different ways: lump-sum payments ($3\frac{1}{2}$ per cent of total wages received) to estates of covered workers dying before age 65; lump-sum payments ($3\frac{1}{2}$ per cent of total wages received) to those individuals who would reach age 65 but would not qualify for monthly benefits; and lump-sum payments to estates of beneficiaries who died before receiving in benefits an amount equal to $3\frac{1}{2}$ per cent of the total wages received.

The socialized concept of old-age security was further illustrated by the provisions that retirement benefits were to be paid only if the individual actually retired from work, and that in any month in which he received wages from regular employment his old-age benefit for that month was to be cancelled.

Reserves. The fifth fundamental issue which was considered by the Committee on Economic Security was the method of financing. Should the program be put on a “pay-as-you-go” basis or upon a

reserve basis? There was no disagreement regarding the fact that the "pay-as-you-go" basis would be simpler administratively and financially. However, advocates of the reserve idea emphasized certain inherent difficulties in the use of the "pay-as-you-go" method.

It was pointed out that in a system under which benefits are paid only to those who reach retiring age after the system is established, there will be comparatively small benefit payments in the early years before many individuals are qualified, while in the later years the payments will become much larger.²⁴ By levying in the early years rates considerably higher than are needed to support current benefit payments, a reserve can be accumulated, from the interest on which part of the cost in later years can be covered. Contributions can thus be kept more nearly uniform over the entire period.

It was estimated that in order to support the benefits provided in the Social Security Act, it would be necessary, when the system was fully matured, if no reserve were accumulated, to raise contributions amounting to 10 per cent of the pay roll (5 per cent from employers and 5 per cent from employees). It was the judgment of the staff of the Committee that this might constitute too heavy a burden upon employers and employees, especially in view of the fact that other types of insecurity than old age might in time be insured against. The Committee therefore recommended a tax schedule starting at 1 per cent of pay roll (employer and employee rates combined), and rising gradually at five-year intervals to a maximum of 5 per cent. This was calculated to provide a reserve fund somewhat in excess of 15 billion dollars, to be attained in 1965.²⁵

Congress decided to make the system more nearly self-supporting by levying higher taxes and accumulating a larger reserve. It was provided therefore that the tax rates begin at 2 per cent of pay roll (1 per cent each from employers and employees), and rise at three-year intervals to 6 per cent (3 per cent from employers

²⁴ In the Railroad Retirement Act, with a program designed for a single industry, eligibility is based retroactively upon past employment. Thus the railroad retirement system carries a relatively heavy burden in its early years.

²⁵ For details of tax rates and reserve fund, see Social Security Board, *Social Security in America*, pp. 210-14.

and 3 per cent from employees) in 1949 and thereafter. The purpose of this change was to create a reserve of sufficient size so that the interest upon it would be large enough to cover the deficit between the income yielded by the taxes and the disbursements involved in benefit payments. The reserve under these circumstances would exist in perpetuity. The actuaries of the Committee on Economic Security, whose calculations were of necessity mostly guesswork,⁶⁶ estimated that under the plan adopted the reserve fund required for this purpose, as well as the amount which would be accumulated, would be about 47 billion dollars by 1980.⁶⁷ The actuaries, of course, were unable to guarantee either that such a reserve would eventuate from the tax receipts and benefit payments set forth in the act, or that this figure measured the reserve which would be necessary to meet the specifications established by Congress—that is, that it be large enough so that the interest payments would meet the annual deficit.

Several major criticisms of the reserve system developed after the plan went into operation. One of the most common objections was that the reserve funds were being invested by the Treasury in special obligations, the proceeds of which were used for financing the current federal deficit. Hence, it was argued that the funds which were supposed to be set aside for the old folks in future years were being spent on public works, farm benefits, and other administration measures. Sometimes this argument took a naive form, such as the criticism that the Treasury was not setting aside these old-age receipts in cash or in gold until they should be needed to pay benefits. The warning frequently broadcast to working people that “your money isn’t there—it’s been spent” is indicative of this type of reasoning.

Some economists attacked the reserve as a deflationary influence in the economy. The reasoning for this position runs somewhat as follows: the economic system is suffering currently (and perhaps

⁶⁶ W. R. Williamson, “Cost Factors in Old-Age Insurance,” *Social Security Bulletin*, July 1938, pp. 3-15.

⁶⁷ 74 Cong. 1 sess., *The Social Security Bill*, S. rep. 628 (1935), p. 9.

more or less permanently) from over-saving or under-consumption; the pay-roll taxes abstract purchasing power from the workers, diverting it from consumption to savings; if there are no corresponding benefit payments the net result is an accentuation of the over-saving which already exists. Therefore, the extent to which the reserve is built up in any year is the measure of its deflationary influence.

Some individuals contended that investment in government bonds would result in "unproductive" capital expenditures (roads, parks, museums, schools) as contrasted with the more "productive" expenditure in private investments (factories, railroads, office buildings). These critics often expressed the fear that the reserve fund would draw savings away from the private capital market and hamper private investment in future years.

A political argument which was often advanced was that the existence of these surplus funds flowing into the Treasury every year would lead Congress into extravagant appropriations for purposes which would never be authorized if alternative taxes had to be raised in order to finance them, or if funds had to be borrowed in the market. Congress, like all other legislative bodies, is reluctant to tax, and therefore is likely to weigh appropriations carefully when new taxation will be required; but with the reserve available, it is argued, the spending habits of Congress would not be subject to this salutary check.

This is not the place to enter into an exhaustive analysis of the economics of the old-age reserve,⁸⁸ but a brief consideration of these criticisms may serve to clarify the issues. In the first place, the deflationary influences (if any) of the old-age insurance system should be considered only in relation to government finances as a whole. On June 30, 1939, after two and a half years of tax collections, the reserve reached a total of 1.2 billion dollars;⁸⁹ yet over this same period the expenditures of the entire federal government had exceeded revenues from all sources by more than 3 billion

⁸⁸ For some discussion of this problem by persons with differing viewpoints, see 76 Cong. 1 sess., *The Social Security Amendments of 1939*.

⁸⁹ Social Security Board, *Fourth Annual Report, 1939*, p. 210.

dollars.⁴⁰ In fact, the old-age reserve was in considerable measure offset by other Social Security expenditures; for example, in the period referred to, federal grants-in-aid to the states for old-age assistance totaled about 457.2 million dollars, over one-third of the amount in the reserve fund at the end of the period.⁴¹

Second, the question of the relative social productivity of various forms of capital goods should not be confused with the question of their capacity to yield a money income. A toll road built by private capital, for example, may yield interest on the investment, but it would have no greater social productivity than a similar road built with public funds and made freely available. However, there is this difference. In private investment each project's value (in so far as this can be measured in money terms) is subjected to a market test; while government investment does not ordinarily undergo such a test, item by item. Consequently, there is a greater risk that government investment, especially if limited in its choice of projects, might (for example) use too much of the nation's savings in laying out parks or building roads.⁴²

Third, the accumulation of a reserve does not have the function which is traditionally associated with the reserves of insurance companies; indeed it serves no real purpose in the financing of benefits. The total amount of taxes levied must always be at least equal to the total amount of the benefits, regardless of whether there is a reserve or not, since the interest on the reserve must itself be financed out of taxes. In the absence of a reserve, the special taxes in the early years need only be sufficient to meet the lower level of benefit payments. What the accumulation does in these earlier years is to provide funds for other government payments, while in the later years it will serve no useful purpose, except as its existence on paper may create a moral obligation on future Congresses to continue the system.

Nothing more than an implied pledge exists, to be sure, that

⁴⁰ See current issues of the *Treasury Bulletin*.

⁴¹ The major deflationary influence of the old-age insurance system, however, results from the effect of the pay-roll tax on employment.

⁴² For further analysis, see Chap. XXIX.

future Congresses some decades hence will continue the system in operation. Many doubt that this is enough protection for present contributors; they want some tangible evidence that these claims shall have first consideration, and suggest that the deferred obligations of the government be recognized through the issuance of bonds. Congress, so the argument runs, would have to tax for the payment of interest on government bonds or repudiate the debt, whereas it would be much less certain to tax for old-age benefits.

The validity of this argument is difficult to assess. The strength of a claim represented by government bonds is undoubtedly strong; but nations have been known to repudiate them, and at times to scale them down, directly or indirectly. On the other hand, after the German inflation, when bonds had become worthless, old-age insurance rights in Germany were revalued in the new money. Thus, it may well be that the moral claim of the old-age beneficiaries is stronger than their legal rights.

The pay-roll tax. The pay-roll tax became an issue in the election campaign of 1936, and subsequently there was more extensive discussion of the merits of this tax. Two criticisms seem worthy of comment.

First, it is contended that through a pay-roll tax the cost of old-age insurance falls almost wholly on the workers—directly in so far as it takes the form of employee contributions or leads to reduction of wages, and indirectly to the extent that the employers' share is passed on in higher prices to the ultimate consumers, the great majority of whom are workers and their families. It is argued that the burden should be borne more largely by other groups through the substitution, for example, of income and inheritance taxes, or as the Townsendites urged, a universal transactions tax (though the latter would probably be similar in incidence to the pay-roll taxes).

Second, the plight of the excluded classes is emphasized. In so far as the employers' tax is passed on to them, they bear part of the cost of the system but receive none of the benefits. Furthermore, some of these excluded classes (agricultural workers and domestic

servants, for example) are among the least able to carry such a burden.

In countering these criticisms it has been held that the pay-roll deductions tend to develop in the minds of the masses who participate in the program a sense of financial responsibility, and aid therefore in preserving political sanity in the general population with respect to these matters. Furthermore, it is pointed out, the deductions need not be viewed as taxes at all, but rather as contributions (compulsory, of course) toward an eventual asset. In governmental retirement systems—federal, state, or local—the government employees do not consider their retirement payments as taxes. Finally, it is held, the pay-roll taxes need not, by themselves, meet all the acceptable standards of sound taxation. The tax system of the government must be viewed as a whole. There are already in existence steeply progressive income and inheritance taxes, and it may well be that the pay-roll tax, even if regressive, does not unbalance the whole tax structure.

Revision of the program—social security amendments of 1939. Many of the questions which had been raised concerning the old-age insurance system came to the attention of Congress in the spring of 1937. In May, the Chairman of the Senate Finance Committee appointed a special committee of three members to co-operate with the Social Security Board in studying the advisability of amending the old-age insurance provisions of the Social Security Act.⁴³ The special committee and the Board jointly appointed an Advisory Council consisting of six persons representing employers, six representing employees, and thirteen representing the general public. The Council held a series of meetings during 1937-38, and rendered a final report in December 1938. In January 1939 the Social Security Board also made a report⁴⁴ to the President and to Congress concerning proposed changes in the Social Security Act.

On the whole, the Board and the Advisory Council recommended

⁴³ Press Announcement, May 1937. Reproduced in *Final Report of Advisory Council on Social Security (1938)*, p. 3.

⁴⁴ Social Security Board, *Proposed Changes in the Social Security Act (1939)*.

the same general changes. The Board emphasized particularly certain basic principles which they believed must underlie an old-age security system consisting of both insurance and assistance. The Board said:

The basic problem of old-age insurance is to make the system more immediately and fully operative without destroying the reasonable relationship which must exist in such a program between benefits payable and past earnings. Such a relationship must exist under any system of retirement insurance, whether social insurance or an industrial pension plan, unless the term "insurance" is to lose all its meaning. For the protection of future beneficiaries and future taxpayers it is essential that this reasonable relationship be maintained; just as in the case of old-age assistance it is necessary to maintain a reasonable relationship between assistance granted and the needs of the individual.⁴⁵

In summary, the Advisory Council and the Social Security Board recommended that payment of old-age benefits should be advanced from January 1, 1942 to January 1, 1940; that the old-age benefits payable in the early years should be increased, but that the eventual cost of the revised benefits should not exceed those in prospect under the existing act; that benefits should be paid to wives of annuitants and to widows of insured workers, and to children left dependent upon the death of an insured worker. The Council was also in unanimous agreement as to the desirability of paying benefits for total and permanent disability, but did not reach agreement on the timing; some members favored immediate legislation, while others believed the problem should receive further study.

The Board made one important recommendation with respect to benefits, namely, the utilization of average wages instead of total accumulated wages as the benefit base. The average wage would be obtained by dividing the total accumulated wages by the length of time during which an individual might have worked in covered employment (regardless of whether or not he actually held such a job during such period). Thus the benefits payable in the early years of the system would be substantially higher, as compared with the later years, than under the old plan, since they would be related

⁴⁵ The same.

to the average wage-earning capacity of the individuals who were near retirement age, and not to their relatively small total accumulations. To compensate in part for the possibility that the worker's earnings (and consequently his eventual monthly benefits) might decline after middle age, the Board recommended that in addition to the average wage there should be taken into account, in the computation of benefits, a small percentage increment, based on length of time insured, to be added to the basic benefit. Thus, two workers with the same average wage upon retirement would receive different benefits if one had worked longer than the other.

With respect to coverage, both the Council and the Board recommended extension to certain excluded classes, mentioning particularly employees of non-profit institutions and of farms, domestic employees, and ultimately self-employed persons and government employees. With respect to finance, it was recommended that in addition to the pay-roll taxes on employers and employees, there should be federal financial participation out of general revenue; that the old-age insurance fund should become a trust fund with automatic crediting to that fund of the taxes levied for that purpose; that the reserve should consist of a reasonable contingency fund only; and that changes in the tax schedule should be postponed until after the rates of $1\frac{1}{2}$ per cent each upon employer and employee were in effect.⁴⁶

Extensive hearings on proposed amendments or revisions of the Social Security Act were held by the Ways and Means Committee of the House of Representatives,⁴⁷ and later by the Senate Finance Committee. The Ways and Means Committee later reported to the House of Representatives in May 1939 a bill entitled "Social Security Amendments of 1939," which was eventually passed, in amended form, by both houses.⁴⁸

Significance of the changes. While the new old-age insurance measure embodies many of the same fundamental principles as the old one, some very important modifications were introduced. The

⁴⁶ For details, see *Final Report of the Advisory Council on Social Security*.

⁴⁷ 76 Cong. 1 sess., *The Social Security Act Amendments of 1939*; 76 Cong. 1 sess., *Social Security*, Hearings before (Senate) Committee on Finance (1939).

