

## Can Law-Makers Solve the Economic Riddle?

I. In approaching the problem of the relation of law to present economic difficulties, I may say, first, that I am conscious of the fact that law must necessarily lag behind thought in other fields relating to social order, until at least a certain crystallization of public sentiment occurs which makes it possible to array the community behind legislative enactment. In a recent public pronouncement, the governor of the Bank of England stated that the causes and forces at work in the present economic disorder are so great that no individual can understand them, and that the entire world is at sea with reference to constructive measures for restoration. This gloomy view, if generally accepted, would prevent any effective attempt toward reconstruction. It seems that in our own country at least we have arrived recently at a point in the process of crystallization which makes it possible for us to ascertain the general direction which reconstructive effort should take, and to consider concrete steps for the program.

The recent presidential campaign turned largely on economic issues. Other important problems, such as prohibition, assumed a relatively minor position. In reference to the predominant issue three general views were presented, two of which we may designate as the extremes. On the one hand Mr. Hoover, representing the conservative element in the community, defended the traditional American individualism. He was concerned perhaps, as much about the preservation of the individual initiative as about the necessity for restoring economic order. By and large, his program was one of free economic development. He insisted, in accordance with the view of the great conservative mass, that there should be no government in business. This attitude involved two aspects: first, that government should not own or operate business enterprise, either as monopoly or in competition with private industry; second, that private industry should be as free as possible from government interference and regulation. The

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basic philosophy was the theory that the so-called law of supply and demand is immutable and operates as the best check upon economic misconduct. Accompanying this undoubtedly, is the factor that the conservative element has a grave distrust of the efficiency and even of the integrity of governmental effort in the operation and control of business enterprise, perhaps the most serious and most worthy objection to extension of governmental control of industry. By and large, the conservative position was that our economic and political institutions are fundamentally sound, and that present difficulties constitute only an emergency, in the relief of which governmental action should be extended as little as possible. In giving the emergency relief, however, this group has no qualms at gambling with the credit of the government as means of bolstering up the faltering business structure. (glass=R.F.C.=agency of destruction)

At the other extreme, Mr. Thomas took the position that capitalism is a dying institution. He based this conclusion upon a belief that it is not only unjust and undemocratic in its operation but also incapable of supporting itself. As it operates at present, he thinks the system is like an engine without a governor, breaking down of its own irregularity in the business cycle. He believes, further, that it is impossible to secure an equitable and efficient distribution of the benefits of the system, either with or without governmental regulation. With the demise capitalism, in his view, depart both of the old parties, designated by him, as "Tweedle-dee" and "Tweedle-dum" -- there is hope for constructive leadership and action neither in industry nor in the presently dominant political institutions.

His proposal is the socialization of industry, involving ultimate government ownership and operation of the vital industries of the country; it is to eliminate rather than restrict profits, and to set up a system of state capitalism which perhaps, would be not less extensive than those prevailing in Italy and Russia.

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Between these extremes Mr. Roosevelt advocated “the new deal”. Its nature is still somewhat vague, but I believe it may be summarized broadly as involving a system of effectively regulated industry, privately owned and operated. His view is that government ownership and operation are not inherently evil, but should be resorted to only as a last resort or as an example for or measuring rod of private industry in restricted fields.

II. The election may be taken as a repudiation of both extremes. On the one hand, it evidenced discontent with the relative inactivity of the present administration. On the other, it is clearly demonstrated that the American people are not prepared, as yet, to accept socialism. In a general way it evinced their faith that economic democracy can be achieved without destroying the fundamental integrity of the present system. Within these lines then it seems that efforts at restoration will occur during the next few years if there is to be a substantial change. This raises the question, what concrete measures will Mr. Roosevelt and his associates in power take to bring about or begin an achievement of these ideals. The next few months will demonstrate whether they propose simply another set of “plasters”, substituting the Democratic label, or whether they propose an effective program of economic reconstruction. Assuming the latter is their purpose, we may inquire what specifically are the things which it is possible to do within the limitations of popular mandate. In order to make this inquiry intelligently it is necessary to segregate as far as possible concrete causes of present disruption which lend themselves to a program of action.

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### III.

It seems to me that there are four fundamental causes of the present crisis, all of which are inter-related in their effects; but they may be differentiated for the purpose of devising concrete measures for correction. These causes are, first, the collapse of our foreign market; second, the so-called business cycle; third, technological unemployment; and fourth, the centralization (or mal-distribution) of wealth.

