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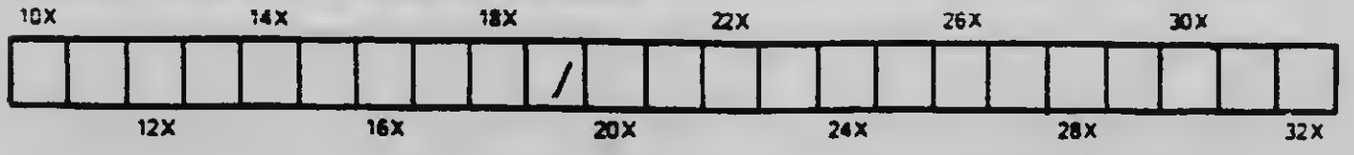

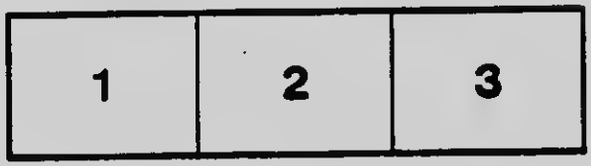

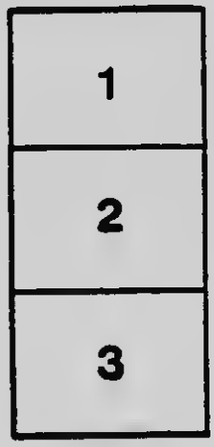

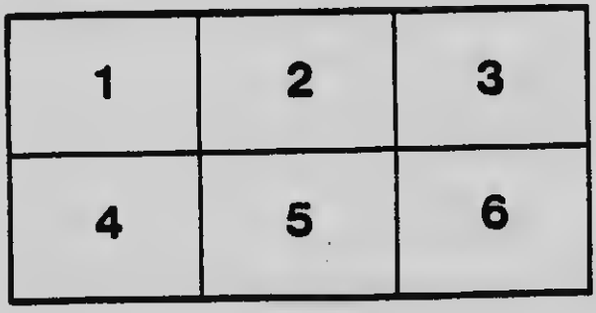

ECONOMICS

LESSON 17

By
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ECONOMICS

LESSON XVII.

Trust and Monopoly Problems.

N.B.—The student should, before beginning work on this lesson, read over Lesson VII, especially the part treating of the fixation of monopoly and competitive prices.

Monopoly Profits.

IN Lesson VII it has been already pointed out that monopoly prices may quite conceivably be less than competitive prices, though this probably rarely occurs in actual business. Monopoly profits, however, will never be less than competitive profits, since the only object of monopolizing the sale of a commodity is to secure the greatest total net profit from it. Monopoly profits on a given product in a given market, will be greater than competitive profits on that article in that market, and where the monopoly is in control of an enormous market, such as that of the United States, the profits which it can make are stupendous. There is, therefore, every reason why producers who are desirous of making money and who already possess or can secure the capital necessary to establish a monopoly, should do so. If they themselves have not sufficient capital to control the situation, their best scheme is to enter into a combination with other producers for the purpose, arranging perhaps the terms on which the product shall be disposed of, or the territory in which each of the producers joining the combination shall, so far as the combination is concerned, be left in exclusive and monopolistic possession of the market.

Combinations Are Formed in Hard Times.

Producers are all the more apt to enter into such agreements and combinations if they have found themselves being driven into bankruptcy by hard times and "cut-

throat'' competition. When men find themselves being driven to the wall, they play for safety and an exclusive market, rather than attempt the almost hopeless task of securing a larger and more profitable trade by still keener competition. Under such circumstances, the first man who is keen enough to see the advantages of substituting combination for competition as the rule of trade, will find the people whom he approaches disposed to listen to him.

An Early Pool.

Competition was keen and profits were small in the United States in the period following the Civil War. Consequently we find here the loosest kind of combination (the pool) coming into prominence in American manufacturing industry. An instance given by Ripley is the case of the Michigan Salt Association. Competition in the salt trade had proved very destructive of the capital engaged in it, and finally about 1866 we find the salt manufacturers in Michigan agreeing to sell their product to an Association which was to dispose of it for them. Thus they would cease to compete against each other in the market and would be enabled to secure enhanced profits.