⁴⁸ For a summary analysis of this act, see pp. 1232-33.

**SOCIAL SECURITY ACT
TITLE II: OLD-AGE AND SUR-**

	Primary Insurance Benefits (Formerly monthly old-age benefits) Section 202 (a)	Wife's Insurance Benefits Section 202 (b)	Child's Insurance Benefits Section 202 (c)
Benefit Conditions	<ol style="list-style-type: none"> 1. Attained age 65. 2. Filed application. 3. Fully insured individual after December 31, 1939. Must satisfy one of two conditions: <ol style="list-style-type: none"> A. Had at least 1 quarter of coverage for each 2 quarters after 1936, or after quarter in which attained age 21, whichever is later, and up to quarter in which attained age 65, or died, whichever first occurred. B. Had at least 40 quarters of coverage. 	<ol style="list-style-type: none"> 1. Wife of man entitled to primary insurance benefits after December 31, 1939. <ol style="list-style-type: none"> (a) Married to him before January 1, 1939, or, if later, before he attained age 60, or (b) Mother of man's child. 2. Attained age 65. 3. Filed application. Identity of applicant as wife to be determined in accord with State intestacy law. 4. Living with husband at time of application. <ol style="list-style-type: none"> (a) Members of same household, or (b) husband contributing regularly to support, or (c) ordered by court to contribute to support. 5. Not entitled to primary benefits on own account, or entitled to primary benefits on own account equal to less than half primary benefit of husband. 	<ol style="list-style-type: none"> 1. Child of individual entitled to primary benefits, or who died a fully or currently insured individual after December 31, 1939. Includes: <ol style="list-style-type: none"> (a) Stepchild by marriage contracted before stepparent attained age 60 and before beginning of 12th month prior to month in which died. (b) Child legally adopted before foster parent attained age 60 and before beginning of 12th month prior to month in which died. 2. Filed application. Identity of applicant as child of particular insured person to be determined in accord with State intestacy laws. 3. Unmarried and not attained age 18 at time of application. 4. Dependent on parent at time of application or at time of parent's death. <ol style="list-style-type: none"> (a) Dependent on father or adopting father, unless— <ol style="list-style-type: none"> (1) Father not living with or contributing to support of child, and (2) Child neither his legitimate nor adopted child, or (3) Child adopted by some other person, or (4) Child living with and supported by stepfather at time of father's death. (b) Dependent on mother, adopting mother, or stepparent, provided— <ol style="list-style-type: none"> (1) No parent other than such individual contributing to child's support. (2) Child not living with father or adopting father.
Benefit Rate	<ol style="list-style-type: none"> 1. Average monthly wage of \$50 or less: 40% of average wage. 2. Average monthly wage of over \$50: 40% of \$50, plus 10% of difference between \$50 and average monthly wage not in excess of \$250. 3. Plus 1% of amount computed under "1" or "2" above x number of years in which at least \$200 of wages were paid. 4. Minimum shall be \$10. 	<p>One-half primary benefit of husband.</p> <p>If entitled to primary benefit on own account, wife's benefit to be reduced by amount of her own primary benefit.</p> <p>(Deduction is theoretical only; individual's own primary benefit would be paid.)</p>	<p>One-half primary benefit of parent on whose wages child's benefits are based.</p> <p>If more than one insured parent, child's benefit to be one-half of whichever primary benefit is greatest.</p> <p>(Note: Presumption of dependency on father.)</p>
Benefit Period	<p>Beginning: Month when first entitled to benefits.</p> <p>Ending: Month preceding that in which he dies.</p>	<p>Beginning: Month when first entitled to benefits.</p> <p>Ending: Month preceding month of</p> <ol style="list-style-type: none"> 1. death 2. husband's death 3. divorce <p>4. entitled to primary benefit on own account at least equal to one-half of husband's primary benefit.</p>	<p>Beginning: Month when first entitled to benefits.</p> <p>Ending: Month preceding month of</p> <ol style="list-style-type: none"> 1. death 2. marriage 3. adoption 4. age 18.

* As summarized by the Social Security Board.

AMENDMENTS OF 1939^a
 VIVORS' INSURANCE BENEFITS

Widow's Insurance Benefits Section 202 (d)	Widow's Current Insurance Benefits Section 202 (e)	Parent's Insurance Benefits Section 202 (f)	Lump-Sum Death Payments Section 202 (g)
<p>1. Widow of man who died fully insured after December 31, 1939. (a) Married to him prior to beginning of 12th month before month in which he died, or (b) Mother of man's child.</p> <p>2. Not remarried.</p> <p>3. Attained age 65.</p> <p>4. Filed application. Identity of applicant as widow of particular insured person to be determined in accord with State intestacy laws.</p> <p>5. Living with husband at time of his death. (a) Members of same household at time of his death, or (b) wife receiving regular contributions from husband towards support, or (c) husband had been ordered by court to contribute to support.</p> <p>6. Not entitled to primary benefits on own account, or entitled to primary benefits on own account equal to less than three-fourths primary benefit of husband.</p>	<p>1. Widow of man who died fully or currently insured after December 31, 1939. (a) Married to him prior to beginning of 12th month before month in which he died. (b) Mother of man's child.</p> <p>2. Not remarried.</p> <p>3. Not entitled to widow's insurance benefit.</p> <p>4. Not entitled to primary benefits on own account, or entitled to primary benefits on own account equal to less than three-fourths primary benefit of husband.</p> <p>5. Living with husband at time of his death. (a) Members of same household at time of his death, or (b) wife receiving regular contributions from husband towards support, or (c) husband had been ordered by court to contribute to support.</p> <p>6. Filed application: Identity of applicant as widow of particular insured person to be determined in accord with State intestacy laws.</p> <p>7. At time of application has in her care child of husband entitled to child's benefits.</p> <p>----- Note: <i>Currently insured individual</i>—One who has been paid wages of at least \$50 for each of not less than 6 of the 12 calendar quarters immediately preceding the quarter in which he died. -----</p>	<p>1. Parent of person who died fully insured after December 31, 1939. (a) Mother or father. (b) Stepparent by marriage contracted before such person attained age 16. (c) Adopting parent by whom person was adopted before attained age 16.</p> <p>2. Insured person left no widow and no unmarried child under age 18.</p> <p>3. Parent attained age 65.</p> <p>4. Wholly dependent on and supported by insured person at time latter died. Filed proof of dependency and support within 2 years after insured person's death.</p> <p>5. Has not married since insured person's death.</p> <p>6. Not entitled to any other insurance benefits, or entitled to receive one or more of such benefits for a month, but total for month less than half a primary benefit of dead insured person.</p> <p>7. Filed application. Identity of applicant as parent of particular insured person to be determined in accord with State intestacy laws.</p>	<p>1. Payable on account of a fully or currently insured person who died after December 31, 1939, leaving no widow, child, or parent entitled to a benefit for the month in which the insured person died.</p> <p>2. Payable to any of the following categories of relatives or other persons in the order indicated: (a) Widow or widower, (b) Child or children, and any other person or persons entitled under State intestacy law to share with children. (c) Parent or parents in equal shares. (d) Any other person or persons who paid burial expenses of deceased to extent of and in proportion to expenses incurred.</p> <p>3. Filed application within 2 years from date of death.</p>
<p>Three-fourths of primary benefit of husband. If entitled to primary benefit on own account, widow's benefit to be reduced by amount of her own primary benefit. (Deduction is theoretical only; individual's own primary benefit would be paid.)</p>	<p>Three-fourths of primary benefit of husband. If entitled to primary benefit on own account, widow's current benefit to be reduced by amount of her own primary benefit. (Deduction is theoretical only; individual's own primary benefit would be paid.)</p>	<p>One-half of primary benefit of son or daughter. If entitled to other benefits on own account, parent's benefit to be reduced by amount of other benefits receivable. If parent was dependent on more than one son or daughter, parent's benefit to be based on whichever primary benefit is greatest. (Deduction is theoretical only; primary or other benefit having priority would be paid.)</p>	<p>Six times primary benefit (maximum).</p>
<p>Beginning: Month when first entitled to benefits. Ending: Month preceding month of 1. remarriage. 2. death. 3. entitled to primary benefit on own account at least equal to three-fourths husband's primary benefit.</p>	<p>Beginning: Month when first entitled to benefits. Ending: Month preceding month of 1. there is no child (of deceased) entitled to receive child's benefits. 2. entitled to primary benefit on own account at least equal to three-fourths deceased husband's primary benefit. 3. entitled to widow's insurance benefit. 4. remarriage. 5. death.</p>	<p>Beginning: Month when first entitled to benefits. Ending: Month preceding month of 1. death. 2. marriage. 3. entitled to other insurance benefits at least equal to one-half deceased son's or daughter's primary benefit.</p>	

most important of these was the fact that the insurance benefits were "socialized" to a much greater extent than in the original act, in which benefits were payable to an individual wage earner without reference to his family or dependents. Under the revised act, benefits are paid to the retired annuitant and to his wife if aged 65 or over, and the amount of the benefit is increased on behalf of any children under 18 years of age if in school. Survivors' benefits are also paid to the widow of the annuitant when she reaches retirement age. To illustrate, if a single man after retirement would draw a benefit of \$40 per month, a married fellow-worker, with exactly the same wage record, would draw \$40 for himself and \$20 on behalf of his wife, if she was also of retirement age. Should a retired beneficiary have a dependent child under 18 years of age, going to school, an additional \$20 per month would be allowed for the child.

A second important modification is the provision that the widow and children of an insured worker who dies at any age are entitled to survivors' benefits until all children have reached the age of 18 years, if they are in school. This is in addition to the survivors' benefits paid the widow (if her husband died fully insured) upon the attainment of retirement age. The provision for these benefits to the widows and children of deceased workers greatly expands the protection afforded under the system, and meets a demand which in the case of younger workers is in certain respects more urgent than the demand for a retirement benefit many years in the future.

Third, an effort was made to keep the costs of the new system within the bounds set by the old system. This result was accomplished by reducing the benefits to single men and women, by eliminating lump-sum benefits to workers ineligible for retirement benefits, and by limiting the lump-sum payments to the estates of workers who die before reaching retirement age to a maximum of six times the basic monthly benefit, and by making this lump-sum payment only when no survivor is immediately entitled to an annuity. The savings achieved by these changes are expected to provide the funds for wives', widows', and dependent children's benefits.

A further important change was the "freezing" of the pay-roll

taxes for the next three years, 1940-42, at 1 per cent each from employers and employees, and the amendment of the provisions concerning the old-age reserve account so that in the future the goal is not to provide a large reserve, but only a "contingency" reserve of much smaller proportions. After 10 or 15 years the pay-roll taxes, together with the interest on this reduced reserve, will probably be insufficient to pay the benefits that are provided for. It will be necessary either to reduce benefits, to increase pay-roll taxes or to make government contributions from general revenue.

No provision was made in the revised legislation for the worker who becomes disabled by accident or disease before he reaches retirement age. The Advisory Council and the Social Security Board both recommend that provision should be made eventually, but not immediately, for disability benefits to such workers and their families.

Railroad retirement. A separate system of old-age insurance for railway workers was provided in the Railroad Retirement Act of 1934. This act was declared unconstitutional by the Supreme Court in May 1935. A second act approved in August 1935 resulted in protracted litigation. At the suggestion of President Roosevelt, a conference of railroad managements and railroad unions met and devised a mutually acceptable retirement system, which led, in June 1937, to congressional amendment of the 1935 act. Benefit payments began in July 1936 and have continued without interruption but did not reach any considerable proportions until after the amendments of June 1937.⁴⁹

The railroad retirement system has the same general characteristics as the larger old-age and survivors' insurance program, with taxes or contributions⁵⁰ from employers and employees, and with benefits based upon the previous earnings history of the worker.

⁴⁹ A considerable number of the railroad companies had earlier established private retirement systems for their employees; some of these systems had been in operation for many years. The workers, however, became increasingly dissatisfied with these private systems. They favored a separate system for railway workers over merging with the general social security system which was then being considered.

⁵⁰ The excise tax on employers and the income tax on employees begin at $2\frac{3}{4}$ per cent each in 1937 and rise by $\frac{1}{4}$ per cent each every 3 years until they reach $3\frac{3}{4}$ per cent each in 1949.

In certain respects, however, they are different. In the first place, the railroad retirement system took over the private pension systems which had preceded it, including payments already being made to railroad workers previously retired. Second, the railroad retirement system includes provisions for payment of benefits for permanent total disability, which have not so far been incorporated in the general old-age and survivors' insurance system. Such benefits are limited to workers who either have 30 years' service or are over 60 years of age. Third, the qualifications required for eligibility for retirement benefits differ greatly from those in the general social security program. Under the railroad act, service prior to the passage of the act is recognized up to a total of 30 years. Fourth, benefits under the railroad system are considerably higher than under the larger program, but this is partly offset by the fact that the railroad act makes no provision for benefits to dependents.

Thus far there has been no legislative provision governing any overlap between the railroad system and the general system. It is possible now that workers entitled to railroad retirement benefits may also acquire eligibility under general old-age and survivors' insurance, and will have legal rights to benefits from both systems simultaneously.

E. Old-Age Insurance in Operation

Below is set forth a statistical analysis of the operation of our system of old-age insurance.

OLD-AGE INSURANCE: FEDERAL TAXES COLLECTED, CERTIFIED LUMP-SUM PAYMENTS, AND EMPLOYEE ACCOUNTS ESTABLISHED

Year Ending June 30	Federal Taxes Collected (In thousands of dollars) ^a	Certified Lump-Sum Payments ^b		Employee Accounts Established (Cumulative total) ^c
		Number of Claims	Amount (In dollars)	
1937.....	198,341	4,419	59,612	30,296,470
1938.....	510,551	165,203	5,855,755	39,565,157
1939.....	529,443	212,053	14,315,164	44,727,520

^a *Annual Report of the Social Security Board, 1938*, p. 157; the same, *1939*, p. 214.

^b The same, *1938*, p. 173; *1939*, p. 230.

^c The same, *1939*, p. 218.

