§ 11

Summary

In this chapter we have been concerned especially with and have discussed at considerable length, problems connected with the public service industries. We saw, first, that these industries differ from most others in that cost per unit of service decreases for a single plant up to and beyond the point at which the entire demand in a given market or territory is met. In consequence, more than one plant is an uneconomical method of producing the service and two or more plants can ordinarily provide a potential supply of the service far beyond the public needs, so that, if there is competition between them, they tend to carry this competition so far that they receive unduly low—if any—returns. The solution appeared to be in monopoly,—but not unregulated monopoly.

Coming to the problem of discrimination we saw that certain differences in rates for different services are economically justifiable even though the special costs per unit of service may be the same. Thus, a railroad with unused facilities may properly carry coal for lower rates than brick if these low rates will pay only a very little towards returns on investment, and if the traffic cannot be had at higher rates. So, too, lower rates for night than for day messages seemed to be economically justifiable. On the other hand, freight rate discriminations between competitive articles or between raw materials and finished products may tend to produce consequences economically undesirable; and arbitrary discrimination between shippers tends to build up monopoly and is wholly bad. In general, discrimination between places is economically undesirable.

Rates as a whole should yield, in public service industries, the ordinary return on investment as measured by the gains of competitive business, with due allowance for possible differences in risk. If the services are not worth this much to the public, it is a fair presumption that the necessary capital should be used, rather, in other lines. Yet the rates should not be excessive so as to constitute an undue burden on the public or prevent use of the service in question by persons who are willing to pay a reasonably profitable rate.

In the case of railroads, rates between two points should be only what is necessary to yield a fair return, without discrimination against its intermediate points, to the line able to give the cheapest service. It may sometimes be reasonable for a railroad to make relatively lower rates, where it meets water competition, than at intermediate cities not on the water. A less economical—perhaps because a more circuitous—railroad line may properly carry overflow traffic, and without reducing its intermediate rates, in case it can afford the low rates on the competitive traffic which the more direct line may fairly charge. It thus obviates the necessity of new construction over the cheaper route and economizes the community's savings. To keep the rates up on the cheaper route in order that the less economical road may make a larger return than it otherwise would be able to make, or in order that it may be able to reduce the rates to intermediate points on its line, involves a discrimination against the points which have to pay these higher rates, tends, like a protective tariff, to interfere with worth-while trade and may amount to a subsidy paid by some towns for the development of others.

But in case the more direct line cannot handle all the traffic which would naturally go over it and, because of physical limitations, such as rivers and mountain ranges, on the width of its right of way, finds new construction impracticable, then no economic waste results from basing the rates on the cost of service of a circuitous line which, in that case, should not discriminate against intermediate towns on it. The surplus return of the favored road is economic (land) rent. If the public, rather than the lucky railroad, is to secure this rent, it may better be taken by taxation than by attempted rate regulation with consequent unfair discrimination.

A parallel case is that of an electric power company having a valuable water-power site from which, however, the available power is insufficient for the district, so that some of the industries or consumers have to use electricity generated by steam at higher cost. Discrimination between users is unfair. The surplus gain from the more-cheaply generated power is economic rent (land rent) which should be dealt with by taxation rather than by rate reduction.

We came, then, to the problem of how should be determined that value upon which a reasonable per cent return is to be allowed. Some urge actual historical money cost, in case the money was prudently spent, and do not even make allowance for changes in the purchasing power of the money unit. But careful consideration revealed the likelihood that such adherence to historical cost would bring various undesirable economic consequences. It would, perhaps, sometimes prevent new construction. It would, if historical costs were greater than current costs, prevent transportation or other service well able to pay its contemporary costs; and it would give some communities an economically undesirable advantage over others, so tending to divert industry from the latter to the former. Arguments emphasizing the unfortunate predicament of common stockholders during falling prices were judged insufficient to offset the considerations in favor of a contemporary cost basis, especially as the losses referred to in regard to stockholders are not confined to the public service industries and, therefore, require a general rather than a specific preventive.