1. In the recent campaign we were informed that the depression is not merely a national, but a world catastrophe, and therefore that the causes both of international and of national distress are beyond our control. If this is true, one logical conclusion would be that there is little if anything which we can do about the situation except to wait for world conditions to adjust themselves. It is not necessary however, to accept this thesis as the only possible basis for action. On the contrary, it may be inquired whether it is not possible for us to establish a relatively self-contained national economy which will eliminate the major evils characterizing our present economic order, and the further inquiry is suggested whether we can wait for world recovery without grave danger to our institutions.

Passing for the moment the question of the possibility of a self-contained national economy, it should be noted that there is a basis for some relief in reference to our foreign trade in three matters which ultimately require political action.

The first of these involves our policy toward Russia. This nation offers the only prospect for a real expansion in foreign trade at the present time. It is practically the sole, solvent existing foreign market for new business. Furthermore, a special opportunity for the creation of trade relations has arisen through the recent abrogation of trade agreements between the British Empire and Russia. Our present policy toward the Russian government has been

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based largely upon two considerations, both of which are now obsolete. The first of these is the so called "fear" argument, namely, that recognition of Russia will make it possible for communistic agents to permeate our society and ultimately accomplish the overthrow of democratic institutions. The rejection of socialism in the recent election should be a sufficient guarantee against such an eventuality. The second argument for non-recognition of Russia was the fact that the soviet government repudiated the debts incurred by the imperial regime. This basis also has gone by the board in view of the fact that practically every other nation which is a debtor to the United States has now actually, if not legally, repudiated its obligations to this country. Finally, the American nation should be the last to refuse recognition on the basis that the internal political institutions of the nation seeking recognition are contrary to our own. This policy has never been applied toward absolute monarchies and it is difficult to see why it should apply toward even so despotic a form of socialism as that which prevails in Russia.

Some measure of relief for international trade might have been secured several years ago, and yet may be secured, perhaps, through a rational re-adjustment of tariffs to permit at least a reasonable degree of commercial intercourse among nations.

Finally, in so far as our prosperity depends upon international relations, it seems to me that we should now recognize that war is too costly a means of settling international disputes for civilized nations to employ and therefore that the establishment of peace and the prosperity which accompanies it requires a more active international co-operation on the part of the United States than has characterized our foreign policy during the past twelve years.

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These measures, if adopted, probably would not be sufficient to bring the degree of relief which is needed at the present time. Furthermore, it is questionable whether we can wait until world adjustment takes place to set our house in order. It is also incredible that a nation of the wealth in natural resources and human power possessed by the United States, should be incapable of establishing relative economic stability and security even in the face of adverse world conditions. Further, I believe that the three additional causes of depression above enumerated have played a larger part in its creation than the collapse of foreign trade. Having taught the remainder of the world the ills of mass production & tariff-making, we may as \_\_\_\_\_

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#### IV.

The most fundamental of the domestic destruction forces is the business cycle, which must be eliminated or reduced in intensity and frequency if the institutions of private property and democracy are to survive. The business cycle has characterized corporate activity from a period when the corporate device was introduced on a large scale in the era of colonial expansion. In his History of Joint Stock Companies to 1720 Professor W. R. Scott includes a table of crises in trade and business from 1620 to 1720. In this century there were twenty-one periods of alternate prosperity and depression, the cycle averaging about five years, a remarkable correlation with the history of the 19th century in this country. Perhaps the most interesting of these periods was that beginning in 1711 and ending in 1720. During the first nine years of the period there was a constant expansion of business, credit and speculation, reaching its peak in 1719. This was stimulated to a considerable extent by the fact that the government of England placed its credit behind a number of colonial enterprises which, to say the least, partook of the

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nature of vast speculations. Mr. Scott quotes a statement from a writer of the period just prior to the crash which recalls some of the campaign literature of 1928. This writer speaks of “the mysteries, or indeed miracles, wrought -- things as incredible as the greatest minds in nature could hope them to be, things that now they are done are as a dream to those that see them.” In this period many abuses of the corporate privilege first became pronounced, and later they became apparent. The boom reached its height in June of 1920. Then, as in our recent prosperity, there were “signs portending serious trouble in the future,” including inflation of the rate of interest on stock exchange loans in some cases to the extent of one per cent a day. Inevitably the bubble burst, taking the form then as in November 1929, of a stock crash which was followed by a period of business stagnation substantially similar to that of the present time. After the damage had been wrought, the parliament wreaked its vengeance upon the mechanism rather than upon the causes of the disorder, by passing a statute which was intended to check the formation of stock companies and the issuance of corporate securities, but which actually operated to place a halter upon legitimate business in a period requiring expansion, and to bring about evasion of its provisions through legal technicalities.