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OLD-AGE INSURANCE: TOTAL NUMBER OF EMPLOYEES COVERED, TOTAL TAXABLE WAGES, AND AVERAGE WAGES, BY INTERVAL OF EARNINGS, 1937^a

Interval of Earnings (In dollars)	Employees		Reported Taxable Wages		
	Number (In thousands)	Per Cent of Total	Amount (In thousands of dollars)	Per Cent of Total	Average per Employee ^b (In dollars)
1- 99	4,412	14.6	170,762	0.6	39
100- 199	2,249	7.5	330,018	1.2	147
200- 299	1,802	6.0	446,532	1.7	248
300- 399	1,643	5.5	572,185	2.1	348
400- 499	1,545	5.1	693,815	2.6	449
500- 599	1,521	5.0	834,117	3.1	548
600- 699	1,539	5.1	997,468	3.7	648
700- 799	1,538	5.1	1,152,842	4.3	749
800- 899	1,394	4.6	1,182,686	4.4	848
900- 999	1,336	4.4	1,265,962	4.7	948
1,000-1,499	5,272	17.5	6,486,143	24.2	1,230
1,500-1,999	3,087	10.2	5,306,683	19.8	1,719
2,000-2,499	1,334	4.4	2,958,638	11.0	2,217
2,500-2,999	605	2.0	1,647,116	6.2	2,723
3,000 and over	880	3.0	2,780,399	10.4	3,161
Total	30,158	100.0	26,825,366	100.0	890

^a Compilation based on wage items posted by July 9, 1938 relating to 93 per cent of total taxable wages reported for 1937 and 96 per cent of estimated total number of employees receiving such wages in 1937. Data are corrected to Mar. 1, 1939. *Social Security Bulletin*, March 1939, p. 7.

Preliminary data for 1938 supplied by the Social Security Board indicate 31.3 million employees and 28.6 billion dollars of taxable wages.

^b Average affected by part-time employment in covered industries.

RAILROAD RETIREMENT: NUMBER OF ANNUITIES AND PENSIONS IN FORCE, AMOUNT OF BENEFITS PAYABLE PER MONTH, AND AMOUNT OF BENEFIT PAYMENTS CERTIFIED^a

Year	Number of Annuities and Pensions in Force ^b	Amount of Benefits Payable per Month ^b	Amount of Benefit Payments Certified (In year ended June 30)
1936	1,742	\$ 108,261	...
1937	86,632	5,214,726	4,604,232
1938	123,630	7,717,077	82,994,286
1939	138,808	8,740,110	106,841,632

^a *Social Security Bulletin*, July 1939, pp. 8 and 10; August 1939, p. 67; February 1940, p. 77.

^b As of December 31.

IV. SECURITY AGAINST UNEMPLOYMENT

A. Nature of the Problem

For ten years there has existed in the United States persistent unemployment ranging, according to current estimates, from a minimum of about 4 million workers in the early months of 1930 to a peak of 14 to 16 millions in the depths of the depression in the spring of 1933, and fluctuating around 8 to 10 millions in the closing years of the decade. In certain previous periods—1927, 1924, 1921-22, 1914-15, 1907-08, 1893-95—large-scale unemployment existed in the United States; while in other periods, such as 1929, 1926, 1923, 1916-20, 1909-10, 1905-06, 1898-1900, the problem largely disappeared.

In so far as unemployment is the product of depression it may be expected that it will largely disappear in the next era of prosperity. There is a widespread belief, however, that unemployment is not wholly a depression phenomenon—that some degree of continuous unemployment is unavoidable in our modern economy—and this belief has undoubtedly contributed to the acquiescence of the public in proposals for unemployment insurance.

One other aspect of unemployment should be emphasized. Amidst all the unemployment which has existed in the past ten years, there are many workers who have never experienced any unemployment at all, and most others have had work from time to time. Only a small minority of those who have become unemployed during this long depression have remained entirely or even largely unemployed over the whole period. At all times there is a turnover in the employed labor force which inflicts unemployment upon some of those who have been at work and provides job opportunities for some of those who have been out of work.

Observation of this phenomenon in England over a period of two decades has led students of the problem to divide the unemployed into two groups: the short-run unemployed, and the long-run unemployed. The members of the latter group are sometimes defined as those continually out of work for a year or more, and are referred to as the "hardcore" of unemployment. Unemployment

thus presents two problems. The first concerns the short-run unemployed who face the necessity of tiding themselves over a temporary difficulty. For these, unemployment compensation may be a reasonable and practicable device. On the other hand, for the "hardcore" there may be required a change of occupation and perhaps the learning of new skills.

B. Devising an Unemployment Insurance System

There was very little American experience to guide the Committee on Economic Security in developing a comprehensive system of unemployment insurance for the United States, although after the beginning of the depression several bills had been introduced in Congress, and commissions to study unemployment insurance had been appointed in a considerable number of states.⁵¹ Wisconsin was the only state in which unemployment insurance legislation had actually been passed when the Committee on Economic Security was appointed, although six more states had enacted legislation before the federal Social Security Act was passed.

The role of the government. The first major question faced by the Committee on Economic Security⁵² concerned the proper role of government, particularly the federal government. In considering this problem, the committee reviewed a series of different alternatives.

One possibility was that of encouraging voluntary unemployment insurance by individual employers, either with or without governmental support. This alternative had been incorporated in the Wisconsin act, discussed above.⁵³ From Denmark and Belgium came reports of fairly successful trade union systems. The committee, however, concluded that an exclusively voluntary system was undesirable. Voluntary action, the Committee decided, might leave important aspects of the problem of unemployment untouched, and

⁵¹ One student reports that between 1930 and 1936 no less than 35 commissions made reports in 19 states. Harry Malisoff, "The Emergence of Unemployment Compensation," *Political Science Quarterly*, Vol. 54 (1939), pp. 237, 248.

⁵² The following discussion has drawn freely upon the review of this whole subject in Social Security Board, *Social Security in America*.

⁵³ See pp. 1209-10.

would almost certainly limit the benefits of the program to a small fraction of the industrial population.

A second alternative was to leave unemployment insurance entirely to the states. The precedent of workmen's compensation was cited in this connection. But workmen's compensation had developed very slowly and unevenly among the states; there were still a few states in which no compensation existed after two decades of intensive activity in other states.

A third alternative was a straight national system. The extensive movement of workers from state to state pointed strongly toward a national system as the suitable method of handling certain aspects of the problem. Quite clearly, also, the actuarial basis of the system would be sounder if all the risks were pooled.

In favor of establishing unemployment insurance on some state basis was the fact that many of the basic issues in unemployment insurance had not yet been solved. Concretely, for example, there was disagreement as to whether unemployment insurance should be based upon individual employer reserves or upon a pooling of funds from all employers. Wisconsin had adopted employer reserves, but most state commissions favored the pooling of funds. The establishment of a national system would force an immediate decision upon this question, while a state system would permit experimentation with different arrangements in different states.

Further, there was danger of administrative rigidity in a nationwide organization, especially in view of the fact that the administration of placement and of payment of benefits would necessarily be localized.

In view of all these factors, as well as constitutional uncertainties, the Committee on Economic Security decided against a straight system, either state or national, and recommended a system of federal-state co-operation. In general, the committee thought that the function of the federal government in this field should be to encourage the passage of state laws by removing the competitive disadvantages which they imposed. It was known that the passage of workmen's compensation laws had been blocked in some states by the claim that such laws competitively burdened industry in the

states having them, as compared with those states which did not impose such burdens. On the other hand, it was thought that the states were better fitted than the federal government to administer the program.

Even within such a system of federal-state co-operation, there were several alternatives. In particular, there was a long struggle between those who advocated a federal subsidy plan and those who favored a tax-offset plan. These two plans are described as follows:

Under the plan for federal grants of all funds, the entire amount of the federal tax was to be collected by the federal government and an amount equal to the tax so collected from each state returned to it as a federal grant if its unemployment compensation law complied with standards prescribed by federal law. The advocates of this procedure argued that it would make possible the writing of definite standards into the federal legislation; federal standards would result in more uniform state legislation and administration. . . .

The second type of federal-state system considered was the tax-offset plan, under which a federal tax was levied on the pay rolls of all employers and a credit up to 90 per cent of the tax allowed for contributions paid by employers into a state unemployment compensation fund.⁵⁴

The committee recommended the tax-offset plan. In reaching this decision, the factor which seems to have influenced the committee most was the fear of concentrating too much responsibility in one agency. Under the subsidy plan, all funds would be raised and all appropriations made by the federal Congress, states being only administrative agencies; under the credit-offset plan, the states were expected to provide independent funds through their own tax systems. The committee was convinced also that for constitutional reasons the credit-offset plan was the more expedient. Accordingly, they recommended that type, and it was incorporated in the new legislation.

The system of unemployment insurance. Since the actual legislation itself was to be written by the states, there remained for federal consideration only the general principles to govern the action of the states. The first of these was the actuarial basis on which the system should be developed. On this point there were two possi-

⁵⁴ Social Security Board, *Social Security in America*, pp. 94-95.

bilities. The rate and duration of benefits might be fixed, and the contributions determined in accordance with the requirements of such standards; or the contributions might be fixed, and the rate and duration of benefits adjusted to the funds thus made available. The committee adopted the second of these alternatives, probably for two reasons. First, there was some concern lest the rate of contributions be fixed at a level too high for industry to sustain without undue hardship; and second, the natural pattern of a credit-offset plan would point in the direction of establishing a fixed federal tax on a nation-wide basis and letting the benefits be adjusted to the yield of such a tax. The program finally arranged provided for a 3 per cent federal tax upon the total pay rolls of employers covered by the system, with a 90 per cent credit-offset to employers in states which passed approved unemployment insurance laws.

The coverage for unemployment insurance conformed in general to that which was simultaneously established for old-age insurance, except that workers employed in small firms were excluded, and workers over 65 years of age, if otherwise eligible, were included. The exclusion of small establishments from unemployment compensation was partly because employment in small firms was believed to be more stable than in large establishments, and partly for administrative reasons, particularly the difficulty of giving small employers appropriate credit for favorable employment experience. It was recognized also that the administrative burden and the costs of handling the workers employed by small firms would be very heavy.

As finally worked out by the Committee, and eventually passed by Congress, only employers who had eight or more employees in each of 20 weeks within the year were included.

Passage of state laws. There were doubts as to whether the proposed federal tax would have the desired effect of inducing the states to pass satisfactory unemployment compensation laws. It was recognized that the program would be a failure unless a substantial majority of states passed such laws. These fears, however, proved to be groundless. By the end of the first six months of 1936, a total of 15 state unemployment compensation laws had been

passed, most of them closely modeled after one or the other of the alternative draft bills issued by the Social Security Board.⁵⁴ Other states followed, until within less than two years after the Social Security Act was approved, every one of the 48 state and the three other jurisdictions (District of Columbia, Alaska, and Hawaii) had passed laws which were eventually approved by the Social Security Board. Thus the credit-offset plan was strikingly successful, in so far as its purpose was to stimulate the establishment of unemployment compensation systems in the states.

The first laws passed by the states, partly because of pressure of time, followed the federal draft bills closely. Later, however, a considerable number of states revised their laws, with resulting diversity. This process is still going on. The general situation at the end of 1939, representing mostly the results of the 1939 sessions of the state legislatures, may be summarized as follows:

The coverage of the state laws corresponds closely to that specified in the federal act.⁵⁵ Occasionally, however, a state excludes employments which are taxable under the federal law, and some states include kinds of employment that are not covered under the federal act. For example, the Idaho law covers domestic servants in private homes, and the New York law brings in domestic servants when the number of employees in the home is four or more. Twenty-six states have extended the coverage to firms smaller than the federal limit. The other 25 jurisdictions have kept the size-of-firm exclusion at eight employees, as in the federal law.

The maximum employer credits allowed by the federal act amount to 2.7 per cent of pay roll. All but three jurisdictions have taxed their employers at this rate, two setting the rate at the full

⁵⁴ Social Security Board, *Third Annual Report, 1938*, Table C-1, p. 175. One of these laws (Utah) was later repealed and re-enacted; another (Washington) was held by the state supreme court never to have become effective.

⁵⁵ The federally excluded employments are very similar to those noted previously for old-age insurance—namely, agricultural labor; domestic service in a private home; casual labor; service performed on vessels on navigable waters; family employment; services performed for the United States government or its instrumentalities, or for a state, its local political subdivisions, or instrumentalities of such; and service for non-profit organizations of a religious, charitable, scientific, literary, or educational character.

3 per cent and the other at 3 per cent for employers not subject to the federal tax.

No employee contributions are levied under the federal act. Comparatively few of the first state laws provided for employee contributions, and as time went on the number decreased. At the end of 1939 only six jurisdictions out of 51 made any provision for employee contributions, and these were in all cases considerably smaller than employer contributions, the majority setting the rate at 1 per cent and not to exceed one-half the employer contributions.

The federal act is so drawn that states can establish either a pooled fund for all employers in the state, or an individual employer reserve system under which an employer is charged with the benefit payments to his own employees. A total of 44 jurisdictions have adopted the pooled fund. Only three (including Wisconsin) have a straight employer reserve, and even in these three the earnings of the fund are deposited in a pooled account, while in one of them there are employee contributions which also go into the pool. Four have adopted a hybrid system of employer reserves with partial pooling. In these jurisdictions a certain fraction of the employer's contribution is put into the pooled fund, which is used for payment of benefits to employees whose employers have exhausted their reserve accounts.

While the employer reserve plan has not had much appeal, some of the principles of such a plan have found expression in another way—through “experience rating.” Of the 44 states with pooled funds, only 12 do not have some form of experience rating either written into the law or left to be determined by the administrative agency. Among these 12 all but one have made provisions for study of experience rating, with the implication in many instances that the study is to result in a plan. Only one state (Pennsylvania) has what might be called a straight pooled fund without any implication of future modification.

The principle which lies back of experience rating is to reward the employer whose employment is more stable than the average by giving him a tax reduction, and in some instances to penalize the unstable employer by assessing him at higher than the standard

rate. Experience rating takes so many forms that it is difficult to summarize the provisions on this subject. Of the states which levy higher than standard rates on employers with unfavorable experience ratings, eight (including both pooled-fund and employer-reserve states) provide for a maximum rate of 4 per cent, while in a considerable number of other states the maximum is 3.6 per cent or 3.7 per cent.

