

T H E C A S E F O R
P R I V A T E
E N T E R P R I S E

*An Address delivered by invitation at
Princeton University on December 12, 1935,
before a joint meeting of The American Whig
Society and The Cliosophic Society of Princeton*

By

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The occasion of this Address was a debate on the question: "RESOLVED: That Private Enterprise is preferable to Public Ownership, for Electric Utilities." The debate was before the Whig-Clio Forum, held in the historic Whig Hall on the Princeton Campus. The American Whig Society upheld the affirmative and The Clisophic Society the negative

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¶ *At the conclusion of the debate a vote was taken which resulted in favor of the affirmative side of the question*

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The American Whig Society was founded in 1769, as a reorganization of the "Plain Dealing Club." The Cliosophic Society was founded in 1770, as a reorganization of the "Well Meaning Club." They are the oldest college literary and debating societies in America, having a continuous history of more than 160 years. Their early beginnings go back some ten years before the date of the signing of the Declaration of Independence. James Madison of Virginia, Princeton 1771, later President of the United States, was one of the Charter Members of American Whig Society. Woodrow Wilson, Princeton 1879, was a member. The founders of Cliosophic Society included: William Paterson, Princeton 1763, United States Senator, Justice of the U.S. Supreme Court, and Governor of New Jersey; Oliver Ellsworth, Princeton 1766, Chief Justice of the United States, U.S. Senator, and Ambassador to France; Luther Martyn, Princeton 1766, Delegate to the American Congress and member of the Constitutional Convention; and Tapping Reeve, Princeton 1763, Chief Justice of the Supreme Court of Connecticut. Aaron Burr, Princeton 1772, was a member of Clio Hall. The two Societies, known on the Campus as Whig and Clio Halls, have taken distinguished part in the development of culture in America and have contributed to the early training of many leaders in public life



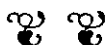
Biographical Sketch of Speaker



FRANK WHITNEY SMITH. *Public utilities executive. Born Alden, Erie County, N.Y., June 22, 1867, of Revolutionary War stock, tracing its descent from Sir Francis Drake. Educated public schools, New York City. Office Boy, United States Illuminating Company, pioneer arc lighting organization, 1880; General Clerk, 1883. Paymaster, United Electric Light and Power Company, New York, 1889; Assistant Secretary, 1899; also Secretary, Brush Electric Illuminating Company; Secretary, United Electric Light and Power Company, 1905; Vice-President, 1912; Vice-President and General Manager, 1916; Vice-President, The New York Edison Company, 1931; President, 1932; also President, The United Electric Light and Power Company. President and member of board of trustees, Consolidated Gas Company of New York, 1935; President, The New York Edison Company, Inc.; President and Director, New York and Queens Electric Light and Power Company; President and Director, Brush Electric Illuminating Company; Director, Northwestern Mutual Life Insurance Company of Milwaukee; Trustee of Edison Electric Institute, Chairman of its Prize Awards Committee. Member, Advertising Club, Engineers' Club of New York, Manhattan Club, Downtown Athletic Club, City Club, Rockefeller Center Luncheon Club. Office, 4 Irving Place, New York City. Residences, 1 Lexington Avenue, New York, and Tompkins Corners, New York.*



THE CASE FOR PRIVATE ENTERPRISE



This address, by one who holds the respect and regard of his industry, reviews briefly what has been accomplished by the electric utility industry in the United States since 1882, when the speaker's own Company had the distinction of placing in service the World's first electric central station, the Pearl Street Station at New York City. The beginnings of regulation in this country and the creation of Interstate Commerce Commission in 1887 during the administration of Grover Cleveland, are traced. Reference is made to a tone of debate stated regrettably more on political grounds than economic, in the discussion of Private versus Public Ownership. Fundamental engineering aspects and the vital factor of capital requirements, are developed. The output of municipal plants is cited. The various grounds are examined upon which the claim is made that private enterprise should now be superseded by public operation. Rural electrification is discussed. The advantages of self-reliance, the sense of personal individual accomplishment and initiative, as demonstrated in what is now a Key Industry in America, are analyzed. Basic principles are outlined as inherent in the Capitalistic System and related to the electric utilities. Taxation and its mounting burden are touched upon. Administrative methods and costs are described as between Private and Public Operation. The case for private initiative is summarized. Three questions are put, in conclusion, which the proponents of public ownership are fairly required to answer.