Other Varieties of Pools.

This selling Association is perhaps the most common, but not the only type of pool. Palgrave's Dictionary of Political Economy mentions four other classes with the principles on which they operate: first, division of the field, where each competitor agrees to take the traffic of a certain district and withdraws from competition elsewhere; second, division of traffic, where the competitors agree upon the percentage of the business to be handled by each concern; third, gross money pools, where they agree upon a percentage of gross receipts; fourth, net money pools, where they agree upon a percentage of the profits. These latter are the closest and require a system of joint book-keeping.

Pools Illegal Under Common Law.

These arrangements are, however, regarded by the English common law as illegal combinations—conspiracies in restraint of trade. That law holds good in England, in Canada and in the United States, except in so far as it may have been modified by Statute law—law made by regular Parliamentary or Congressional methods. English common law forms the groundwork of the English and American legal systems, and the position which the English-speaking peoples take towards industrial combinations has been profoundly modified by the fact that such organizations are conspiracies in restraint of trade and have no legal right to exist.

The Pool An Unsatisfactory Organization.

What is the consequence? It is this: a manufacturer who has entered into one of these pools and has thus incurred certain obligations to the other members of the pool, may break his contract at any moment when he finds it advantageous to do so, and he cannot be held legally accountable for so doing, since the law will not enforce an illegal contract. The other members of the pool are in the position of gamblers who cannot collect debts due them. They can receive no legal redress because the courts will not enforce contracts which are in themselves violations of the law.

The pool agreement had, therefore, its disadvantages. It was formed primarily in order to extract unusually high rates of profit from the public, and its members who were so willing to extort money from the people, were, many of them, not averse from violating their agreement with each other when they found this to be to their immediate interest. As the law would not punish the offending party, the others in the agreement were powerless. Thus they found it necessary in many cases, to substitute some closer arrangement for the existing one. If we may judge by German experience, it is unlikely that had the agreements of the pool been enforcible by law, it would ever have developed into the trust.

The Kartel.

In Germany industrial combinations have arisen as in America, and have taken the form of pools—or Kartels as they are called in that country. Their agreements have been recognized as enforcible by the German law, though the Government keeps a strong hand over them and sees that they do not unduly overcharge the public. Thus they secure all the natural profits resulting from the very large scale on which their enterprises are operated, and from the division of labour between them, without being able to evade the supervision of the Government or their obligations to each other. The result of this is that in Germany industrial combinations have remained for the most part in the pool or Kartel stage. An important German legal decision quoted in the report of the American Industrial Commission runs as follows:

"When in a branch of industry the prices of the product fall too low and the successful conduct of the industry is endangered or made impossible, the crisis setting in as the result of such a state of affairs is detrimental not only to individuals, but also to society as a whole: and it is therefore in the interests of the community that improperly low prices should not exist in a certain branch of industry for a long time. On the contrary, when prices are for a long time actually so low that financial ruin threatens the entrepreneurs, their combination appears to be not merely a legitimate means of self-preservation, but also a measure serving the interests of the community. The formation of syndicates and kartels of the kind here discussed is, on many sides, thought to be a means particularly suited to render great service for the adequate progress of the whole economic life of society, in so far as it prevents uneconomical working at a loss, overproduction and the catastrophes connected with it."

A Closer Combination.—The Trust.

It is a debateable question whether the German method of dealing with industrial combinations has not proved more successful than the English and American system.