In the matter of benefits the states also vary widely. In every state benefits are graduated in some degree in relation to wages previously earned. In the District of Columbia alone they are modified in accordance with the number of dependents. Broadly speaking, the benefits run about 50 per cent of a worker's weekly earnings in regular employment, up to a maximum benefit which is usually set at \$15 per week, with five states at \$16, and four states at \$18. One state has established a minimum of \$10, one of \$7.50, four of \$7, four of \$6, and a considerable number of \$5 or less. Three states have set no minimum benefits.

The period for which benefits may be drawn also varies widely. In the beginning, practically all states adopted systems which resulted in different duration for different individuals, depending on their previous earnings in covered employment. Some employees might draw benefits for only 3 or 4 weeks, while others, with longer employment experience, might draw benefits for 16 weeks or more; in one state the maximum was indefinite, depending upon the worker's record of prior employment. There is a movement, however, to make the permissible duration for all eligible employees more uniform. Nine states now have a simple system of flat duration only, usually 16 weeks, while many others have greatly narrowed the range of permitted duration, usually by extending the lowest maximum period. Few states now terminate benefits at less than six or eight weeks.

The period which the worker was required to wait prior to the first payment of benefits was usually, in the early state laws, three weeks, with two states having four weeks, and a few two weeks. There were, also, waiting periods for later spells of unemployment. In the revisions of the laws which have occurred since, the tend-

ency has been to shorten the waiting period. Two weeks is now the general rule, with three weeks in a number of states. Additional waiting periods for later spells of unemployment have been practically eliminated.

In the early state laws the employment experience required in order to establish a worker's qualification for benefits was frequently as short as seven to ten weeks. The result was a high degree of eligibility. Later amendments generally raised the minimum qualifications so that the typical qualifying period (measured in most cases by amounts of earnings) is now equivalent to 15 weeks. This development was a natural parallel of the general increase in duration of benefits mentioned above. The tendency has been to provide more benefits for the more regular employees, and to eliminate entirely from benefits the irregular or short-time employees.

Under certain circumstances, unemployed workers are disqualified from receiving benefits. Workers who voluntarily quit their jobs without good cause, those who have been discharged for misconduct connected with their work, and those idle because they are participating in a labor dispute, are subjected to certain penalties, usually in the form of greatly extended waiting periods. In many states strikers are disqualified from benefit while the dispute is in progress or while a stoppage of work exists at the place of employment, but in others they may become qualified after a prolonged waiting period. In a few states a voluntary quit or a discharge for misconduct is penalized by complete loss of previously acquired benefit rights or by a decrease in total benefits to which the worker is entitled in the benefit year, but in most states the disqualification acts simply to postpone the drawing of benefits. The period of disqualification is in some states fixed by statute; in others it is variable within limits at the discretion of the administrator.

Disqualifications also arise in connection with opportunities for new employment. Should a worker fail to take an available job for which he is fitted and which meets certain standards, his benefits may be discontinued. This raises the question as to what is "suitable" employment. In general the rule is that the work must be of a kind identical with or closely related to his previous occupation, and must

be suitable for this particular employee in the light of personal circumstances, such as distance and home conditions. The Social Security Act requires, as a condition of approval of state laws, that compensation shall not be denied to an otherwise eligible worker for failure to accept new work "(1) if the position offered is vacant due directly to a strike, lockout, or other labor dispute; (2) if the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality; (3) if as a condition of being employed the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor organization."⁵⁷

The railroad unemployment insurance law. After the federal-state unemployment insurance system set forth above had been in operation for about two years, the railroad workers of the country began to press for the establishment of a separate unemployment insurance system for the railroad industry. There were several reasons for this demand. The railroad workers already had their own separate old-age retirement system, and they were excluded from the unemployment compensation systems in two states. Those railroad employees who regularly or frequently worked across state lines claimed that they were under handicaps in obtaining benefits under the state systems. Finally, some railroad workers believed that they could obtain more liberal treatment in a system planned for railroads only.

In the spring of 1938 the Railroad Unemployment Insurance Act⁵⁸ was passed. This act imposed a tax system upon the railroads and upon certain of their affiliates and subsidiaries; provided a system of benefits for unemployed railroad workers; and specified in detail the administrative procedure for segregating the railroad unemployment insurance system from the existing state systems, and for transferring appropriate amounts from the state unemployment trust funds to a Railroad Unemployment Trust Fund, which was set up in the United States Treasury. The amount transferred was to be determined for each state separately by finding the propor-

⁵⁷ Title IX, sec. 903 (a) (5), 49 Stat. L. 622, 639.

⁵⁸ 52 Stat. L. 1094.

tion which railroad contributions were of total contributions collected up to June 30, 1939, and applying this fraction to the balance in the Unemployment Trust Fund of the state as of that date.

C. Unemployment Insurance in Operation

The federal-state system of unemployment compensation has been in full operation (including the payment of benefits) for more than two years in 23 states, and for somewhat shorter periods in the rest. The last two states began the payment of benefits in July 1939. Benefits were first payable under the railroad system in that same month.

A few salient facts concerning the operation of our system of unemployment insurance are set forth below.

UNEMPLOYMENT COMPENSATION: FEDERAL TAXES COLLECTED, BALANCE IN TRUST FUND AT END OF YEAR, AMOUNT OF BENEFITS CHARGED UNDER STATE UNEMPLOYMENT LAWS, AND NUMBER OF WORKERS COVERED
(In thousands)

Year	Federal Taxes Collected ^a (In year ended June 30)	Balance in Trust Fund on June 30 ^b	Amount of Benefits Charged under State Unemployment Compensation Laws ^c		Number of Workers Covered ^e
			All States ^d	23 States	
1936.....	\$ 18,949
1937.....	\$ 57,840	313,603
1938.....	90,127	881,868	\$393,668	\$332,530	27,602 ^f
1939.....	100,759	1,273,609	429,398	273,041	27,980 ^g

^a *Annual Report of the Social Security Board, 1938*, p. 157; the same, *1939*, p. 214. The sums here represent taxes paid after deduction of credits for amounts paid into state unemployment funds in states having unemployment compensation laws certified for the taxable year by the Social Security Board.

^b Total for all states, Alaska, District of Columbia, and Hawaii. Includes interest credited. *Annual Report of the Social Security Board, 1939*, p. 212.

^c Net amount of payments, after adjustment for voided benefit checks. For 1938, *Social Security Bulletin*, February 1939, p. 35; for 1939, *Social Security Bulletin*, February 1940, pp. 32, 43.

^d Wisconsin was the only state in which benefits were payable prior to 1938. Benefits became payable in 22 additional jurisdictions in January 1938; in 2 states in April 1938; in 3 states in July 1938; in 1 state in September 1938; and in 2 states in December 1938. Thus at the end of 1938, benefits were payable in 31 jurisdictions. Benefits became payable in January 1939 in 16 states, Alaska, and Hawaii, and in the 2 remaining states in July 1939.

^e *Annual Report of the Social Security Board, 1938*, p. 176; the same, *1939*, p. 237. Includes workers who have acquired wage credits under state unemployment compensation laws.

^f As of May 1938.

^g As of June 1939.

UNEMPLOYMENT COMPENSATION: NUMBER OF INDIVIDUALS RECEIVING BENEFITS IN 1939, BY MONTHS, DURING WEEK ENDED NEAREST THE MIDDLE OF THE MONTH^a

Period	Number
January.....	657,208
February.....	769,770
March.....	833,159
April.....	685,073
May.....	776,006
June.....	802,209
July.....	764,262
August.....	797,345
September.....	729,929
October.....	501,714
November.....	637,104
December.....	658,295
Average.....	717,673

^a *Annual Report of the Social Security Board, 1939, p. 255; Social Security Bulletin, September 1939–February 1940 inclusive.*

The figures are not strictly comparable from month to month. Six jurisdictions began payment after January 28 and two states after June 30. One state suspended operations July 28 to September 26 inclusive.

The Social Security Board has estimated that between 4.8 and 5.0 million different individuals received compensation for varying periods of total and partial unemployment under state unemployment compensation laws during the calendar year. *Social Security Bulletin, February 1940, p. 45.*

RAILROAD UNEMPLOYMENT INSURANCE: WAITING PERIODS AND BENEFITS
CERTIFIED JUNE–DECEMBER 1939^a

Certificates of waiting period issued.....	130,257
Number of individuals certified for benefit payments.....	96,793
Benefit payments	
Number certified.....	385,450
Amount.....	\$5,767,508
Average amount.....	\$14.97
Average daily benefit amount ^b	\$2.26

^a *Social Security Bulletin, February 1940, p. 47.*

^b For October 28–December 1.

D. Emerging Problems

An important series of problems arose when the states began the payment of unemployment benefits. For nearly half the states this was at the beginning of 1938.

Eligibility requirements. A major difficulty arose in some states because of very low minimum qualifications for benefits. Workers with a comparatively small amount of covered earnings were to be eligible, but only for very small benefits, sometimes under \$1 per

week; frequently also for only a short period—not more than four or five weeks. Yet a worker who was eligible for unemployment compensation was ineligible for W.P.A. employment during the waiting period of three weeks, and thereafter as long as his benefit rights existed. In some states the agencies were able to lump the unemployment payments into a few weeks, thus providing higher benefits for a shorter period, or even to make full payment of these small benefits in a single week. Eventually there resulted a general raising of minimum qualifications for benefits, together with the establishment of higher weekly benefits and the lengthening of minimum periods of duration of benefits.

Partial employment. Another question which arose with the beginning of benefit payments related to the problem of partial employment. In slack times employers may spread the work among their employees so that a great deal of part-time employment results. So long as an individual remains employed he cannot obtain unemployment benefits, while if he quits voluntarily he will be disqualified for benefits. As a protection to the worker in this situation most unemployment compensation systems prescribe a system of partial benefit payments, which take effect whenever the reduction in working time is such as to bring the worker's earnings down near the level of the benefit payments to which he would be entitled if fully unemployed.

A number of difficult problems arose in administering a system of partial benefits. It was hard, for example, to know when a worker was entitled to a benefit as partially unemployed, since the only test was a comparison between his current rate of wages and his full benefit rate, which was generally not known to the employer, to the worker, or even to the administrative agency. The partially employed worker is not likely to go to the employment office to look for work; he therefore may be unaware of his benefit rights. The employer ordinarily does not have the basic information as to whether his workers have rights. The agency finds it is expensive to determine partial benefits and pay out small weekly sums. Under the Wisconsin system of wage-and-separation reporting, the employer is held responsible for notifying the agency concerning the partial benefit rights of workers, although the workers

themselves may make independent application if they wish. In other states the responsibility has been placed on the worker to make a claim whenever he feels he is entitled to partial benefits.

Grants for administrative expenses. Another set of problems arose in connection with the grants for unemployment compensation administration made by the Social Security Board to the state agencies. Under this program it was specified that all the administrative costs of unemployment compensation in the states should be paid by the federal government through the Social Security Board. It was expected that the 90 per cent tax credit allowed to employers in the states would provide a basis for the state tax collections which constitute the unemployment trust funds of the states, while the remaining 10 per cent of the pay-roll tax which comes to the federal Treasury would constitute the source of payment of the administrative costs of the program.

This arrangement gave rise to what was in effect a 100 per cent federal grant-in-aid to the states, in contrast to the usual system of federal matching. Since no state money went for administration, the states had no strong incentive to require economy and efficiency of their agencies. In fact, except for pride in efficient administration, the incentive was to expand the budget for administration to the maximum possible extent.

Faced with this situation, the Social Security Board instituted a system of itemized budgets for the state agencies, determined every quarter. The resentment to which this gave rise has been perhaps one of the most frequently recurring causes of disturbances in federal-state relations in this program. Over the last few years the Social Security Board has gradually been improving the system: first, by broadening the budget items and making them more flexible; second, by giving authority to its field representatives to permit adjustments between items; and third, by allowing longer-period budget grants.

Interrelationships with the relief program. Unemployment compensation is frequently characterized as being the "first line of defense against unemployment," with the implication that unemployment benefits are the first type of aid which the unemployed worker can obtain. On this ground some unemployment compensa-

tion administrators at first opposed the integration of this program with the general relief program. However, it soon appeared that a close integration of unemployment insurance and relief was desirable. In the first place, when a state first begins the payment of unemployment compensation it finds an accumulated load of unemployed who are eligible for benefits, some of whom have already been accepted for relief. In January 1938 the relief agencies in the states, as well as the W.P.A., had on their rolls many potential unemployment compensation beneficiaries. Their natural inclination was to send all these workers at once to the unemployment compensation agencies, which were swamped with work already. An arrangement was finally made with the W.P.A. to delay putting pressure upon its workers to apply for benefits.

After the disappearance of the somewhat abnormal situation connected with the inception of the unemployment compensation program, there emerged the situation, which may recur in many cases, of individuals receiving unemployment compensation, or about to become eligible for such benefits, who are at the same time receiving supplementary relief, or emergency work.

To begin with the latter case, workers frequently obtain relief or emergency work prior to becoming eligible for benefits. This may occur because the unemployment compensation system operates on a "benefit year" system, which means that any worker who exhausts his rights to compensation in any one year is thereafter ineligible for benefit payments until the end of a full year after he first received benefits, at which time any new wage credits he may have accumulated become available. Sometimes workers exhaust their unemployment rights in the first few months of the benefit year, after which they obtain employment for a period of several more months, and then, becoming unemployed, find their way to the relief agency or obtain jobs with the W.P.A. Eventually, their current benefit year comes to an end and the wage credits which they obtained by working during the past year become available to them for benefit purposes. Under such circumstances, especially if their benefit rights are small, they may be reluctant to leave general relief or relinquish their jobs with the W.P.A. for the sake of their

unemployment benefits. Nevertheless, these agencies insist upon the exercise of these unemployment benefit rights.

In these cases there is a transition from relief back to unemployment compensation, although in most cases the transition is in the other direction, with the worker first exhausting his benefit rights and then applying for relief. The extension of the amount of unemployment compensation benefits lessens the incentive to move from such benefits to relief, while an increase in the size of unemployment benefits enhances the incentive of the worker himself to make the transfer to unemployment compensation voluntarily. There is a feeling in some circles that unemployment benefits should be reserved for those workers with substantial employment records; if the compensation system takes in many short-time or casual workers for low benefits of short duration, the situation described in the preceding paragraph is greatly accentuated.

