CHAPTER XVIII

THE MORAL ASPECT OF MONOPOLY

THE conclusion was drawn in the last chapter that the surplus gains of corporations operating in conditions of competition can justly be retained by the stockholders as the remuneration of exceptional productive efficiency. It is, of course, to be understood that the proper allowance for interest on the capital is not necessarily the amount authorized by the stipulated rate of dividend on the stock, but the prevailing or competitive rate of interest plus an adequate rate of insurance against the risks of the enterprise. If the prevailing rate of interest is five per cent, and the risk is sufficiently protected by an allowance of one per cent, the fair rate of return on the investment is six per cent. The fact that a concern may actually award its stockholders ten per cent dividends, has no bearing on the determination of the genuine surplus. If the actual surplus that remains after paying all other charges and allowing ten per cent on the stock is only $50,000, whereas it would be $100,000 with an allowance of only six per cent, then the true surplus gains, or profits, are the latter amount, not the former. No part of the $100,000 can be justified as interest on capital. It must all find its justification as profits proceeding from superior productivity.

Bearing in mind this distinction between the actual rate of dividend and the proper allowance for interest on capital, we take up the question of the morality of profits or surplus gains in conditions of monopoly.

Surplus and Excessive Profits

Several of the great industrial combinations of the United States have obtained profits which are commonly stigmatized as "excessive." For example, the Standard Oil Company paid, from 1882 to 1906, an average annual dividend of 24.15 per cent on the capital stock, and had profits in addition at the rate of about eight per cent annually;[1] from 1904 to 1908 the American Tobacco Company averaged nineteen per cent on its actual investment;[2] and the United States Steel Corporation obtained an average annual return of twelve per cent on its investment from 1901 to 1910.[3] A complete list of the American monopolies that have reaped more than the competitive rate of return on their capital would undoubtedly be a very long one.

Is it possible to justify such returns? Has a monopoly a right to take surplus gains? Let us suppose a concern which is getting fifteen per cent on its investment. Inasmuch as the risks are smaller than in competitive enterprises, six per cent is an ample allowance for interest. Of the remaining nine per cent, four per cent, we shall assume, is derived from economies of production as compared with the great majority of competitive concerns. This portion of the surplus, being the reward of superior efficiency, may be retained by the owners of the monopoly quite as justly as similar gains are taken by the exceptionally efficient corporation in conditions of competition. The objection that the monopoly ought to share these gains with the public, since it limits individual opportunity in a socially undesirable way, has some merit, but it can scarcely

[1] Report of the Commissioner of Corporations on the Petroleum Industry, II, 40, 41.

[2] Report of the Commissioner of Corporations on the Tobacco Industry, II, 26, 34.

[3] Report of the Commissioner of Corporations on the Steel Industry, I, 51. According to F. J. McRae, the expert accountant for the Stanley congressional investigating committee, this concern secured 40 per cent on the *cost* of its property.

be urged on grounds of strict justice. At most it points only to an obligation in equity.

By what canon of distribution can the retention of the other 5 per cent of surplus gain be justified? Not by the titles of needs and efforts, for these have already been satisfied through the salaries paid to those stockholders who perform labor in the management of the concern. These titles afford no basis for any other claim than that which proceeds from labor. They cannot be made to justify claims made on behalf of capital. Not by the title of productivity, for this has already been remunerated in the 4 per cent just considered. Not as interest on capital, for ample allowance has already been made under this head in the original 6 per cent. As we have seen in an earlier chapter, the only reasons that give ethical support to interest on capital are the sacrifice that is involved in some kinds of saving, the possibility that interest is necessary in order to induce the provision of sufficient capital, the certainty that the State would be enabled to enforce the abolition of interest, and some presumptive considerations. Since all of these reasons and ends are satisfied by the competitive rate of interest, none of them will justify the exaction of more than the competitive rate. It is not possible to justify a higher rate on either social or individual grounds. Therefore, the only basis that is left upon which to defend the retention of the five per cent surplus that we are discussing, is the power of appropriation. The monopoly possesses the economic strength to take this five per cent because it is able to impose higher than competitive prices upon the consumer. Obviously such power has no greater ethical sanction or validity than the pistol of the highwayman. In both cases the gains are the product of extortion.