In the United States especially, the result of the non-enforcibility of pooling agreements has been that closer organizations have arisen, in which the manufacturer who enters the organization makes over his entire plant to a group of trustees in return for certain stock or bonds in the new company, or perhaps for a cash payment. Since these various manufacturing plants are placed in the hands of trustees, the whole concern is known as a "trust."*

Under the trust agreement it was arranged that those who held stock in the constituent companies should all transfer their shares to a few persons selected as trustees, that these trustees should hold the shares and possess the voting rights thereof, while remaining under obligation to use their powers for the benefit of those who had entrusted them with their property and to whom they must turn over all dividends and profits. Thus all the enterprises composing the trust would be irrevocably bound to it. At the same time the trustees would he bound to administer these companies for the benefit of the real owners. In the case of the Sugar Refiners, however, the courts refused to enforce this agreement on the ground that it was monopolistic and in restraint of trade, so that some new device had to be invented. The first of these Trust Agreements was that of the Standard Oil Company made in 1879.

The Sherman Act.

The famous Sherman Anti-Trust Law was passed in 1890. This act begins: "Every contract, combination in the form of trust or otherwise, or conspiracy in restraint of trade or commerce among the several States or with foreign nations, is hereby declared to be illegal."

*A "trust" should be distinguished from a trust company whose chief business is the administration of estates of deceased persons in the interest of beneficiaries—widows, children, etc.—who are often incompetent to invest the money for themselves. Though their present functions are more varied, this is the original object of the trust company, and out of this its other functions have arisen.

New Jersey the Refuge of the Trust.

This attack on the trusts led several of them, whose great resources enabled them to secure the skill of the best lawyers, to change their form. This was rendered easier by an Act of the State of New Jersey passed in 1889.

"Be it enacted that the directors of any company incorporated under this Act, may purchase mines, manufactories or other property necessary for their business, or the stock of any company or companies owning mining, manufacturing, or producing materials, or other property necessary for their business, and issue stock to the amount of the value thereof in payment therefor, and the stock so issued shall be declared and taken to be fully paid stock and not liable to any further call."

This New Jersey Act, then, enabled, for instance, the Standard Oil Company of New Jersey to purchase with its own stock and hold the stock of all the other companies controlled by the Rockefeller and allied interests and made possible a unity of administration which would otherwise have been impossible. This stage is called that of the holding company. A corporation is formed which acquires the stocks of the several combining concerns—either all or a majority—and gives its own stock therefor. Its directors become the real managers of all the constituent companies, and though the original corporations nominally retain their existence, the whole control is centred in one board of directors.*

The Holding Company Declared Illegal.

Recent decisions of the United States Supreme Court (notably those against the Standard Oil Co. and the American Tobacco Co.) have, however, been to the effect that the holding company scheme is a violation of the

*"The power of holding the stock of another corporation," says Taussig, "never belongs to a corporation under English and American law unless given in express terms by the grant of its charter from the sovereign power. In the absence of express grant, such holding is ultra vires"—outside of its legal powers.

Sherman Anti-Trust Law and have led to the dissolution of these combinations into their component parts. This dissolution, however, while legally carried out, appears to have had little practical effect, as stock in the companies formerly composing the trust is worth more than ever. It is almost if not quite impossible to prevent men who hold a preponderating interest in a number of corporations, and thus possess a voting power proportionate to the size of their holding, from regulating the policy of the various companies which they control, so as to make these companies work into each other's hands and refrain from competition. In such a case, the companies guided by one man or by a group of associates, will, whatever may be the strict law of the case, be operated as one.

The Measures Proposed to Defeat the Trusts.

A bill recently brought forward by the President of the United States, proposes, while allowing trusts to continue, to control all interstate trade by a commission to be known as the Interstate Trade Commission. This Commission or its authorized agents, is to have complete access to all records, accounts, minutes, books and papers of corporations, and will thus be able to ascertain if such corporations are violating the famous Sherman Act or a new measure to be known as the Trade Relations Bill, which provides that it shall be deemed an attempt to monopolize trade or commerce for any person to discriminate between different purchasers of commodities in the same or different sections or communities, or to make rebates from list prices on condition that the purchasers of their goods shall not handle the products of their competitors.

Why Are Monopolies Detested?

What are the abuses of monopoly against which these measures are directed? And why are the people thus disposed to crush monopolies, though such monopolies may be the most efficient of producers?