Another type of problem grows out of the fact that some workers find it necessary to apply for relief for themselves and their families while they are actually receiving unemployment benefits. This cannot be entirely avoided. Relief organizations find it necessary to grant relief to some workers even while they are employed at regular work in private industry. A worker who cannot support his family on regular wages could hardly hope to do so while receiving compensation benefits which are scaled to approximately half the full-time wage rate; other workers who can get along while earning wages fall below the line while receiving benefits.

If a considerable proportion of the recipients of unemployment compensation were receiving supplementary relief, serious administrative and political questions would be raised. Quite clearly, unemployment compensation would not be serving its primary purpose if this situation existed on a large scale. However, statistics drawn from relief agencies in large cities throughout the United States¹⁰ show that this kind of supplementation does not involve more than 1 or 2 per cent of the unemployment compensation beneficiaries.

¹⁰ See *Social Security Bulletin*, December 1939, p. 76, and earlier monthly issues.

Interrelationships with railroad unemployment insurance. Another set of problems which has become important since July 1939 has grown out of the interrelationships between the unemployment compensation programs and the railroad unemployment insurance system. Mention has already been made of the legislation governing the transfer of funds from the state unemployment trust funds to the railroad fund. Complicated problems with respect to coverage of employers have also arisen and will continue to arise; in border-line cases it is difficult to determine in which system a specific employer belongs.

Of more significance for the workers, however, are the questions of coverage, eligibility, and duration of benefits for employees. There is considerable shifting of employment during the year between railroad and other industries, and the worker is faced with the problem of establishing the necessary minimum qualifications for eligibility under the one or the other or both systems. If he is fortunate enough to obtain employment sufficient to qualify him under both systems, then he is entitled to benefit rights in both systems when he becomes unemployed. But if he fails to obtain the necessary minimum employment in either system, he has no benefit rights at all, even though the combination of the two employments would have made him eligible in one. No adequate test of the size of this problem has yet been made. Under the railroad unemployment insurance law, the railroad insurance administration has the authority to make agreements with the states for the accumulation of rights under both systems; and 27 states have similar authorizations. It is possible that the ineligibility of workers because of lack of minimum qualifications in either system may be greatly reduced if and when these agreements come into effect. Thus far nothing has been done.

Further problems are involved in handling workers entitled to benefits in both systems. There are questions as to whether both sets of benefits should be paid concurrently, or if not, which should come first; whether the waiting period for one might be served while drawing benefits from the other; and other problems. Decisions with reference to these questions are being worked out between the agencies. There are provisions in both the railroad law

and the state laws which prevent the concurrent payment of benefits under both systems; the rule applied by both sets of agencies is that a worker is not eligible for benefits in one system in any week in which he is drawing benefits from the other.

E. Unsettled Issues

Solvency. A basic question to which the answer is not yet clear is the solvency of the various state unemployment compensation systems. It was thought in the early months of benefit payments that a number of state systems were threatened with insolvency, but the improvement in the employment situation, together with the leveling out of the accumulated load which the states faced at the beginning, eventually modified the outlook. The reserves which had been built up during two preliminary years of contributions proved more than adequate in all instances.

The outstanding development of the situation during 1938-39 turned out to be not the problem of solvency of any state fund, but the extreme divergence in benefit experience. At one time one state was paying out less than 30 per cent of its current contributions while another state was paying almost 300 per cent.⁶⁰ These divergences were due partly to differences in liberality of the state laws, and partly to actual differences in economic conditions, but the relative importance of these two factors has not been determined. So long as wide divergences in benefit payments continue to exist a uniform federal tax may provide unneeded surpluses in some state trust funds, while driving other state funds into insolvency.

The variations among states in the cost of unemployment compensation may lead to pressure for tax rates graduated according to state experience. If there develop differences in tax rates between states the entire system may be threatened by the reappearance of interstate competition and consequent pressure on the level of benefit payments.

Experience rating. The prevalence of experience rating in the state laws reflects a widespread interest in the use of this device as an incentive to the stabilization of employment. American literature on unemployment insurance is strongly tinged with emphasis

⁶⁰ *Social Security Bulletin*, February 1939, p. 35.

upon the preventive aspects of an insurance program. Employer interest in experience rating is very often expressed in these terms, although under present circumstances (when experience rating is not yet in full effect) this attitude of employers probably reflects mainly an interest in general reduction in contributions. Employees, on the whole, are inclined to be critical of experience rating for this reason; they fear that it will become a device for tax reduction, and hence may bring a reduction of benefits. At bottom, however, the question is whether or not the types of experience rating which are administratively feasible⁶¹ will be conducive to any appreciable improvement in stability of employment.

Those who favor the idea of experience rating emphasize the effect of experience rating in workmen's compensation in reducing industrial accidents, and cite also the natural effect of graded contribution rates in stimulating employers to avoid lay-offs.⁶² The opposite school of thought urges that the present crude devices for experience rating provide rewards to employers who may have made no special effort to regularize operations, merely because their industries are already stable, while in the inherently unstable industries employers are penalized, though they may have made intensive individual efforts to stabilize.⁶³ In other words, experience rating, as now established, is based more upon broad differences in the inherent stability of the various industries than on the policies of individual employers.⁶⁴

It has been suggested, therefore, that experience rating should be put on an industrial basis, maintaining the average contribution rate for each industry as a whole at some common standard, but subjecting employers to variations in rates in accordance with their individual showings in comparison with the showings of other members of the same industry. This would undoubtedly give the individual employer a greater incentive toward stabilization, but no

⁶¹ The expense of determining the experience ratings is very heavy; indeed some contend that it is greater than the insurance system can stand.

⁶² Heyman Feldman and Donald M. Smith, *The Case for Experience Rating in Unemployment Compensation and a Proposed Method* (1939).

⁶³ Richard A. Lester and Charles V. Kidd, *The Case Against Experience Rating in Unemployment Compensation* (1939).

⁶⁴ Charles A. Myers, "Employment Stabilization and the Wisconsin Act," *American Economic Review*, Vol. 29 (1939), pp. 708-23.

satisfactory system of industrial experience ratings of this character has yet been developed.

The labor groups, in general, are strongly in favor of abolishing experience rating in favor of a straight pooled-fund system. Straight pooling, in effect, requires the more stable industries to support unemployment benefits in those which are relatively unstable. This is the theory of the British system, in which experience rating was tried in the early years and later abolished. It is not without significance that the only state which has adopted a straight pooled-fund system in this country is Pennsylvania, which has a larger proportion of employment in very unstable industries (such as steel, coal, and glass) than have most other states. One of the major problems for the future is whether these unstable industries shall bear the burden of their own unemployment, even to the extent of paying contribution rates of 5.6, and higher, percentages of pay roll, while stable industries such as public utilities and trade have the advantage of lower rates.

Employee contributions. Within the Committee on Economic Security there was considerable discussion of the desirability of employee contributions, but it was decided to leave the matter entirely up to the states. Only a few states included them in their plans. The addition of employee contributions would greatly add to the funds now available for benefits, and would give the state trust funds a sounder actuarial basis. In foreign unemployment insurance systems, employee contributions are practically universal. In the United States, employee contributions are more widely favored among labor organizations than among employers. Some workers favor such contributions as a means of raising the level and extending the duration of benefit payments. Primarily, however, both employee support and employer opposition rest on the presumption that such contributions would strengthen the forces working for pooled funds and against experience rating.

It is not unlikely that the issue of employee contributions will remain dormant until the next serious depression, when depletion of the unemployment trust funds and the increase in the number of workers exhausting their benefit rights without finding employment may lead to a demand for more revenue.

Adequacy of benefits. The basic question which has been raised concerning the unemployment benefits is whether they are high enough, or last long enough, to be of real significance. The weekly benefit rates in the various states range from as low as \$1 or \$1.50 to a maximum of \$18 per week, with 50 per cent of average full-time wages as the theoretical standard.

The problem of adequacy has given rise to some demand for the substitution of the British system of allowances for dependents for the American method of gearing benefits to previous earnings. The District of Columbia has a system of allowances for dependents, but no state has followed this example. The system of allowances for dependents has one important weakness, namely, that it may in a considerable number of cases result in benefits actually higher than the full-time earnings of the worker, thus giving him a strong incentive to remain unemployed. The prevailing opinion at present appears to be that the earnings base is reasonably satisfactory and that there is not yet sufficient evidence of inadequacy to warrant a change. The establishment of higher weekly benefit rates and the lengthening of minimum duration has done much to eliminate the worst cases of inadequacy.

The prevailing duration of unemployment compensation in the state laws is 13 to 16 weeks. Recent liberalizations have pushed some limits up to 20 weeks, or even higher. In Great Britain, 26 weeks has become the rule, and extensions to a year can be made under certain circumstances. There is little doubt that there will be continued pressure in the United States for an increase in the duration of unemployment compensation benefits. The problem is likely to remain, however, of what to do with workers who have exhausted their benefit rights but are still unemployed.⁶⁵

Limitations of coverage. Though the unemployment compensation coverage of the federal act is set at eight employees or more, many of the states have lowered this limit, some going down to one or more employees. Despite this extension of coverage, the excluded workers are numerous. So far there has been very little pressure at the federal level for a lowering of the limit.

Another coverage problem has developed in connection with in-

⁶⁵ For further discussion, see Chap. XXX.

terstate or "multi-state" workers—those who are employed successively in two or more states by different employers.⁶⁶ These workers may be considered in two classes, those who work long enough to acquire benefit rights in at least one state, and those who fail to acquire benefit rights in any state. So far as the first class is concerned, the situation has been greatly improved by interstate agreements adopted by the state unemployment compensation agencies. Under these agreements a state in which the worker happens to be unemployed will pay benefits to him as an agent of the state in which he has benefit rights. Since all but two states have signed these agreements, it means that workers who have acquired such rights can obtain benefits regardless of the state they may be in at the time of unemployment.

The second class represents a problem which has not been solved, and which is becoming more serious as eligibility qualifications in the various states are raised to higher levels. Highly mobile workers may never be long enough in any one state to acquire eligibility. Therefore, even though they may have worked for a large part of the year (and may have had contributions paid for them to a considerable amount), they may have no benefit rights at all. The number of workers who are in this situation is not large in proportion to the total coverage in the United States, but the complete exclusion of highly mobile workers from unemployment compensation will presumably work in the direction of immobilizing the working force, because workers will be reluctant to lose possible benefit rights by moving to another state. The problem could be handled rather simply if the states could agree to allow cumulation of employment experience, so that it would make no difference at all to the worker where his employment occurred.

Seasonal workers offer a third knotty problem of coverage. Without special restrictions of benefits, workers who are regularly employed at certain times of the year and just as regularly laid off at other times will draw benefits every year and will constitute a serious drain on the fund. If the off season is comparatively short, workers may use their benefits as a device for tiding them over the slack period, instead of attempting to obtain other work.

⁶⁶ The issue does not arise where the same employer is involved.

A few states have attempted to deal with this problem. In Oregon, for example, the lumber industry, among others, was designated as seasonal, and workers in that industry were made ineligible for benefits during the off season. This exclusion of workers in seasonal industries from benefits protects the fund for those who do not drop out of work each year, puts pressure upon seasonal workers to find other types of work in the off season, and saves the employers from paying benefits in a period during which they have little or no possibility of operating. Complications arise from the fact that seasonality is not always complete. There are industries, such as boots and shoes, in which seasonal slack periods develop without complete shutdowns of the plants. How can adjustments be made for these industries? In England seasonality is tested not by the employer's record but by the employee's work pattern.

In conclusion, it should be said that we have not considered fully in this chapter the social wisdom of a system of compulsory insurance. In some degree the issues are similar to those which arise in connection with any program of direct government production. These have been set forth in an earlier chapter (Chap. XXIX). There is no doubt that at the time of its passage there was considerable public sentiment in favor of the current program of social insurance. There have developed since then further support, opposition, and also indifference. A full appraisal must await further experience. The public is as yet too unfamiliar with the workings of the system for any significant opinion to have been crystallized.

PART VII
CONCLUSIONS

CHAPTER XXXII

CONCLUDING OBSERVATIONS

We come now to the end of our analysis of that long, intricate, and shifting maze which is the relationship of government to economic life. In this final chapter we shall not attempt to summarize the conclusions reached concerning each of the many forms which that relationship takes. This has been done separately in the preceding chapters. It is worth while, however, to review briefly the major changes that have taken place in the course of the development of American public policy toward economic affairs, to consider certain important contrasts in the relationships which have been established, and to set forth the issues now on the frontier of public discussion.

For these purposes it will be helpful to remind the reader that governmental relationships to economic life in America fall into two broad categories: the implementation, promotion, and regulation of private enterprise; and the direct production by government of consumer services. The relations of government to private enterprise may further be broken down into two major groups: those which apply generally to a wide area of economic life; and those which are limited in their applicability to specific industries or specific time periods.

I. DIRECTIONS OF DEVELOPMENT

From the beginning of our national history there has existed the dual relationship of government to economic life pointed out above. At the very outset, the federal government undertook to organize directly our relationships with foreign nations, and to provide for the national defense; and its activities in the protection of person and property constituted an important implementation of private enterprise. The singling out of areas of private enterprise for special treatment by government began with the tariff act passed by the first Congress in 1789, which declared as one of its purposes "the encouragement and protection of manufactures." The obligations which the common law (taken over from England

in the majority of the state jurisdictions) imposed upon "common carriers" and "common callings" to serve all comers at non-discriminatory rates, further provided special treatment for the transportation and public utility industries.

Early emphasis on implementation and promotion. During the course of the next century, the activities of the federal government in relation to economic life were concerned primarily with the implementation and promotion of private enterprise. In addition, however, during this period the tariff became more highly developed as an instrument for bestowing private favors, the postal system was developed, and several wars were waged, each of which required temporarily an extension of direct government production and special regulation of private enterprise.

The elementary structure of implementation was established when the "principles" of property and contract of the common law of England were in large part taken over and enforced by the state governments in the United States. These principles provided the basis for the formation of both individual proprietorships and partnerships for the conduct of business enterprise. By the third decade of the nineteenth century, however, a great advance in the implementation of private enterprise was under way in the adaptation of the corporate device to business enterprises. This organizational form, growing in response to the expanding opportunities for large-scale production, conferred upon those using it the possibility of greatly increased power through extended capitalization. On the other hand, it tended when applied to vast enterprises to divorce ownership from control and thus raised problems concerning the solicitude of management for the interests of the stockholders.