The conclusion that men have no right to more than the competitive rate of interest, as interest, on their capital, and that a monopoly has consequently no right to those surplus gains that are not produced by superior efficiency, is con-

firmed by public opinion and by the decisions of the courts. The monopolistic practice of taking more than the usual rate of return on capital merely because there exists the power to take it, is universally condemned as inequitable. In fixing the charges of public service corporations, the courts allow only the rate that is obtainable in competitive conditions of investment.

The statement that the monopoly may retain those surplus gains which are derived from superior efficiency assumes, of course, that fair wages have been paid to employees, and fair prices to the sellers of materials, and that fair methods have been used toward competitors. In so far as any of these conditions is not met, the monopolistic concern has not right to surplus gains of any sort.

The Question of Monopolistic Efficiency

So much for the moral principle. What proportion of the surplus gains of monopoly are due to extortionate prices rather than to economics in production cannot be known, even approximately. According to Louis D. Brandeis, who is one of the most competent authorities in this field, only a very small part of these gains is derived from superior efficiency.[1] Professor E. S. Meade writes: "During a decade (1902-1912) of unparalleled industrial development, the trusts, starting with every advantage of large capital, well-equipped plants, financial connections, and skilled superintendence, have not succeeded."[2] On the other hand, President Van Hise thinks that, "the weight of argument is strongly in favor of the increased efficiency of large combinations of industry on the average."[3] The difference of opinion existing among students of this subject is due to lack of adequate data, par-

[1] Hearings Before the Interstate Commerce Committee, U. S. Senate, Part XVI, pages 1146-1166.

[2] *The Journal of Political Economy,* April, 1912, p. 366.

[3] "Concentration and Control," p. 20.

ticularly to the absence of such uniform and comprehensive systems of accounting as would be required to provide a basis for reliable general conclusions. Opposing particular statements may be equally true, because based upon different instances; but general statements are little better than guesses.

Let us approach the question from another side, that of prices. Whenever the charges imposed by monopolistic concerns upon their products are higher than those that would have prevailed under competition, the surplus gains are obviously to that extent not due to superior efficiency. They have their source in the arbitrarily made prices. The Final Report of the United States Industrial Commission, which was made at the beginning of the year 1902, declared that, "in most cases the combination has exerted an appreciable power over prices, and in practically all cases it has increased the margin between raw materials and finished products." [1] Since the cost of production had decreased during the preceding decade, this increase in the margin, and the ensuing increased profits, necessarily involved an increase in prices to the consumer. Taking the period of 1897-1910, and comparing the movement of prices between eighteen important trust-controlled products, and the same number of important commodities not produced by monopolistic concerns, Professor Meade concluded that the former were sold at a "much lower" relative level than the latter.[2] His computations were based upon figures compiled by the Bureau of Labor. According to the Commissioner of Corporations, the Standard Oil Company "has taken advantage of its monopoly power to extort prices much higher than would have existed under free competition." [3] The same authority shows that the American Tobacco Company used its power to obtain con-

[1] Page 621.
[2] *The Journal of Political Economy,* April, 1912, p. 363.
[3] Report on the Petroleum Industry, II, 74.

siderably more than competitive prices on some of its products.[1] Excessive prices, as measured by the standards of competition, were also established by the United States Steel Corporation, the American Sugar Refining Company, and the combinations in meat packing and in lumber.[2]

A safe statement probably would be that the greater part of the surplus gains of the most conspicuous American monopolies have been due to excessive prices rather than to economies of production.

Let us turn from the subject of unjust monopoly gains to that of unfair methods used by the great combinations toward their competitors. These methods are mainly three: discriminative underselling, exclusive-selling contracts, and advantages in transportation.