In the first place, monopolies are detested because of their very name—because monopoly implies special privi-

leges—the exclusive right of selling something—and special privileges are obnoxious to a democratic society. Such a community does not like to feel that John D. Rockefeller, for instance, is in control of the United States' supply of oil, can at any time crush out the small competitor whom he encounters and hold up the people of the United States for the oil. He is an "oil king," absolute and despotic, and the people of the United States do not like even constitutional monarchs. To Canadians too the despotism of such a corporation as the Standard Oil Company is very obnoxious.

The abuses of monopolies are, however, not only sentimental; they are exceedingly practical; otherwise so practical a people as those who reside on this North American continent would hardly have acted so vigorously against them. These practical abuses may now be considered.

The Trust is the Enemy of the Competing Producer.

The trust is able to crush competitors by three kinds of alleged unfair dealing. The first of these is local discrimination in prices. The trust, being the largest producer in its field, may sell goods for less than cost in some parts of its territory, provided that it makes enough in other parts to continue operating at a profit. The smaller producer is thus driven out.

"Do you not see," said an independent producer once, "that in my territory I can produce more cheaply than you can?"

"Do you not see," replied the manager of the trust, "that if we lose money in the twenty cities where you are operating, and make money in the two hundred other cities where we are operating, we come out ahead?" This policy is effective in keeping down small but rising competitors.

A second means used by the trust is, in cases where it produces many lines of goods, and its competitor only one, to cut its prices on such part of its product as competes with his, while maintaining or even increasing its prices on other products. This will be just as effective in putting him out of business as the first method.

A third scheme adopted by the trust is that of refusing to sell goods at all except under certain conditions. It may and often does boycott merchants who will not promise to deal exclusively in its goods and refuse to handle those of its competitors. Under these so-called "factors' agreements," a trust that has a number of products essential to a merchant's business, may refuse to sell him anything, unless he agrees to cease handling the goods produced by the trust's competitors.

In these and in many other ways the trust, with its great capital and enormous power is able to crush its small competitors and reign supreme over a field of ruins. However, for one reason or another, perhaps as a concession to public opinion, perhaps because the game is not worth the candle, most trusts do not pursue the warfare against their competitors to the bitter end, as long as these refrain from cutting prices and are content with only a small share of the trade while the bulk goes to the trust. Such competitors, however, exist only on sufferance, and generally adopt the same or practically the same scale of prices as the trust itself. Their continued existence, therefore, while no doubt very satisfactory to themselves, constitutes no protection to the public against the monopoly prices charged by the trust.

The legislation proposed by President Wilson seems to be carrying out the ideas of Prof. Clark of Columbia University. Laws which would give to every customer of a trust the right to buy from the trust at the same rate, would prevent the operation of the first and third schemes for driving out competitors—that of local discrimination in prices and that of refusing to sell to retailers who handle competitors' goods.

Difficulty of Preventing Trust From Underselling or Refusing to Sell.

But however desirable such laws may be, the legislator must also consider how far their enforcement is practicable, and whether it is really possible to prevent a trust from selling its products cheaper (transportation costs of

course eliminated) in one place than in another, or to prevent them selling more cheaply to one person than to another. To bring this to pass would require a much greater efficiency of administrative supervision than has existed up to the present in the United States or Canada.

The Trust and the Investor.

We have now shown how the competitor and how the consumer of the trust's products suffer from the methods used by the trusts and how it is proposed to deal with their case. The competitor and the consumer, however, have not been the only sufferers.

The Small Investor Has Also Lost by Investing in the Common Stock of the Trust.