IT WILL BE my endeavor to present for the consideration of tonight's forum, the case for private enterprise in the continued development of this country's great electric power services. This presentation necessarily will include not only an exposition of the achievements of private enterprise thus far made in this field, but also a frank examination of the various grounds upon which the claim is made that private enterprise should now be superseded by public operation. It would be idle for me to attempt to set myself up on this matter as a completely

unbiased commentator. The subtle prejudices of a life-long association with private management of the electric light and power industry must have some effect upon my judgment. I shall try, however, to discuss the question as I honestly see it.

The unfortunate aspect of this so-called "Power Issue" is that it seldom receives wholly rational consideration; and I do not mean to imply that the irrational arguments have always been on the side of the proponents of public operation. Private management, however "monopolistic" it may be deemed to be, has not claimed and ought never to claim a monopoly on brains, clear thinking and sound judgment. Nevertheless, it must be admitted that the prevailing climates of opinion, in which this question has been discussed, have more often than not been charged with a superabundance of emotion, which has prevented a final, satisfactory, intelligent conclusion.

The Discussion Political

The reason, of course, is that the discussion of the problem has most frequently been political. The electric light and power industry had its small and tentative beginning in 1882. As you may know, national political thought at that time was preoccupied with the problem of regulating the railroads. Largely through the activities of the Granges, there had been over the preceding decade a bitter campaign for increased regulation by the States, and in 1887, the Interstate Commerce Commission was set up by the National Government, superseding to a large extent, the regulation of railroads by individual States. In 1876, the United States Supreme Court had decided that certain businesses which enjoyed virtual monopolies in their fields, or depended upon public grants or franchises, were "affected with a public interest," and so, subject to State regulation of the price paid for their services. At the time there were those who thought that this decision of the highest Court of the land had sounded the death-knell of private initiative and that the *laissez faire* doctrine of political economy had been finally rejected.

It was in this atmosphere that the electric light and power industry began its struggles for existence. Now, the nature of that industry was such that in its first stages it could be no more than a service within relatively densely populated areas, and was dependent upon franchises from the public authorities of such areas for the necessary privilege to use the streets. The ways and means for securing these franchises raised new political questions—similar to be sure, to the questions which had arisen much earlier respecting gas companies, but more accentuated by reason of the consciousness of the recent railroad questions.

In those days the "Power Issue" was fought largely over those franchises and provisions as to duration, maximum price, and in some cases, recapture by the City. Then arose a second great movement in American politics, "The Progressive Era," in which the insistent voice of the "Muckrakers" was heard calling for *reform* and incidentally calling for public ownership of all municipal services.

Yardsticks and Relief

It was from this period, early in the present century, that the debate on public ownership really began. In those days, the question was the fundamental one of whether any group representing private capital was to own any electric light company. Today, of course, the issue is phrased more modernly, as "should there be 'yardsticks' of public operation"—or "should there be a program of public works for relief purposes, even though it involve the building of duplicate dams, generation stations and distribution systems in the light and power field."

This sketchy survey of the trend of the "Power Issue" has been for the purpose of showing the background in which the issue has arisen. It goes without saying that out of this atmosphere of politics, necessarily has arisen an essentially political discussion of the issue. It has been a temptation, only infrequently resisted, for candidates for public offices to seize upon the "Power Issue" as a platform. It is easy to arouse the voters'

suspicion, and easier to convince them that they are paying too much for electricity.

Economics, Not Politics

With the *tone* of the debate thus established, it is regrettable that the case for private enterprise has too often been stated on political rather than economic grounds. I hope that by presenting to you tonight my ideas of the *economy* of private management, we may avoid as much as possible irrelevant questions of politics.

What is this electric light and power industry which for the past fifty years has been so susceptible to the designs of politics? In the first place, it is the practical realization of the genius of such men as Faraday of England, Edison and Steinmetz of our own country, and thousands of other individual scientists who have devoted their lives to a search for new ways in which to subject nature to the use of mankind.