Closely related to the provision of organizational forms for business enterprise was the development of the law of bankruptcy and reorganization. The laws in this field were designed primarily to liberalize and to define more clearly the responsibilities involved in financial failure, and thus to stimulate the use of credit and encourage a maximum of enterprise. The first federal bankruptcy law was passed in 1800; and in comparison with the changes which were to be made in later years it was distinctly favorable to credi-

tors. This law and its successor of 1841, which was enacted in response to the distress caused by the panic of 1837 and which cared more liberally for the interests of debtors, each remained in effect but two years. No further bankruptcy legislation was provided until 1867—and the motivating force was again widespread distress. This law survived for eleven years. It was not until 1898 (under the spur of the adverse business conditions following the panic of 1893) that anything in the way of a permanent federal bankruptcy policy was developed.

A further important implementation of private enterprise provided by the federal government during the early period of American history was our system of patent rights, designed to provide an incentive and reward for invention. The first patent act was enacted in 1790, and during the next century the system underwent progressive liberalization in favor of the patentee.

The provision of a monetary mechanism to facilitate the conduct of private enterprise also occupied the attention of the federal government in the early years. One of the first tasks undertaken was the direct provision of money through the minting of coins and protection against counterfeiting. This was followed shortly, but only temporarily, by the provision of a paper currency through the First and Second Banks of the United States. Prior to the Civil War, the primary source of paper currency was private bank notes, and the regulation of their issue and value by the state governments was one of the earliest forms of governmental regulation of private enterprise. The establishment of the National Banking System in 1863 marked the permanent entry of the federal government into the regulation of note issue by private banks, as well as of the relations of these banks with their depositors. The greenbacks issued during the Civil War, moreover, constituted a direct provision of paper currency by the federal government. Full recognition of bank credit as a medium of exchange, and its regulation, did not come until the establishment of the Federal Reserve System in 1913. Under the Federal Reserve System, the regulation of commercial banks has developed from controls designed primarily to protect depositors and note holders from bank insolvency and to stimulate the currency of these notes and deposits, into controls

designed to influence the level of interest rates and the availability of credit with a view to mitigating the severity of the business cycle.

In many ways most spectacular among the early activities of our governments in relation to economic life were their promotional activities in connection with internal improvements and education. In an effort to promote the settlement and development of the West, grants of free land and other financial assistance were provided for highway, canal, and railway projects, and there were a few instances of direct government production of each of these forms of transportation. To assure proper educational facilities for newly settled regions, grants of land were made for school purposes; in some instances these grants were made specifically to finance instruction and research in "agriculture and mechanic arts." A considerable development of this character took place also at the local level of government.

The elaborate standardization and research activities of our federal government in the interest of producers, consumers, laborers, and investors, with which we are now familiar, are largely the product of the twentieth century.

The development of regulation. In the last decade and a half of the nineteenth century the emphasis in federal relationships to economic life shifted to the imposition of controls over private enterprise, designed to guide it into socially more desirable channels and to prohibit certain practices which had been widely condemned. The common law rules against "restraint of trade" and "conspiracy to monopolize," and against fraud and deception, as well as much of our tort and criminal law, provided governmental regulation of this character from the beginning of our national history. The increasing industrialism and greater urbanization of the post-Civil War period, however, gave rise to demands for added controls in this direction.

The earliest objects of widespread public demands for additional regulation were the railways. As the railways grew to importance in the seventies and eighties, the discriminatory practices of the monopolized lines, and the poor service they often provided, led to considerable dissatisfaction, particularly among farmers, who were their main customers in the West. These demands brought

forth, first, a program of state regulation, and eventually a series of federal controls, beginning with the Interstate Commerce Act of 1887. The object of these early regulations was to enforce competition in the industry. This was done primarily by prohibiting certain practices leading to and resulting from monopolistic controls, such as the charging of "extortionate" or "discriminatory" rates, and pooling.

The Sherman Act, passed in 1890, reflects a broader demand for similar efforts to maintain competition in the general fields of trade and industry. The rise of business units operating on a national scale in the period after the Civil War (fostered by our tariff and corporation laws as well as by the settlement of the West and changes in technical conditions of production) increased the dependency of individuals upon employment by others, and was accompanied by a greater urbanization of our population. At the same time the free land of the West was gradually absorbed, restricting opportunities on this frontier. In these circumstances, recessions in business activity during the eighties were frequently attributed to the existence of large units of enterprise, and a movement developed to restrict them by more stringent controls than had been provided under the common law, which relied largely on private suits for damage, or under state laws, which could not effectively reach the great interstate combinations. The Sherman Act prohibited contracts, combinations, and conspiracies in restraint of trade, and attempts to monopolize—made them public offenses and provided means of dealing with interstate transactions.

As the judges have read the Sherman Act, its purpose was not to condemn mere size or even market control. Only power unreasonably acquired or abused was held to be proscribed; and *intent* to harm competitors or abuse customers and the *existence* of collusive action became the prominent tests of unreasonableness. It proved difficult under court interpretation of this law to attack practices which *tended to lead to* monopoly, prior to evidence that substantial market control had actually been acquired. It was such interpretation, making it impossible to check certain market practices believed to bring about the destruction of competitive forces, which led in 1914 to provisions in an amendment, the Clayton Act,

prohibiting such actions as price discrimination, tying contracts, inter-corporate stockholding, and interlocking directorates, the effect of which might be substantially to lessen competition. In 1936 price discrimination was further regulated by the Robinson-Patman Act.

The year 1914 also saw the establishment of the Federal Trade Commission with broad powers to stamp out "unfair methods of competition" in commerce. Under this authority, the Commission has attacked a wide range of deceptive and obstructive practices by sellers, and thereby aided in elevating the plane of competition. The Wheeler-Lea Act of 1938 has recently strengthened the powers of the Commission in this regard.

The common law had earlier provided remedies against deceptive, fraudulent, and obstructive practices, but it relied on private suit for enforcement, and on judicial decisions and precedents to indicate the range of prohibited acts. This was a slow, expensive, and uncertain procedure. Several factors provided an urge to the imposition of more responsive, more direct, and more extensive controls. The advance of manufacturing technique widened the opportunity for the creation of deceptive form; the range and rate of change in the variety of commodities offered on the market increased, so that it became more difficult for consumers to evaluate alternatives on the basis of their own experience; and the growth of advertising, according to some views, widened the possibilities of deception. To meet this situation, the Federal Trade Commission Act made deception of various forms a public offense, and provided for the surveillance of selling practices by a governmental agency armed with what appeared in the beginning to be broad powers to issue cease and desist orders.

The effort to prevent the deception of consumers began, on a more limited scale, even before the Federal Trade Commission Act, and has been extended in many special forms since. Important beginnings were made in 1906 under the Food and Drugs Act, and a year later under the Meat Inspection Act. A number of special acts since that time have provided similar specific regulations for a number of other industries, covering primarily agricultural commodities and supplies for agricultural production.

Somewhat different in character, but directed toward a similar objective, has been a considerable body of legislation establishing compulsory requirements of disclosure and minimum standards of composition or quality for a number of different commodities, primarily foods and drugs—in which deception of the consumer would be likely to have the most serious consequences. Moreover, over this same period of time there has been an enormous extension of governmental activities in the grading and standardization of commodities, and in otherwise furnishing useful information to buyers and sellers at all stages of the production and distribution process.

The remaining major field in which regulation developed relates to workers, the conditions of their work, and their relations with their employers. The common law established the principle that it was socially desirable to preserve individual freedom in seeking work and competition in securing it. It expressed, in general, an opposition to combined action among workers, and dealt with such action in the same terms of conspiracy and restraint which were applied to business men uniting to maintain prices or restrict production. The more extreme positions of the common law in this regard were materially modified by the courts during the first half of the nineteenth century.

The general attitude of the common law toward combined action among workers found further expression when the proscriptions of the Sherman Act against contracts and combinations in restraint of trade were applied to the activities of labor unions. This gave rise to strong labor opposition, and in the Clayton amendment of 1914, it was declared that the Sherman Act should not be construed as forbidding the existence and operation of labor organizations, and certain provisions were made against the issuance of labor injunctions by the courts. Other laws modifying the common law doctrines and strengthening concerted action among workers were the Erdman Act of 1898 forbidding discrimination against railroad workers for union membership, the Railway Labor Act of 1926 protecting railway workers in their right to organize, and the Norris-LaGuardia Act of 1932 further limiting the use of the strike injunction by the federal courts.

A major change in the social expression of what was regarded as a proper degree of competition among workers came with the National Industrial Recovery Act in 1933, which declared that workers should be permitted to "organize and bargain collectively through representatives of their own choosing . . . free from the interference, restraint, or coercion of employers." Although this act was declared unconstitutional in 1935, the National Labor Relations Act passed in that year reasserted the right of employees to organize, and defined a series of "unfair labor practices" which employers were forbidden to use.

The declared public policy concerning a desirable degree of competition among workers has thus shifted during our history from the restriction of combination and concerted action to the gradual modification of many of these restrictions, and, under the most recent legislation, to a tendency to facilitate labor organization and limit competition.

Beyond these regulations concerning combined action by labor, a wide range of legislation has been enacted directly controlling terms and conditions of employment. Beginning with limitations on the labor of children in one state in 1848, the states in general have provided such legislation, and there has been a progressive raising of the age limit and extension of the number and kinds of industries covered. Federal legislation on this subject has met with a number of reverses at the hands of the Supreme Court on grounds of constitutionality. The most recent legislation in this field, the Fair Labor Standards Act of 1938 (Wages and Hours Act), prohibits the employment of individuals under 16 years of age. However, the Supreme Court has not yet passed upon its constitutionality.

Similar changes have taken place in the regulation of hours of work. The daily hours of work of children were limited in a single state as early as 1842, and five years later 10-hour legislation for women was enacted in another state. By the end of 1938 all but five states had established some restrictions upon the length of the work day for women employees, and all but three states had prohibited the employment of children in factories at night. The regulation of hours of employment for men did not begin until 1895,

and has been confined generally to trades involving unusual dangers. In 1938, under the Fair Labor Standards Act, Congress established for employees in general a "ceiling" of eight hours of work a day, and a weekly maximum which is subject to progressive reduction during the first three years of the act's operation.

It was not until the twentieth century that regulation of wage rates was begun in the United States. Such regulation was, prior to 1933, limited to women and minors. The first important federal attempt to establish minimum rates of wages came in 1933 under the N.R.A. The Guffey Act of 1935, regulating wages in the coal industry, was declared unconstitutional. In 1938 general minimum wage rates were provided under the Fair Labor Standards Act.

Regulations have also been applied to the physical conditions of work. So-called industrial homework has been made the subject of restrictive legislation in numerous states, and special regulation of conditions of work has been applied to many industries, particularly mining and transportation.

The growth of special treatment. The implementation and regulation of private enterprise by inclusive laws applicable in general to all individuals and all forms of industrial activity have, as we have seen, been extensively supplemented by special governmental regulations on certain occasions and in the case of particular industrial areas. Historically, the first important examples of such special treatment were the industries benefited by the protective tariff, and the public utilities. The use of the tariff as a protection against foreign competition began in the earliest days of the first Congress, as we have seen, and has been continuously and progressively an integral part of our public policy from that time to this.

The special treatment of public utilities originated, as was noted above, under the common law. So long as the services provided by this industry did not absorb an important proportion of the individual's income (and as they were often provided by individuals for themselves), the procedure of the common law, with its vague, general standards established through centuries of precedent and enforced through private suit, raised little public criticism. As the industry grew, however, its essentially monopolistic nature and the dangers of extortion, discrimination, and poor service came more

prominently to public attention, and led to demands for greater precision in the definition of standards and more intensive controls by government. In the beginning, added controls were imposed by state and municipal authorities through charter and franchise provisions and through general statutes and ordinances. These took mainly the form of specifying maximum rates and minimum service requirements. This type of regulation soon proved ill adapted to the exercise of managerial controls over a rapidly changing industry, and one which quickly outgrew city boundaries. There followed, beginning on a significant scale in 1907, public utility regulation by state administrative commissions endowed with broad, discretionary powers over the price, quality, and adequacy of service. The interstate character of many of the problems of regulation led finally to various forms of federal control, mainly after 1933. The basic structure of public utility regulation remains, however, at the state level.

The railway industry began to emerge as an area of special treatment as early as 1906. Prior to that time, as we have seen, regulation of the industry had been designed primarily to maintain competition. Beginning in 1906, however, the industry came to be accepted as essentially monopolistic, and there was gradually developed a system of positive managerial controls by government over rates and over the quantity and quality of service. This development was given great impetus by the experience with government operation of the railways during the war, and saw its culmination in the Transportation Act of 1920. There has remained throughout the special treatment of the railways, however, some flavor of the earlier efforts to maintain competition.

Special treatment was also applied at an early date to certain of the food and drug industries, and to petroleum and natural gas when these industries became important. Food and drug products are of special public concern because of their peculiar relation to health and morals, and because consumer misunderstanding cannot be so readily corrected through progressive experience as is true of most other commodities. For this reason special restrictions of production and sale have continuously been imposed in this field, beginning as early as 1848 and now elaborated to an imposing structure of regulation.

The petroleum and natural gas industries are of relatively recent origin. Special treatment of these industries did not begin on any important scale until 1914, and the development of regulation has taken place primarily through state action. In the case of oil, the pressure for special treatment has come primarily from producers who have been plagued periodically by sharp price declines accompanying the opening of new fields, and who have sought to enhance their profits through production controls. Public support for special treatment has been enlisted primarily on the ground of the need for conservation of a limited natural resource. The controls enacted over this industry have consisted chiefly of restrictions on output, and certain technical regulations of production methods designed to reduce costs, increase recovery, and limit waste.

In the period since the World War, and especially during the last decade, we have witnessed a rapid extension of special governmental treatment of private enterprise. The World War, itself, involved our government in an elaborate set of special controls over private enterprise, designed to make it function more effectively in the prosecution of the war. The post-war period, however, gave rise to more permanent changes in public policy.