Discriminative Underselling

The first of these practices is exemplified when a monopoly sells its goods at unprofitable low rates in competitive territory, while maintaining higher prices elsewhere; and when it offers at very low prices those kinds of goods which are handled by competitors, while holding at excessively high prices the kinds of commodities over which it has exclusive control. Both forms of the practice seem to have been extensively used by most of the monopolistic concerns of America.[3] The Standard Oil Company has been perhaps the most conspicuous offender in this field.[4] This practice is unjust because it violates the fundamental moral principle that a man has a right to pursue a lawful good without hindrance through illicit means. Among the illicit means enumerated by the moral theologians are force, fraud, deception, lying, slander, intimidation, and extortion.[5]

[1] Report on the Tobacco Industry, II, 27.
[2] Cf. Van Hise, op. cit., pp. 140, 149, 153, 159.
[3] Final Report of the Industrial Commission, pp. 660-662.
[4] Report on the Petroleum Industry, I, 328-332.
[5] Cf. Lehmkuhl, "Theologia Moralis," I, no. 974.

The illicit means employed in discriminative underselling are chiefly extortion and deception. If the very low prices at which the monopoly sells in the field which contains competitors were maintained outside of that field also, and if they were continued not merely until the independent concerns were driven out of business, but indefinitely afterward, no injustice would be done the latter. For no man has a natural right to any particular business. If a powerful concern can eliminate competitors through low prices made possible by superior efficiency, the competitors are not unjustly treated. They have no more just cause of complaint than the inefficient grocer whose custom is attracted from him by other and more efficient merchants. The offense is at the worst contrary to charity. But when the monopoly maintains the low and competition-eliminating prices only locally and temporarily, when it is enabled to establish and continue these prices only because it sells its goods at extortionate rates elsewhere, the latter prices are evidently the instrument or means by which the competitors are injured and eliminated. In that case the monopoly violates the right of the competitors to pursue a lawful good immune from unfair interference. The lawful good is a livelihood from this kind of business; and the illicit interference is the unjust prices maintained outside the competitive field.

In the preceding paragraph we have assumed that the extortionate prices are operative at the same time as the excessively low prices, but in a different place. Suppose that the former are imposed only after the independent concerns are eliminated. The injustice to the competitors remains the same as in the preceding case. Although the extortionate prices are later in time, they are the instrumental cause of the destructive low prices through which the competitors were driven out of business. If the owners of the monopoly were not certain of their ability to establish the subsequent extortionate prices, they would not have put into effect the unprofitable low prices. Hence

there is a true causal connection between the former and the latter. Although the connection is mainly psychical, through the consciousness of the monopoly owners, it is none the less real and effective. Its practical effectiveness is seen in the fact that the subsequent possibility of imposing extortionate prices will induce men to lend the monopoly money to carry on the process of exterminating competition. The process is maintained by means of the extortionate prices quite as effectively as though the two things were simultaneous.

In so far as the patrons of the independent concerns are deceived into expecting that the very low prices will be permanent, and in so far as this impression causes them to withdraw their patronage from the independents, the latter are injured through another illicit means, namely, deception. The competitors have a right not to be deprived of their customers through imposture.

What is the measure of extortionate prices in this connection? How can we know that the high, competition-eliminating prices are really extortionate? There are only two possible tests of just price. The first is the proper cost of production—fair wages to labor, fair prices for materials, and fair interest on capital. If the monopoly does not raise prices above this level, it obviously does not impose extortionate prices, nor inflict injustice upon the eliminated competitor. Moreover, if the monopoly has introduced economies of production it may, as we have seen, justly charge prices somewhat above the cost-of-production level. But it may not raise them above the level that would have prevailed under competition. This is the second test of just price. No possible justification can be found, except one to be mentioned presently, for charging the consumers higher prices than they could have obtained under competitive conditions. At such prices the monopoly will be able to secure the prevailing rate of interest on its capital, and all the surplus gains that proceed from superior efficiency. A higher scale of prices

will be, therefore, extortionate, and the competitors who are eliminated through its instrumentality will be the victims of injustice.[1]