Fundamental Engineering Aspects

Whether a particular unit of the industry today extends over wide reaches of the nation's territory, or whether it be confined to the narrow limits of a single village, it has the same fundamental engineering aspects. First, there is a generating unit which creates electric power, through the agency of steam, water or some other source. Second, there are the mechanical and electrical devices for transmitting and distributing energy so generated to the place of its use. Finally, there are the connections with the ultimate points of use to the customers. This set-up, however simple or complex in a given situation, is the physical phenomenon, so often ignored, unknown or forgotten, which has caused the "Power Issue."

In addition to the physical phenomenon of the industry, there is the *organization*, that is, the people who actually maintain and operate the physical units, composed of engineers, accountants, laborers, clerks, and such useless appendages as Presidents and

Vice-Presidents. (Some 250,000 people form this army of utility workers under private operation.)

Capital a Vital Factor

Finally, there is that rather intangible but vital factor of the industry, its *capital*. This has come from millions of citizens, who have wanted to secure interest on their money, or who have been willing to share the risk of a development of the industry in a particular locality in the hope of earning some profit.

These three factors, physical units, organization, and capital investments, are indispensable to the industry, and, as I understand it, their indispensability is not challenged by the most radical proponent of public ownership.

That being true, the question arises whether any of these factors could be made to function better under public operation than through private initiative. At the outset of a consideration of this question, I shall stipulate that at the present time, the industry is by all odds characteristically the result of private initiative.

Municipals' Output Small

Without burdening you with statistics, I can state that there are relatively few public units of the industry in this country today. After a half century of trial and error, the municipal plants supplied, according to the 1932 census, only 5 per cent of the total volume of electricity generated by the electric enterprises of the country. The majority of the existing municipal plants which remain in operation are located in small towns and villages; the average size of the towns being served by the typical municipal plant being less than two thousand people.

Furthermore, I shall stipulate that the industry in its present advanced stage of development in this country is the *achievement* of private enterprise. And there can be no doubt that comparatively, the light and power industry is in an advanced stage in this country. The rapid technological advances made

during the past twenty years are astounding—electrical energy has been made available for almost every conceivable purpose. Within the industry, the improvements in the art have been continuous and extensive, with remarkably increased efficiency at progressively lower costs per unit. This story of the technological advances made in the physical plant, almost wholly under private auspices, is a fascinating story and a brilliant chapter in the history of American industry. Time does not permit a further discussion of it, but I referred to it for the purpose of making my first major point in the case for private initiative.

Could Not Better Service

No serious question has ever been raised by the proponents of public operation as to the results of the technological development of the power industry through private initiative. You never hear it suggested, for instance, that a city, a state or even the federal government take over any branch of this industry because the private operators have failed to develop the engineering aspects of the field.

Similarly, you never hear a candidate for public office campaigning on the proposition that a publicly operated plant will give *better service* than the existing plant under private management.

At the outset, therefore, it seems to me that there is one point definitely in favor of the continuation of private initiative in this field. It has not failed in the job of originating, developing and transferring from the laboratories of the scientist to the sphere of highly efficient practical operation, one of the most complex and yet most advantageous technological inventions known to mankind.

Farm Current and Costs

Perhaps some of you at this point will be asking—What about the much discussed question of *rural electrification*? Has not private initiative *failed* to develop the *extent* of electric service?

In answer, it may be said that there is still a field in which greater use of electricity may be promoted, but the problem is not essentially technical; it is, rather, one of cost.

As an illustration, I ask you to consider present mechanisms for *voting*. You all are familiar with the highly developed voting machine employed today in most cities. Its technique is almost perfect. It is accurate, honest and efficient, and has become so definitely accepted as to make the slogan "Pull the Second Lever" (or first, if you will), the epitome of political campaigning.

But are voting machines installed in every crossroad general store where elections are held? Some of you may come from small towns and villages, and such places as Tompkins Corners, in New York State, where I live a good deal of the time, and you know that in many parts of the country the ancient ballot box is still in use, for the obvious reason that the number of votes cast in each election does not justify the use of a voting machine. And so, I say, the question of rural electrification is not alone a technological one, and the industry cannot be charged on that score with engineering inefficiency.

Now a Key Industry

Today, however, what was at first a laboratory experiment, undertaken with great doubt and trepidation, has become one of the country's outstanding industries. Beginning its service to the public in a limited area of the downtown business section of one city, the network of electric lines has been extended until it is now available to everybody who wants it in every community of more than one thousand people.