Many industries which had expanded during the war found themselves in difficulties when the more normal demands and channels of trade were resumed. Three industries in particular—agriculture, cotton textiles, and coal—gained public sympathy for their plight. They experienced, in addition to the ordinary post-war readjustments, increased competition from substitute products or from newly expanded production areas; and they were well organized to voice their complaints and to urge special treatment designed to restrict production and keep up prices. Other wars had left similar demands in their wake, but the cry for protection had been mainly against foreign competition and was usually satisfied. Agriculture, cotton textiles, and coal, however, were industries which had outgrown their domestic markets, and a new type of problem was raised. A fourth large and vociferous group—small retail distributors and wholesalers—met increasing competition from large-scale distributors during the twenties, and raised a similar cry for protection.

Nothing much was done by government to meet these demands

for special treatment during the prosperous years of the first post-war decade. Within the industries themselves, however, developments took place, both of a restrictive nature and in the form of improved efficiency. The depression beginning in 1930 accentuated the difficulties of these industries and brought them many companions who sought similar governmental assistance. For a period of two years under the National Recovery Administration the non-agricultural industries saw many of their highest hopes for restrictive regulation fulfilled; and under the Agricultural Adjustment Administration there was begun a program of special controls and subsidies which has established agriculture, at least for the time being, as a specially supported area of economic life. Both of these instances of special treatment were motivated in part by a desire to protect the members of the industry against competitive forces, and even to subsidize them. There were also present, however, the objectives of stimulating a recovery of general business activity, and, in the case of agriculture, general relief purposes and the alleged desire to compensate the farmer for the inequities of the tariff.

Even before the demise of the N.R.A., ineffective enforcement of the code brought forth pressure from labor and producer interests in the bituminous coal industry for the enactment of special controls for that industry. There resulted legislation providing for wage and hour controls, and for price fixing. Two years later, after this act had been declared unconstitutional, a new act was passed providing only for price fixing.

The other interests pressing for similar special controls were not so well organized to exert pressure, with the exception of the wholesalers and small-scale retailers in the grocery and drug trades. Largely through the efforts of these latter groups, federal legislation placing further limitations on price discrimination and legalizing resale price maintenance was enacted. A number of states enacted similar legislation and provided further for the support of small business and "legitimate" or "customary" channels of distribution by laws restricting entry, imposing special taxes on chain stores, and providing for minimum mark-ups above invoice costs. Special legislation was strongly urged for the support of the cotton textile industry, but none was enacted.

The increase in direct government production. Since the beginning of American history the direct production of final consumer services by government has shown a slow but steady increase. This increase has taken place both in the provision of free services and in the production of services for sale. Shifts in population and in the industrial structure, and changes in social attitudes, have been the principal causes affecting the expansion of free services in the fields of education, welfare, recreation, and health, and in the development of highways. The services produced for sale by the federal government were until recent years confined almost entirely to postal services and governmental publications.

Under the pressure of the prolonged and intense depression of the thirties and under the leadership of the federal administration, the program of direct governmental production has recently been enormously expanded and elaborated. While the principal expansion has taken place in programs of direct and work relief, and in the provision of old-age and unemployment insurance and public assistance to certain dependent and defective groups, there have also been great expansions into certain other fields, particularly public utilities and housing.

These various extensions of direct production by government appear to reflect the existence in the popular mind of something decidedly different from those attitudes which have brought about expansions of governmental operations in the past. Just as the development of special treatment for particular areas of economic life reflects a desire to modify the operation of private enterprise with a view to improving the status of certain groups, so the public relief and social security programs suggest a lack of trust in the capacity of private enterprise to protect individuals against unemployment and to provide a means of livelihood for the aged, the incapable, and the incapacitated. These developments thus indicate a desire to assure individuals of an income quite apart from their own efforts, and in this regard are in sharp contrast with the earlier emphasis on preserving for individuals an opportunity to earn a livelihood through the exercise of their own initiative.

Before proceeding to a discussion of the issues which are now

most prominently on the frontier of public discussion, let us set forth briefly certain important contrasts and comparisons which may clarify the nature of the elaborate structure of governmental relationships to economic life we have erected over the years.

II. CONTRASTS AND COMPARISONS

In the objectives sought, the methods pursued, and the administrative and enforcement devices employed, there are clear differences between the general relationships of government to private enterprise, the special governmental treatment of such enterprise, and the direct production of final goods and services by government. Let us look briefly at the major forms of these differences.

Objectives. The general relationships of government to private enterprise, which are described in Volume 1, have for the most part been founded on public objectives of the broadest character. While in their inception special interests have often played a prominent role, these forms of governmental action have usually been regarded as serving general social purposes, such as the best allocation, and the most efficient and fullest use, of productive resources. In the special treatment of private enterprise more attention has been given to the protection of limited group interests.

The pleas which have been used to gain public support for special treatment of private enterprise have been many and diverse and have varied from case to case. Declarations of broad social purposes have not been lacking, though more important has been the desire of particular groups of workers or business men for private advantage (a desire often based on erroneous reasoning as to their own interests), and the unorganized and uninformed state of those who might be directly or indirectly injured.

In the case of the protective tariff, for example, the infant industry argument had wide public acceptance in the beginning, as did the contention that retaliatory measures might be used to free the channels of trade. These have been supplemented since by the "national defense" and "pauper-labor" arguments, and needless to say, by the urge of particular industries and workers' groups for protection—each of which may more easily be made the basis of claims for permanent special treatment. Industries stimulated by the stoppage or diversion of channels of international commerce

(particularly in times of war), and incapable of full survival under freer conditions of trade, have often been able to gain acceptance for a "vested right" in the domestic market by calling to public attention the plight of the industry when faced with world competition.

Somewhat more complete, in the sense that it involves the suppression of domestic as well as foreign competition, is the "sick-industry" argument which has been increasingly employed to advantage in the past decade by many who have sought public support for special governmental treatment. This argument, which usually takes the form of a plea to preserve profit opportunities and hence, presumably, employment, or at least wage levels, against the declining demand for the products of an industry, has been used particularly in the cases of agriculture and bituminous coal, and to some degree in the case of railway transportation. In its application to agriculture, this plea for support and rehabilitation has been combined with allegations that an improved agriculture would stimulate the revival of general business activity.

While touched upon only slightly in this study, it may be added that a variant of the sick-industry argument, emphasizing the frequently weak competitive position of small-scale enterprises, has been advanced in urging their protection. The effort to secure the protection of small business is based in important degree on a desire merely to preserve the existing units against the competition of larger-scale organizations. The arguments for such protection are, however, often combined with other issues, such as the presumed social desirability of preserving conditions of easy entry into an industry, and of maintaining a large number of competing units.

The plea for special treatment of petroleum and natural gas has been complicated by technical factors. The limits of the known supply, the irregularity of new discoveries, and the peculiar conditions of production which if unregulated may lead to waste, have been applied in arguments both for "stabilization" in the interests of the industry and for "conservation" for the public benefit. The conservation argument has also played a part, though a small one, in the movement to secure special treatment for agriculture and bituminous coal.

Legislation to provide protection for some industries has not infrequently been disguised as a revenue measure. In other cases, which have been illustrated in the field of food and drugs, legislation having this purpose has been passed under the pretense of an effort to protect public health and morals. On the other hand, special treatment of particular areas has often rested on valid public reasons. There are few, if any, who would question special treatment for public utilities and, in its early stages at least, the special treatment given railway transportation. Whatever the deficiencies and limitations of commission control, it is believed more satisfactory to the public to utilize such control in these naturally monopolistic industries than to suffer the numerous disadvantages which occur under competition.

The objectives of special regulation in time of war are obviously based on public considerations of the broadest consequence. They reflect a unanimity of individual desires for a single objective—victory in conflict—which can never occur to a comparable degree under other situations. They reflect also a wider opportunity for effective governmental action, because of the peculiar capacity of government to function in national defense and the unusual need which exists at such times for speed, as contrasted with economy, and for close co-ordination of many phases of industrial life.

The National Industrial Recovery Act declared broad public objectives, the most inclusive of which was the stimulation of general business recovery. The codes formulated under that law, however, were framed almost entirely on the basis of purely private considerations.

Broad social considerations have also governed a large part of our direct public production. The major factors bringing about such production have been the essential nature of the goods and services to society generally (such as the protection of person, property, and health, and the provision of schools and highways), and the incapacity or failure of private enterprise to provide what is regarded as socially adequate production.

Methods. The methods of regulation employed in the special treatment of private enterprise differ greatly from those which

have been applied generally to industry and trade. In contrast with the effort generally to maintain competition in the field of private enterprise, the policy of limiting individual independence in determining price and production policies, and of restricting the entry of new competition, has become an integral part of our public policy in the fields of public utilities and transportation. These controls have been designed so as to restrict the flow of capital to an amount regarded as necessary, and to preserve the monopoly which is deemed essential to the most efficient production. They have been accompanied by correlative controls over abandonment, over the quantity and quality of service, over prices, and, especially in recent years, by direct public competition. There has been authority not only to veto private decisions concerning these matters, but to set definite policies which must be followed. Responsibility for the initiation and operation of enterprise, however, remains in private hands.

The production and sale of some agricultural products and of petroleum have been regulated, as have some agricultural prices and the price of bituminous coal. Detailed controls have been imposed as well over technical features of operation of oil and gas wells. These have dealt mainly with well-spacing, oil-gas ratios, and unified operation. The production of certain foods and drugs has been prohibited, and license controls imposed over the introduction of new products.

Subsidies, both direct and indirect, have been employed in the fields of foreign commerce, agriculture, and transportation. These subsidies have been designed either to encourage the curtailment of output and the withholding of supply from the market, as in the case of agriculture, or to encourage the expansion or maintenance of production as in the instances of foreign commerce, transportation, and, at an earlier period, agriculture.

The war-time regulation of industry and the controls attempted under the N.R.A. approached in intensity those which are imposed on public utilities and transportation. War-time controls have comprised the allocation of resources to specific uses, the licensing of various trades and businesses, price fixing, the specification of methods of production and distribution, the requisitioning of sup-

plies, and the commandeering and direct operation of production facilities. The N.R.A. controls included price fixing and wage fixing, production and capacity limitations, and restrictions over the free choice of specialized tasks or areas of operation.

In contrast with the measures employed in both the general and the special treatment of private enterprise are those followed in carrying on the activities of government as a producer of final goods and services. These activities have involved government directly in all phases of allocation, conversion, and distribution—though in some instances government has undertaken only the distribution of privately produced commodities, or has merely promoted and controlled the production of goods and services through the device of grants-in-aid.

Administration and enforcement. The imposition of positive, and consequently more detailed and precise, controls in the special treatment of private enterprise, and the direct production activities of government, call for administrative and enforcement agencies quite different from those which are appropriate for the less ambitious schemes of regulation which have been applied to economic life in general. Detailed, technical regulations covering a broad range of highly specialized and continuously changing situations cannot be framed effectively or efficiently by a legislative body. Nor can the day-to-day administration of productive enterprises be so controlled efficiently. Extensive discretionary powers have accordingly been granted to a group of specially created administrative agencies. However, to hold these agencies accountable for the exercise of these powers, and to guide them in their use, general objectives and standards have been established by law. These means of administration and enforcement are in contrast with those which have ordinarily been applied to the general field of industry and trade, where the legislature has usually defined fairly precise standards, and has given the executive and administrative agencies of government relatively little scope for the exercise of discretionary powers. The contrast is, however, only one of degree, as similar administrative and enforcement devices are employed in some instances even in the general regulation of private enterprise.

III. CURRENT ISSUES

In each of the many aspects of the relationship of government to economic life, problems of the most difficult kind continue to present themselves. The processes of our economic system and those of our government are too complex, too subject to changing forces, to justify the hope that they will ever be perfectly adjusted to each other.

Concerning the implementation of private enterprise, proposals to modify the organizational forms through which business is conducted are prominent. Not new, but urged currently with great vigor, are recommendations to limit the size of corporate units, to increase the personal responsibility of corporate officers, and to limit their powers. By these means, it is contended, market controls will be checked, competition made more effective, and corporation policies made more responsive to the wishes of the stockholders.

Bankruptcy and reorganization procedures, it is argued, should be revised with a view to providing governmental advice and counsel before business situations have reached the stage of insolvency, and so as to restrict from re-entry into the conduct of the nation's economic affairs those guilty of negligence or bad faith. Proposals for patent reform suggest chiefly that patent rights which are believed not to serve social purposes be withdrawn and that there be an effort to promote a broader availability and use of patents and to restrict their employment as means of extending monopoly controls.

It is frequently urged that the recently expanded range of emergency monetary measures (comprising, for example, currency devaluation, controlled exchanges, regulated gold and silver markets, and deficit spending), which have been designed to stimulate business activity in the present and to mitigate future cyclical swings, should be further elaborated and made a permanent part of our public policy.

Many favor an extension of the research and informational activities of government. Particular emphasis is at present placed on adding to the provision of knowledge for consumers. This is urged partly as a means of improving the judgment of buyers, and

partly, as we shall note below, in the belief that it will operate against the growth of monopoly.

In the field of restrictive regulation of private enterprise, our present public policy concerning the maintenance of competition is criticized by two articulate groups. Some question the possibility of preserving a sufficient degree of active rivalry under any circumstances. Others believe it is possible to preserve a socially adequate type of rivalry in a large part of our economic system but hold that in many cases monopolies arise out of sheer efficiency and cannot, therefore, be checked by laws such as we now possess, which are directed primarily against collusion, coercion, and abuse. They point particularly to industries with a small number of units grown large through consolidation and internal expansion, and to those characterized by highly differentiated, advertised, and branded products, as possessors of a monopoly power untouched by the law. As a remedy these critics suggest limits over the size of industrial units (particularly where there would result no loss in efficiency), restrictions on advertising expenditures, the dissemination of information so that monopolies based on the ignorance of consumers might be destroyed, the lowering or withdrawal of tariff protection, and the elimination of some forms of patent protection. In some fields government competition and even government monopoly are urged.

Regarding the area of regulation which we have called the plane of competition, frontier issues relate mainly to further controls over advertising, designed to increase its truthfulness and the completeness of the information given, the establishment of additional minimum quality standards and specifications for certain commodities, and the compulsory use of governmentally determined grades and standards. All of these, it will be seen, are designed to improve the knowledge of buyers and to limit the advantages of the less scrupulous sellers. Another suggestion having to do with both the maintenance and the plane of competition, popular among business groups, and sponsored by the government during the N.R.A. period, is the development of a system of business "self-regulation."