From that time to this the business cycle has operated with almost machine-like regularity. It has characterized not only the corporately organized society but also the early periods of our history, when business was largely individualistic. However, the progressive corporate organization of business has operated unquestionably to enhance the effect of the cycle on the social order.

Fundamentally the business cycle arises from a mal-adjustment of production to the earning and saving power of the consumptive community. This mal-adjustment is probably inherent in a system of unrestricted competition whether the competitive units be individual or

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corporate. It begins with the undue accumulation of profits which become surplus capital in the hands of the owners of industry, since they receive as return on their invested capital more than they can consume. An outlet is required for the surplus. This usually takes one of two forms, either investment in new enterprises as invention makes them profitable, or expansion in the field of established industry.

In the unregulated competitive system there is no limit to the amount which a single investing unit may place in a particular industry, nor is there any limit to the number of units which may engage in the particular industry. The constant accretion of profits in the hands of the capitalist element, together with the absence of limitation of the so-called right of investment, leads inevitably to a surplus productive capital investment, which is followed in turn by a surplus production of consumable goods. This requires an abnormal outlet which may take the form of finding new markets (now largely closed to us) or more frequently, involves an effort to stimulate consumption in the established market at hand. High pressure salesmanship is effective to create desire even though the consuming community is unable to assimilate the product with earnings accruing or accumulated. The community efficiency in purchasing power is supplied through our expansion of credit, the most significant recent development being our wide adoption of installment buying. Unfortunately the process does not end at the point where the purchaser may reasonably be expected to pay for the commodity out of his earnings accruing or accumulated. The acceleration of production and credit sales involves an accumulation of debt which wage increases are insufficient to repay. The consequence toward the end of the boom period is an appearance of prosperity which does not exist, accompanied by the entry of the speculator whose activities enhance the illusion. The whole process is a complex of expansion. Beginning with the accumulation & investment of surplus capital, it runs through



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successive stages of expansion, namely, capital investment, productive capacity, production, sales, credit, debt and security values.

Perhaps the basic influence checking the expansive process is the realization by the individual consumer that there are limits to the amount of debt which he can carry resulting in a restriction of the scope of his purchases often this realization takes place at the source of credit in like effect. This necessarily influences the rate of production, sales, commodity values, and security values. In such circumstances a crash is inevitable with all of the attendant evils of liquidation including unemployment and idleness of industry in general.

It should be apparent therefore after this long experience that the problem of regulating industry requires some method of eliminating surplus productive capital at least in the essential fields of industry and that this involves restriction upon entering the field, restriction of expansion of institutions already established in the field, and perhaps eventually a direct limit upon production, if the first two measures are not effective. This of course creates the problem of disposing of the resulting surplus of capital which a regulatized industry might earn. Consideration of this may be deferred to a later point.

The concrete problem then becomes one as to whether these limitations can be imposed by industry itself or whether it is necessary that they be placed by governmental action.

The long history of the business cycle should be a sufficient answer to the suggestion that industry can limit its own expansion effectively in accordance with the general good under a system of free competition. It has proved almost incapable of self-preservation in the stress of the recurring cycle as witness the necessity for the Reconstruction Finance Corporation. Perhaps the best illustration of this is found in the recent developments in the control of oil production in the southwest where in order to avoid the fatal effects of unrestricted

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competition it eventually became necessary for the governors of Texas and Oklahoma to employ the militia to prevent over-production. A similar condition once existed in the fields of railroading and insurance, in both of which cases it became necessary for government to interfere in order to eliminate the evils of unrestricted competition. It should be apparent therefore that the cycle cannot be eliminated effectively by the action of industry without governmental aid. Many businessmen regard government regulation as inherently evil despite the fact that in the present stress it is probably true that the most stable industries and institutions have been those operating under a relatively effective governmental control. The present status of insurance companies, operating utilities, national banks, and building and loan associations as contrasted with investment trusts, the utility holding company (non-operating), the industrial corporations, state banks, and real estate including the farmer, illustrate the point. The safest form of investment of this period has been an investment in government securities or in the securities of institutions subject to relatively strict regulation.