What accounts for this rapid and highly commendable engineering achievement of the power industry in this country? Some will say, the inherent striving of the human mind to extend its domain over nature. Obviously. And so, some will say, since scientists and engineers are interested only in *physics*, the

same development would have been made under public auspices. Such a claim, however, is confronted with its own hypothesis—"Would have been made under public auspices," as against the realized fact—"Has been made through private initiative."

This opens up a question which hardly can be fully discussed here, namely, whether the self-reliance, the sense of personal individual accomplishment, and the acquisitive nature of man, which finds its fullest expression in private undertakings, give the *push* to experimentation and empire building which would not be found in the collective group undertakings of a governmental character.

Not Better, Only Cheaper

This is somewhat beside the point, since the proponents of public operation never have claimed to be able to do a *better* job—their *only claim* has been that they can do a *cheaper* job. Furthermore, I put it to you that upon analysis the case for public ownership is this:

"Now that the entrepreneur spirit of the American pioneer in business has brought the Power Industry to a high degree of operating efficiency, let's take it over."

In other words, Public Ownership Leaguers do not claim to be able to improve upon the engineering features of the industry, so also there is no claim that the *organization* of the industry will be materially improved. Of course, there is back in their minds the delectable dream that jobs will be plentiful for election day workers (but is never openly admitted), and there is in every campaign for public ownership the expected "pot shots" at such useless ornaments as Chairmen of the Boards, Presidents and Vice-Presidents. But, if you read or listen carefully to any argument for public ownership, you will seldom, if ever, hear a claim that, under City or State government, the organization and personnel of the power company will be improved.

Efficient Workers

Reticence on that point is good sense on the part of these advocates of public ownership, because it is an admitted fact that the organization and personnel of local and state governments in this country is woefully lacking in efficiency. Furthermore, as one who has been in the light and power industry for more than half a century, I have no hesitation in saying that the men and women who run that industry are as a group among the most efficient in the nation.

And, so we come to the final factor of the industry—the *Capital Investment* required to set up the physical plant and bring into being the *Organization*—and here, I suppose, is really where the fight begins.

I should like to begin my remarks on this point with a statement of a few principles of economics upon which it would seem there can be no disagreement, at least under the present Capitalistic System. And in this connection, I wish to emphasize that I am discussing this problem only upon that basis. I refuse to consider, even if I could understand or anticipate what would happen if all private property were abolished and all private institutions, including this University. And so, I say, under the American System, there are principles of economy which I shall state, and which I challenge any public ownership advocate to deny:

Some Basic Principles

1. Just as labor must be paid its wages, so capital must be paid its interest.

2. Where, and particularly in new ventures, the risk of an enterprise is great, capital demands higher return.

These principles are also reduced to the proposition that *price* must in the long run correspond to the cost of production.

In the electric light and power field, the effects of a competitive market are not as directly operative as in other fields, because the *price* for electric service is, and has been, regulated by public

authority. However, this price must under the Constitution, be sufficient to cover the *cost* of the service which is defined to mean the amount of operating expenses reasonably required, *including taxes*, plus a fair return upon the amount and value of the property used and useful in the public service.

It is the aim of private initiative in this industry to reduce the cost of service and thus reduce the price. Whether or not, in the absence of regulation, private initiative would be enlightened enough to refuse to obey the law of monopoly price, i.e., to charge as much as the traffic will bear, is beside the point. The fact is that the publicly regulated price has become so permanently established that the entire industry is built upon it. Consequently, I say, the necessary aim of private initiative is to reduce the cost of service.

Costs of Service

Now, the cost of service in the electric light and power field is a complex thing. It cannot be adequately considered tonight, but I will give you an example. The Company is required at every moment of the day to stand ready to supply its maximum connected load. That is, the Company must be prepared instantaneously to supply service to every outlet—domestic, commercial and industrial. You will say that is only theoretically true—and to some extent you are right. But if I had time to give you examples of emergency conditions which sometimes occur in the City of New York, you would appreciate that this *readiness to serve* requires a very *high investment* for reserve capacity to meet any sudden demand, and to assure the reliability of service which any large city demands.