In the labor field, the leading current issues relate to the re-

quirements for collective bargaining. Experience under the National Labor Relations Act has raised grave doubts in many minds concerning the wisdom of encouraging the organization of labor. Those who have these doubts ascribe to the requirements for collective bargaining under the act many of the strikes (jurisdictional, "sit-down," and others) which have occurred in recent years, and they hold that wage increases or wage rigidities have resulted which in many instances have severely restricted the opportunities for employment. More widely held, however, is the view that current policy toward collective bargaining should be modified rather than abandoned. Important among the suggestions for modification are recommendations for revising the procedure for determining the appropriate bargaining unit, and the provision of greater protection for the employer through legislatively declared "unfair acts" on the part of labor.

It is further urged that the responsibility of labor unions should be increased. This, it is recommended, should be done by making unions financially more responsible for their actions, and through laws requiring their incorporation and the public auditing of their books. It is also contended that employers should be permitted broader rights in influencing employees concerning unionization, and that there should be provided much more adequate means for settling jurisdictional disputes. A significant recent development has been the reinvigorated enforcement by the Department of Justice of the restrictions on concerted action by labor embodied in the Sherman and Clayton Acts.

Aside from these questions of concerted action by labor, there is support for still more stringent safety regulations, and for further restrictions on the minimum age for employment, on the range of industries in which women and children are permitted to work, and on the hours of work. On the other hand, even the current regulation of hours and wages of labor has been condemned on the grounds that it is difficult to administer fairly, and has tended to "freeze" existing unemployment.

In one way or another all of these specific issues are part of the age-old problems of the proper allocation and conversion of society's resources and the distribution of income to the members of

society. The length and severity of the depression of the thirties, however, has focused particular public attention upon one aspect of allocation and conversion—the problem of how to organize the economic mechanism so that the nation's resources would be more fully employed.

Issues in areas of special treatment. In each of the areas receiving special treatment at the hands of government there are also numerous and urgent issues. In the field of foreign commerce the recent extension of the trade agreements program involves a modification of the special treatment accorded under the tariff, though the merits and demerits of the trade agreements program continue to be warmly debated both in general and in relation to particular phases of our industrial life. The difficulties which have been encountered in fixing prices for bituminous coal have raised increasing doubts, even within the industry, concerning the wisdom of special treatment, at least in this form. To some this difficulty has suggested the advocacy of more direct controls over production, and perhaps the purchase of part of the productive capacity by government and its withdrawal from operation. The special treatment of agriculture appears well fortified at the moment, and there seems to be strong support for permanent controls over production, and added subsidies.

In the public utilities field the most hotly discussed question centers about so-called yardstick competition—the production and sale of services by government with a view to influencing the rates and services of private companies. Only by this means, some hold, can the utilities industries (particularly the electric power industry) be subjected to the kind of pressure that will bring about proper rates and experimentation with supplying the lower reaches of demand. Government ownership is actively urged by some who hold that regulation cannot be made effective. In the meantime the perennial controversy over the policies to be followed in setting rates according to more conventional standards continues to occupy the attention of students, administrators, legislatures, and the courts.

The regulation of the transport industries entered a new phase with the passage of the Motor Carrier Act of 1935. Before 1906

special regulation in this field had been designed primarily to secure the enforcement of competition among railways. After that time the railways gradually became accepted as monopolistic and the emphasis in government regulation shifted to the control of this monopoly power. The rise of motor transportation, however, has destroyed the monopoly position of many railway lines and threatened the solvency of some. The result has been the imposition of governmental controls over rates and service in certain phases of the motor transport industry, designed largely to protect the railways against the competition of this substitute mode of transportation (though in some degree merely to restrict competition among motor carriers). At the present time two opposed sets of proposals for change are widely discussed. Some argue for an even broader and more intensive program of governmental controls, designed to create a "unified transportation system" which will assure to each form of transportation its "proper" place; this has in some degree been the declared purpose of recent legislation in this field. Others contend that the development of motor transportation and the prospective growth of air transportation have made the industry in general highly competitive and removed the need for special treatment as a monopoly.

The current issues in the regulation of the petroleum and natural gas industries concern mainly the expansion of the role of the federal government. Regulation at present is confined primarily to individual state laws and interstate compacts. The federal government acts chiefly in a research and advisory capacity, and strengthens state regulation through prohibiting interstate and foreign commerce in oil produced in violation of certain state laws. It is contended that a need exists for more stringent controls over operating practices and rates of production (ostensibly for conservation purposes, though undoubtedly also merely to keep up prices), and that no individual state is likely to undertake such controls, because its withdrawal from the market benefits other states immediately, while it can look forward only to an uncertain gain in the future.

Still pressing strongly for special treatment are various groups of small-scale enterprises—particularly in the wholesaling and re-

tailing fields. Most common among the proposals they suggest for their benefit are anti-chain-store taxation, the subsidization of small-scale enterprise through loans, research and advisory activities to assist them, barriers to the interstate movement of competing products, restrictions on the entry of new competitors, the imposition of limits on the size of individual enterprises, and further restrictions over the pricing policies of the larger units and over the prices at which these units buy.

Special occasions. In the field of particular occasions for special governmental action, the problems of war-time regulation of economic life are of the most vital immediate interest. We are provided at the moment with elaborate regulations designed to preserve our neutrality. At the same time plans are going forward for special controls to be imposed in the event of our involvement in war. Two major current issues exist. One concerns the question whether reliance is to be placed in large degree on private enterprise to organize American industry for war, with government action confined—as it was during the last war—largely to assuring war industries of the necessary supplies, and to certain limited controls over prices and direct production in extreme cases, or whether instead there should be wide conscription of men and resources and extensive governmental operation of industry. A second, and related, question concerns the method of financing war. Some contend for inflationary finance, with moderate efforts to tax away high profits (so that a maximum incentive to private enterprise may be preserved). This plan would concentrate the burden heavily on fixed-income groups. Others contend for heavy taxation as providing both a less costly means of finance and a more equitable distribution of the burdens, and they favor extensive government production if this taxation should destroy the initiative of private individuals. The choices we make among these alternatives may have a profound influence on the character of the post-war organization of our economic life, should we become involved in the present conflict either directly or indirectly.

Direct government production. The recent great expansion in direct government production has made the issues of public policy in that field primarily those of retention rather than extension.

Perhaps the most pressing question is whether relief activities should have a continuous, permanent place in our governmental policies, and, if so, at what level of government—national or state. The place of the housing and power projects is also not yet clearly established. More generally accepted is the social security program, and in this case there is under active discussion the extension of old-age insurance to certain excluded classes, particularly farm and domestic employees and self-employed persons.

Need for appraisal of public policy. No aspect of the great elaboration of governmental functions during the past decade, of which further development is widely proposed, is more significant than the tendency to consider limited parts of the economic system without adequate consideration of their inter-relationship with other parts, and the inclination to appraise limited phases of public policy without a proper understanding of their bearing on other phases. Efforts to deal with some parts of economic life are at times seriously hampered by the treatment given to other parts, and attempts to meet a particular problem by one plan are often nullified by other developments in public action. Moreover, larger social criteria are frequently neglected in the consideration of immediate problems, and once a program is adopted there is a strong tendency to focus attention on the problems of effective administration and to ignore questions concerning the wisdom of what it embodies. While this is perhaps inevitable in times of stress, there is great need for a careful appraisal of the aims, objectives, and effects of the general changes implicit in the recent modifications of public policy, and an analysis of the relation of the details to broad standards of national welfare.

Certain issues raised by recent developments should particularly be borne in mind because of their bearing on the future of democratic institutions. Falling within this class are:

1. The question whether encouragement to the strong organization of partisan groups will operate to obscure larger social considerations from the public mind in the determination of programs of public action.
2. The questions whether such organization will unduly restrict the freedom of individuals, and what results it will have

on the effectiveness of private enterprise.

3. The question whether the strong organization of partisan groups will lead to pervasive governmental regulation of their activities to preserve the social interest.

4. The question whether the current relief policies are delaying the absorption of individuals in private employment, and the issue of what longer run effects these policies may have on the initiative of individuals both in seeking work and in organizing enterprises.

5. The question whether recent regulation of wages, prices, and production is interfering with the allocation of productive resources to their best uses socially, and the probable consequences of applying such controls generally in similar situations.

6. The question whether the increasing exercise of managerial controls over private enterprise has involved serious limitations on the drive and effectiveness of individual initiative, and the issue whether these limitations are justified in view of the social gains they have yielded.

7. Finally, the question whether the great changes which have recently taken place in programs of public action have created uncertainties of such character and degree as to constitute a serious deterrent to private enterprise.

The influence of the depression. The problems of determining a proper relationship between government and economic life, which are complex enough under the simplest of circumstances, have acquired under the influence of the depression of the thirties both a new importance in public thought and a vastly increased difficulty of solution. The distress which was brought about by the widespread unemployment of this period formed the basis of public demands for a considerable expansion of governmental activities to relieve the immediate suffering and to provide safeguards against its recurrence. The added governmental responsibilities which have been undertaken in response to this situation have not only raised problems of finance and administration and of proper integration in a system of private enterprise, which we have discussed in earlier chapters, but they have had a pervasive effect on the whole range of American public policy during the past decade.

In the early years of the depression, the added programs of

public action were not extensive, nor were they expected to be of long duration. The notion was widespread that the country was suffering from "general overproduction," but this was characteristically regarded as a temporary phenomenon which would quickly be corrected without the stimulus of much additional governmental action. Those who held this view favored confining special public activity in relation to the depression to the temporary granting of relief, with a major emphasis on encouraging the acceptance of opportunities for private employment as they arose. The Roosevelt administration altered this policy significantly when it inaugurated elaborate controls over private enterprise and a vast program of public spending designed to spur a revival of business activity. But there was little thought, at least in the beginning, that these special measures would be continued for long.

The persistence of a large degree of unemployment after a period of several years, however, has given rise to a new theory of the proper relationship of government to economic life, involving a fundamental change of outlook. The notion has gained acceptance in many circles that our economy has reached a stage which is denominated as "mature," and that as a result there is no longer any hope that we shall be able to come near the full employment of our productive resources without a continuous program of extensive public spending designed specifically to promote the utilization of idle men and plant.¹

Somewhat different as regards the issues of public policy involved is the current emphasis on price inflexibility as a cause of unemployment. The view has grown that our economy has been increasingly characterized by concentration of control over output resulting from collusive activities among producers, the growth in the size of individual units relative to the size of the market, and, most important, the development of highly differentiated products supported by branding, packaging, and advertising); and that this presumed inflexibility has made more difficult the adjustment of the economy to changes in demands and techniques of production, and has intensified the cyclical swings in general

¹ For an analysis of this issue, see Harold G. Moulton and others, *Capital Expansion, Employment, and Economic Stability* (1940).

business activity. Those who follow this school of thought often propose a considerable elaboration of the present controls over private enterprise, including the breaking up of larger units (they contend that in many cases this can be done without a loss in efficiency), controls over advertising, government competition, and in some instances, government ownership and operation of an entire industry. They do not always point out, however, that the price fixing and wage fixing provided in certain current forms of government regulation may themselves prevent the full employment of resources.

It has by no means been demonstrated by economic analysis, much less by practice, that the means now in operation for meeting the fundamental and serious problem of unemployment, or the more extreme measures which have been proposed, will do more to meet the situation than the less elaborate programs of the early thirties. It is clear, however, that permanent programs of extensive governmental spending, and the broad extensions of governmental regulation, and even displacement, of private enterprise which have been proposed, raise grave questions for the effectiveness, and perhaps the survival, of private enterprise, no less important than those raised by the unemployment they are designed to relieve.

So long as there is a continuation of widespread unemployment we may be certain that it will have the greatest effect on public policy and will lessen the care with which we evaluate proposals for change. The suffering which results from unemployment makes it easy to secure public support for a plan of action merely on the ground that it is designed for the relief of unemployment, though in many instances there may be no clear reason for believing that it will have the results claimed for it. The difficulty of evaluating proposals of this character has added greatly to the danger that ill-considered programs of public action will be adopted. Moreover, it has been easy to attribute the failure of current schemes of meeting the unemployment problem to the shortcomings of private enterprise, and to ignore the fact that the effectiveness of private enterprise itself may have been impaired by the programs of government action. This is not to pass definitive judgment upon the merits of our present public policy concerning un-

employment, nor of the current proposals for change, but merely to point out a significant emotional attitude which has influenced the formation of our public policy in recent years.

The problem of administration. The general directions of change in American public policy over the past decade have, as we have seen, involved a lesser reliance on private enterprise and a wider range of authority for governmental bodies. There has resulted a grave problem of constructing plans of administration and administrative agencies capable of effectively carrying out the policies, while at the same time avoiding undue limitations on individual liberty.

As the range of matters over which governmental controls are imposed is extended, it becomes increasingly difficult for a legislative body to foresee all the issues which are likely to arise. This is especially true so long as individuals are allowed any measure of personal discretion in ordering their economic affairs. There has been a tendency, therefore, as we have noted, to endow administrative agencies with broad discretionary powers. But as a result of this fact, other vital issues arise. How can administrative agencies be endowed with powers sufficiently flexible to enable them effectively to carry out their authority over the changing business scene without at the same time creating the threat of arbitrary action and a menace to civil rights? On the other hand, inflexible controls may themselves be burdensome to enterprise because of their failure to allow for or permit change. Further, how can governmental administrative agencies be infused with the initiative and incentive necessary to the effective regulation or conduct of business enterprise where private decisions are so severely curtailed that there is little or no scope left for individual initiative?³

More significant in many ways is the fact that as the range of public control is extended, the factors which need to be taken into consideration both in framing and in administering policy become so numerous and so complex that they may outgrow the capacity of individuals to comprehend them. In these circumstances there

³ For an analysis of some phases of the problem of administration, see Frederick F. Blachly and Miriam E. Oatman, *Federal Regulatory Action and Control* (1940); and, by the same authors, *Administrative Legislation and Adjudication* (1934).

is further danger of arbitrary action or of stagnation and inefficiency. The limitations which these conditions impose on the effectiveness of public action should constitute an important consideration in weighing the merits of any proposed program of governmental regulation, particularly those involving extensive managerial controls over private enterprise, or its displacement. These limitations of human capacity should, indeed, be a fundamental matter of concern in any attempt to improve upon whatever division of responsibilities exists between government and the individual in ordering and controlling the economic life of our country.

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