When a trust is being formed, financiers usually called promoters go from one producer of a commodity to another, making arrangements for the purchase of their plants in case the venture is a success. They usually propose to pay the vendors of these plants in preferred stock or in bonds of the trust (thus Mr. Carnegie sold his steel plants to the United States Steel Corporation for $320,000,000 of 5% bonds of the United States Steel Corporation), and usually they pay more than the plants are really worth. Then they issue other stock, preferred or common, retain the better class of this for themselves, and get rid of the common stock to the credulous public, which is fascinated by the prophecies of high dividends on the trust's common stock and consequent increase in the price of that stock—prophecies which do not usually "pan out." The promoters make money out of the big block of stock which they have retained for themselves and which they keep if they think that it will pay them to do so, or sell to the public if it will not. Hence, besides all the bonds and preferred stock which together usually amount to the full value of the plants which constitute the trust, there is generally issued and sold to the investing public a vast quantity of common stock in the new trust.

Watered Stock.

In almost every case where a trust has been formed (the Standard Oil Company is the notable exception), the capitalization of the trust has been vastly in excess of the capitalization of the corporations which entered into it. These corporations have received stock amounting to at least as much as their own previous capitalization in return for their investment in the new concern. What does the excess capital mean? The man in the street calls it "water," and to issue it is commonly regarded as illegitimate. But "watered" stock is not usually issued in the belief that it will never be worth anything. It is issued as a capitalization of the prospective earnings of the trust. Why should the trust earn more than its constituent companies taken together? Because it has a more or less complete monopoly of the market. The excess in capitalization, therefore, represents somebody's estimate of the capitalized value of the prospective monopoly profits.

Profits of Trusts Smaller than Anticipated.

Now the persons who organized the various trusts during the past generation have usually, to put it mildly, been excessively optimistic as to the prospective monopoly profits which their trusts would earn. Possibly some of them even deliberately overcapitalized their trusts in order to make more money out of them. When the stocks of these trusts were placed upon the market, they were sold to the public at a fairly high price. Then the trusts and monopolies finding that they could not in practice secure the monopoly profits which had been estimated (see remarks on the limitations of monopoly, Lesson 7, page 10), were unable to pay dividends on their common stock, which was largely held by the public. The result was that the price of such stock very rapidly declined. Thousands of investors were thereby ruined and millions of capital which had been invested in these concerns were lost—or perhaps it would be more correct to say transferred to the pockets of the promoters of the trust.

The process is well described in the Report of the American Industrial Commission:

"The profit of the promoter is generally that portion of the stock issued, that is left after paying for the plants entering into the combination and the expenses of the organization. Usually, therefore, the amount paid for the plants is not known to the investing public; the amount received by the promoter is not known to the vendors themselves; at times no careful estimate is published of the value of the tangible assets; even the earning capacity of the different plants is not always made public. In consequence, the speculative element in the value of the shares for the first few months after the organization, is possibly the most important feature in connection with them.

"The larger combinations usually issue to their stockholders once a year an annual report regarding the business. This report, however, is frequently in terms so general that it is difficult to learn much regarding actual conditions, and this speculative element still remains.

Directors Take Advantage of Shareholders.

"This secrecy in promotion, combined with very large capitalization, gives a great advantage to directors and officers of the combination and others associated with them in knowing the value of the shares. There seems to be no doubt that in many instances the promoters of combinations have been able to unload large blocks of stock at prices far above their values, as shown by later experience. Parties interested in the International Silver Company attempted by a pool to unload stock at 30, which soon afterwards fell to 12. At other times insiders might be able to take advantage of the public in the stock market, as was charged against an officer of the American Steel and Wire Company, and there is no question that some of them do take such advantage of stockholders for whom they are acting substantially as trustees."

Small Investors Suffer From Trusts.

The small private investors, then, have suffered from the trusts only less than the consumers, though we do not

hear nearly so much about them, probably because they are fewer in number. In Germany such a position as theirs would have been impossible. The law there (and German laws are fairly well enforced) provides that the capitalization of a company must not exceed the actual investment, in stock or cash, in that company. Of course in Germany, as in any other country, some corporations fail in business, but at least the dice are not loaded against the small investor. When such an investor buys a $100 share, or what corresponds to it, in a German stock exchange, he knows that in the beginning at least, it represented an actual investment of that amount. This is far—very far indeed—from being the case in the United States, England, or Canada.

Canadian Combinations.