The basic legal device for governmental regulation of business in the public utility concept, by which a certificate of convenience and necessity may be required for the purpose of entering the field and for that of important expansion. Heretofore this conception has been restricted to relatively few industries and businesses, though with an ever-widening scope. Able economists assert the point has now come at which it is necessary to extend this conception to all essential industries of national scope, and if objection be made upon score of constitutionality it is replied that written constitutions yield to the necessities of the people. Furthermore, the regulatory power should be extended to the financial structure of these institutions, particularly with relation to the holding company, if that device is to be retained at all. Finally any such system of control in order to be effective must be by the Federal government rather than by the

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states. No single business can operate successfully under the direction of forth-eight different bosses nor is any single state capable of effectively regulating a national business.

A further instrumentality for the regulation of business has been suggested by the late and revered Robert S. Brookings in his recent volume "The Way Forward", premusing that the corporation has "demonstrated itself as the most efficient organization for the production, distribution and division of wealth", and that "practically all of our corporations are conducting either an interstate or an international business" he suggests "that Congress has the power to require that such corporations should reincorporate under a federal incorporation act; which act, while securing to capital a fair return at a fixed rate of interest and dividends, risk considered, would divide all additional profit or accretions in the form of labor shares between the employees (management and labor) in the ratio of their individual contribution, probably as recorded by their wage or salary compensation." He suggests this as one mode of securing to the "great mass of the population that reasonable capital accumulation which would protect it from unemployment and the many menaces of old age." While the suggestion involves a grave constitutional question, if it can be employed it could be used not only for the purpose of achieving a better distribution of the benefits of industry but also to re-enforce the public utility concept as a means of effective regulation of industrial expansion. Through it the present monkey business of incorporating the business of the nation in Delaware could be dispensed with and thereby could be eliminated many of the trick devices invented principally for the benefit of the promoter & the speculator by the genius of Delaware corporation lawyers, and approved by all the state courts, namely, the holding company, the stock dividend, the legal abuses of management, including the executive bonus and the complete freedom from shareholder restraint

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which results from the almost complete separation of voting power and ownership interest in the most “modern” type of corporate structure.

## V.

The regularization of industrial production and consumption presents the most pressing aspect of the industrial crisis, but even if complete regularity were achieved, there are more deep-seated defects which it would not reach. It is now established that even during the period of so-called prosperity from 1920 to 1929, despite the expansion of every other phase of business, there was a constant contraction in the number of persons gainfully employed in industry. In this respect the statistics of the Department of Commerce and those of the American Federation of Labor are in substantial agreement. It is therefore established that the machine does accomplish its function, which is the elimination of “wasteful” man-power. Despite the now discredited theory of economists that expansion of new industry, introduction of new inventions, etc., is sufficient to “take up the slack” caused by introduction of machines, it now appears that for practically the entire period since the World War we have had a permanent surplus of involuntarily unemployed men. Estimates of the number vary from 2,000,000 to 4,000,000. Further, it is obvious that as machine efficiency increases (and we are only in the initial stage of possible machine development), this permanent surplus of men is an increasing rather than a decreasing one. This factor the regularization of industry as above suggested will not reach. While it would eliminate the unemployment due to the recurrence of the business cycle, further measures are or will be required to control “technological unemployment.” The

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root of this evil lies in the rate at which machinery is introduced in industry as related to the rate of creation of new industry or other means for giving employment to the eliminated personnel.

Several plans for dealing with this problem have been offered. The most popular in the business world, apparently, is that of “staggering employment” and “sharing the job.” Defensible as an emergency measure, the plan amounts really to a mere redistribution of present wages, rather than an increase in ultimate consumptive or purchasing power. The increase in employment and earnings on the part of the worker thereby employed is off-set by the decrease in employment and earnings on the part of the sharing worker. This constitutes a real reduction in the living standards of labor, if accepted as a permanent policy. It is noticeable also that the plan does not apply to executives. So far as I have heard, no business executive has offered to “share his job” with an unemployed executive victim of the depression.