There are other costs which are also high and unavoidable, and finally, there are *taxes*.

There are three broad divisions of taxes: Federal, State and Local. The local taxes, in turn, usually consist of city, county and school district levies. The utilities contribute to all of these; municipal plants to none, except in the comparatively rare cases

where they own some property outside of their own corporate limits.

Taxes in Hundreds of Millions

It has been estimated that the electric utilities will pay this year to the various branches of government more than two hundred and sixty million dollars, or 14 per cent of their consumer revenues.

Taxes in 1934 (that is, local taxes alone) of the electric companies in New York City amounted to over twenty-seven million dollars, or 16½ cents out of every dollar of operating revenue they received. Federal taxes brought the total figure to 18½ cents out of every dollar.

Where municipal operation supplants private ownership, these taxes are lost, and the withdrawal of that much taxable property means that these taxes must be passed on to the public.

I have dwelt upon the cost of operation to emphasize the final point in my presentation, viz: That whether a power plant is privately operated or maintained as an adjunct of City, State or Federal government, the *cost of service* is the same. Municipal plants may conceal their costs, but they cannot avoid them.

How Costs Are Shifted

There is a good deal to the business of supplying electricity besides its mere generation and distribution. Meters have to be read, bills made out, accounts collected. General administration, engineering, legal work, financing, insurance, and a host of other things are necessary which are usually included in the term "general overhead." In municipal operation, frequently the lighting department gets most of these things done for it by the other city departments. Thus we see the electrical department often enjoying free rent for its offices in the city hall; its bills made out jointly with the water bureau; its legal work done by the corporation counsel; its finances handled by the city treasury. In the aggregate, all these things cost a good deal

of money if they are competently done, and in every comparison of public operation with private enterprise this must be borne in mind.

If time permitted, I could give you some concrete examples of how these matters are handled in certain municipal operations.

The Case Summarized

The case for private initiative may be summarized as follows:

1: The present high standard of efficient service in the light and power industry is the achievement of private initiative, and the burden is on the proponents of public ownership to show that the development would not be impaired through a destruction of private initiative.

2: The organization of the industry has not been challenged on grounds of efficiency and economy, while it is at least doubtful that City or State government would be able to maintain the same standards.

3: The price of electricity moves with the cost of service, and the cost of service under public operation would not be appreciably less, although it might be adroitly concealed.

4: Private initiative has occupied the field and contributed brilliantly to the constant improvement in the American standard of living. Conversely, in fields of recognized governmental activities, cost has gone up and efficiency has lagged.

Questions to Answer

In conclusion, may I present *three questions* which, I think, the proponents of public ownership are fairly required to answer:

1: Do you defend the spending of the taxpayers' money to build duplicate facilities?

2: Do you think it is honest to spend, let us say, one hundred thousand dollars on a generating station, allocate fifty thousand dollars of it to "public relief," and then claim that the investment, so far as the cost of service goes, is only fifty thousand dollars?

3: Are you prepared to pay a fair price for the existing plant, built by private enterprise, with money invested in good faith, in the territory to be served?

THE END

Whig and Clio Halls at Princeton have a long record of distinguished history. An interesting account of their activities in 1846, ninety years ago, is included in the memoirs of a Princeton graduate of the Class of 1848, from which the following is abstracted:

Whig and Clio Halls

The two Halls did yeoman service in the cause of education in my time, and supplemented the curriculum of the College. I think the Faculty leaned on them in some things.

Their founders had admirably enlisted a principle which has contributed greatly to the prosperity and growth of Anglo-Saxon commonwealths,—a principle which has made English colonies a success, while the colonies of other countries, subjected to government control have been failures. It is the principle of individual liberty and self-government. The possession and exercise of this liberty in the Halls, to which secrecy lent a zest, made work agreeable because it was self-imposed, and the work of the Halls made them no insignificant vestibules of the great world, which their members were so soon to enter. But these advantages were chiefly possessed by those who made use of their opportunities. All of the College students were then members of either one or the other Hall.



¶ *The above is taken from "REMINISCENCES OF PRINCETON COLLEGE: 1845-1848," by the late Edward Wall, Emeritus Professor, Stevens Institute of Technology, published by Princeton University Press, 1914.*