In the past few years, combinations of various kinds have been formed in Canada on the model of the American trusts. The year books published by the Monetary Times in 1913 and 1914 give lists of such combinations extending over several pages. The capital of these combinations and the capital of their constituent units are given, and it is only in rare cases that the bonds and preferred stock alone of the combination are not equal to the bonds, preferred and common stock of its constituent bodies. If, then, the amount of stock in the constituent bodies actually represented the value of the property turned over by them to the combination, the common stock of the combination represents no actual investment and may be said to be only the capitalized value of prospective monopoly profits yet to be earned by the combination. Most of these combinations—for instance the Canada Cement Company—have not yet paid any dividends upon their common stock, which apparently does not represent any actual investment, but is merely the capitalized value of prospective earning power. This is, indeed, the case with a great many of our industrial combinations, as any one can see for himself by consulting the Monetary Times Year Book.

Canadian Legislation on Combines.

What has been done in Canada to limit the powers of monopolies? So far not a great deal. The general disposition has been to rely upon the common law. In 1888 a committee was appointed by the Dominion Parliament to investigate and report upon alleged combinations in manufactures, trade, and insurance in Canada, and the anti-combines legislation of 1889 which resulted from their report was merely declaratory of the common law on this subject.

Another way in which combines were attacked was by removing the duty on the monopolized article. Thus, as a result of a combine which unduly enhanced the price of paper, the duty on paper entering the country was in 1900 reduced from twenty-six per cent. to ten per cent.

The Combines Investigation Act.

These earlier measures proved inadequate and unsatisfactory, and in 1910 a Combines Investigation Act was passed, which is, in many respects, modelled on the Industrial Disputes Investigations Act of 1907. Under this Act, any six consumers in Canada who have reason to believe that a combination which has unduly enhanced prices exists in any department of industry, may apply before any High Court for the appointment of a Board of Investigation to report upon the alleged combine. If they can produce reasonable evidence in support of their contention, a Board of Investigation is appointed, consisting of three persons, one appointed by the complainants, a second by those accused of being in the combine, while the third who acts as chairman, must be a judge chosen by the other two or by the Minister of Labour. Where it is shown that a combine exists and is favored by the customs tariff, the Governor-General-in-Council is given authority to reduce or abolish the duties on the monopolized articles. Further, if the combine is found to have unduly enhanced prices or restricted competition to the detriment of consumers, a penalty of $1,000 a day is provided, unless the offending

parties desist from the combine within ten days of the publication of the Board's report.

It is as yet too soon to speak with confidence of the results of the legislation of 1910.* Two things are evident—the chief weapons of the Government are public opinion and the customs tariff. These in the hands of an administration resolute to enforce the law, should be effective, especially since very few of the Canadian combinations are strong enough to survive against American competitors if the tariff barrier were once removed. Would-be monopolists in this country must, therefore, account discretion the better part of valour and cannot openly defy public opinion as do the enormous aggregations of the United States.

*No case under the Combines Investigation Act, has, I understand, as yet been tried.

EXAMINATION QUESTIONS

ECONOMICS.

LESSON XVII.

1. Show that the monopoly profits on a commodity will, under like circumstances. never be less than competitive profits on the same commodity. (Refer also to Lesson VII.)
2. What is a pool? Enumerate and describe the different kinds of pools.
3. Why has the American pool proved to be an unworkable form of organization? Compare the American and the German methods of dealing with the pool or kartel.
4. Explain the process of forming a trust.
5. Under what circum- ances was the trust replaced by the holding company? Give an example of a holding company.
6. State the substance of the proposed anti-monopolistic measures of the American Government.
7. Against what abuses are the measures referred to in the previous question directed? Explain fully.
8. In what ways have small investors suffered from the existence of the trust? How are they protected in Germany?
9. What are the causes which lead to the issue of watered stock? Explain the promoter's point of view.
10. Discuss the rise of combinations in Canada and give the substance of the legislation enacted against them. Why are Canadian combinations less formidable than those of the United States?