The price system, as we have it in our modern society, is not perfect. Although, in our analyses and expositions of it, we are prone to consider only its major tendencies, it works, often, with a good deal of unprecision, friction and delay. Within its confines men lie and cheat, and conspire to practice extortion and to defraud. So far as it operates as a servant of society's welfare it does not do this automatically and without governmental supervision and control. Government coins money and establishes a monetary standard of value. Government lays down certain rules regarding contracts and other economico-legal relationships. Even in the competitive industries it prohibits (e.g., through the Federal Trade Commission) certain competitive practices which seem to threaten to bring monopoly or which, through deception of consumers or otherwise, merely prevent competition from working most effectively to the public good. In the industries which are not, like the public service industries, economically best run as monopolies, the proper function of government would appear to be to keep the market uncontrolled and fair. To accomplish this end, it should prevent, as it does not always, the substantially unified control of any specific mineral or other product, and any monopolistic agreement, conspiracy or combination. It should prevent deceit and other unfair competition. And it should, perhaps, disseminate such information—if not otherwise available—that competition will be as perfect as wide knowledge of market forces can make it.

So controlled and aided, the price system, in its competitive phases, is probably the best currently possible device for meeting the needs of our economic life. What the public wants as individual consumers does, at any rate, get produced, because it is profitable to produce it, unless the specific article (e.g., cocaine) or service is regarded by the group as sufficiently injurious in its consequences to justify prohibition of its production and marketing. If, indeed, more is produced of what the rich desire than to meet the wants of the poor, this is because the former have larger money incomes to buy with. And whether or not purchasing power is unfairly or undesirably distributed, an attempt to change matters through a compulsory change in the kinds of production carried on would be unwise. If any change is desirable it should be made through dealing with the sources of the various incomes, as such, rather than through dealing with the direction of industry into different lines. Thus, if the ability of wealthy monopolists to buy goods results in too much of society's labor force being diverted to the production of these goods, the remedy does not lie in prohibiting the production of the specific goods desired by the monopolists—which might result in other and poorer consumers of these goods being also sacrificed and in the monopolists buying other goods instead—but in curbing their monopoly power so that they will not, henceforth, have large unearned incomes to spend. Similarly, if a period of rising prices gives borrowers wealth at the expense of lenders, and stockholders at the expense of bondholders, the remedy does not lie in forbidding men to produce what the prosperous borrowers and stockholders want to buy, but in stabilizing the price level so that borrowers and lenders, stockholders and bondholders, will have reasonably fair and equal chances. And so with those other unearned incomes which we shall discuss at length in Part II.

But the price system, despite the necessary features of control over its operation for the purpose of keeping it or making it as fair as possible, nevertheless still contains a large admixture of freedom of choice,—freedom as to what work to do, freedom as to the acquisition and use of property, freedom as to what to buy. And with this freedom we get a certain rough equilibrium among different producing groups, a certain tendency to balanced returns in different industries, and a meeting of our needs as consumers, all of which it is highly doubtful if we could get so satisfactorily in any other way—say by *compelling* labor to be done in the different lines desired.

And so it is not surprising that we have found reasons for regarding the price system, as it operates in the competitive industries, or as it can be made to operate by maintaining fair and full competition, as a kind of norm or standard for the regulation of the public service industries. We ought, so to speak, to regulate these latter industries in such a way as to make them conform to the essential genius of the price system as a means of getting desired goods produced. Therefore we should allow rates high enough, where they can be secured, to make the investment of the necessary capital worth while. Yet we should forbid rates so high as to be unfair to the public and as to prevent the use of a service for which the consumers are able and willing to pay the full reasonable cost. We should try so to regulate these industries as not unduly and uneconomically to restrict trade or industry or to divert it wastefully from one locality to another.

The field of essential government control over industry seems to widen as our economic system becomes more complicated and the possibilities of abuse more numerous. Railroads, telephones and telegraphs, electric power lines, and oil pipe lines, having rails or wires or pipes running for hundreds of miles from one center of population to another, crossing state and even national boundaries, constitute a significant part of our modern economic life which is not, or a large part of which is not, under the direct sway of competitive forces. But in extending regulation over these utilities as circumstances require, in the interest of the common welfare, let us do so in a way not more inconsistent than we can help with the best traditions and ideals and underlying principles of a price system which is still and which, we may venture to hope, will long remain, in large degree, a system of free competition.