Much has been said also about unemployment insurance. A plan has been advanced by the American Association for Labor Legislation under the heading of “Unemployment Reserve Funds---An American Plan to Stabilize Jobs and Purchasing Power,” which requires, in substance, “that each employer be required to pay a fixed percentage of his payroll into a mutual unemployment reserve fund, out of which involuntarily unemployed workers shall receive a limited proportion of their wages for a limited period of time,” on analogy to Workmen’s Compensation legislation now in force in all but four states. The general principle of unemployment insurance has received the approval of the United States Chamber of Commerce, and of such eminent business executives as John G. Lonsdale, of St. Louis, and Ernest G. Draper, Vice-President of The Hills Brothers Company. Admirable also as an emergency policy, the difficulties with the plan are that it is impossible to institute during a depression, and it becomes apparently unnecessary in periods of prosperity. Speaking with reference to the temporary rise

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of interest in such plans during crises, and the immediate lapse of such interest with the end of the stress, John B. Andrews, Secretary of the American Association for Labor Legislation, concludes from personal experiences as a member of the mayor's committee (New York City) on unemployment in 1914, the President's Conference on Unemployment in 1921 and now the Citizens' Committee in New York City, headed by former Governor Smith; "In each depression, while the emergency is pressing, some forward-looking citizens in each community cooperate in formulating constructive programs for future organization to help stabilize employment and to mitigate the evil effects of unemployment.

When the supposed time comes for the calm consideration of constructive measures, that keen public interest in the problem has vanished. It has been so after every industrial depression."

Valuable as such a system may be immediately, it may be questioned also whether it could stand the strain which will eventually result from the factor of technological unemployment, or whether if it could, such a disposition of the man-surplus is desirable. In the long view, taking account of the fact that science is only in its infancy, is not a more fundamental measure essential? Here, private industry has furnished an example, which the community may adopt and enforce. It is known that some of our larger corporations are now in possession of patents and machines which have been shelved indefinitely, because immediate introduction would result in a greater burden of obsolescence than the industry could afford, and perhaps also because this is no time to eliminate from gainful work a large additional number of men. The machine is neither so sacred nor so essential to social well being that every invention must be immediately and generally adopted in industry, merely because some mechanical genius has brought it forth. Although the reaper was a distinct contribution to community comfort and well-

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being, it is questionable whether we would not be in greatly better condition today if the combine had never been invented, or if, when invented, the blue-print had been destroyed.

In order to reach this fundamental problem, it seems that eventually it will become necessary, not to outlaw further invention, but to control the rate at which machines may be introduced in industry, adjusting it to the ability of the community to find other avenues for employment of the men displaced by it. This might be accomplished by attaching to every patent issued the condition that the invention covered thereby should not be productively employed except upon the issuance of a certificate of public convenience or necessity by the regulatory body above mentioned or by a special commission operating for this purpose under its jurisdiction. This would result in much saving to industry in the item of obsolescence, and preserve for the laborer his means of livelihood until such time as community purchasing power and demand for more consumptive goods would render possible the introduction of the invention without elimination of man-power.

## VI.

Underlying the business cycle and technological unemployment is the factor of the greatly accelerated concentration of wealth in recent years. It is now generally realized that this process cannot continue with safety either to industry or to the community at large. As a matter of self-preservation, it has become necessary for industry and capital to shift a larger proportion of their earnings to the mass of consuming workers. The instrumentality of taxation is now employed as one means of preventing further concentration, but it is effective only to relieve the laboring groups of taxes which would otherwise be imposed upon them, not to

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increase directly (or perhaps indirectly) their buying power. As essential to the preservation of the institutions of private property and democracy, Mr. Brookings has suggested that this adjustment be made by the issuance of labor shares, to be divided between management and labor after the payment of a fixed return to the capital interest. I do not agree with all of the details of his suggested plan, but it appears to involve as practicable a means of achieving the objective as any which has appeared. By converting the stock dividend from an instrumentality of speculation into one for paying the worker a portion of his wages progressively during the period of his employment, it would be possible to transfer to the hands of labor a sufficient interest in and claim upon the earnings of industry to achieve a living wage and perhaps also a reasonable degree of security in disability and in age. The advantages accruing from his having earned his shares, from the employer from elimination of turnover, and to the community from the larger and more regular consumption of goods out of earnings and savings rather than from debts to be paid in the future or never, merit serious consideration for the suggestion.

These suggestions, of course, are not advanced as the final and exclusive method of achieving the millennium. They are, rather, merely indications of the lines along which it now appears development may take place, if any effective reconstruction program is to appear at this time. If, as at present appears, we are emerging from the long strain, it is more than probable that serious consideration by the major political parties will be deferred until we reach the trough of the next depression---if indeed institutions survive that long.