The exception alluded to above occurs when the monopoly uses the excess which it obtains over the competitive price to pay fair wages to those laborers who were insufficiently compensated in competitive conditions. In such a case the eliminated competitors would have no just claim against the monopoly; for their elimination took place in the just interest of the producers. The case, however, is purely academic, since the discriminative underselling practiced by our monopolistic concerns has not been impelled by any such motive, nor has it achieved any such result.

Exclusive-Sales Contracts

The second unfair method employed by monopolies toward competitors is that of exclusive-selling contracts, sometimes called the "factor's agreement." It requires the dealer, merchant, or jobber to refrain from selling the goods produced by independent concerns, on penalty of being refused the goods produced by the monopoly. The merchant is compelled to choose between the less important line of wares to be had from the former, and the more important line obtainable from the latter. He will not be permitted to handle both. "Here is somebody who has been buying goods, let us say by way of illustration, from the American Tobacco Company, and a rival producer

[1]It may be of interest to recall the mediæval attitude toward monopolistic exactions, as summarily stated by St. Antoninus, who was archbishop of Florence in the first half of the fifteenth century: "When monopolist merchants agree together to preserve a fixed price, so as to secure an unlimited profit, they are guilty of sinful trading." He maintained that they should not sell above the market price, and should be prevented from so doing by law. See his "Summa Theologica," III, 8, 3, iv, and II, 1, 16, ii. Present day moral theologians lay down the same doctrine, and in addition condemn the characteristic monopolistic methods as unjust. See Tanquerey, "De Justitia," nos. 776, 777; Lehmkuhl, "Theologia Moralis," vol. I, no. 1119.

comes in whom the merchant likes to patronize. He buys goods for a time from the rival, and an agency of the trust sends him a note to the effect that he must not buy any more from that rival corporation; that, if he does so, the trust will give all of its own goods, some of which the merchant is obliged to have, to another agent. That will probably bring him to terms."[1] By this method the independent manufacturer can be deprived of sufficient patronage to injure him seriously, and perhaps to drive him out of business.

This process is one of intimidation brought to bear upon the merchant. Through fear of loss he is compelled to discontinue selling the goods of the competing manufacturer. It is a kind of secondary boycott. As such, it is an unreasonable interference with the liberty of the merchant unless its object is to compel him to do something that he may be reasonably required to do. In the case that we are considering, the object of the pressure is not of that character; for to drive the rival manufacturer out of business, or to assist in his expulsion, is not a reasonable thing. The exclusive-selling contract which is forced upon the merchant is quite as unreasonable as though its purpose were to prevent him from, say, patronizing manufacturers having red hair. Being thus unreasonable, thus injurious to individual liberty, it violates not only the law of charity but that of justice. It transgresses the merchant's right to enter reasonable contracts with the rival manufacturer, and if it results in a pecuniary loss to the former it is an invasion of his rights of property. It likewise violates the rights of the competitive manufacturer, since it is among the unfair means which may not be used to prevent a man from pursuing a legitimate good. It is an unfair means because it involves unreasonable intimidation, uncharity, and injustice toward the merchant. When the independent manufacturer is injured through such an instrumentality, he suffers injustice quite as certainly at the

[1] Clark, "The Problem of Monopoly," p. 35.

hands of the monopoly as though .his property were destroyed through the strong-arm methods of hired thugs.

Discriminative Transportation Arrangements

Concerning the third unfair method, discriminative advantages in transportation, the United States Industrial Commission declared: "It is incontestable that many of the great industrial combinations had their origin in railroad discrimination. This has been emphasized many times in the history of the Standard Oil Company, and of the great monopolies dealing in live stock, dressed beef, and other products." [1] The American Sugar Refining Company was several times convicted of receiving illegal favors from railroads, and paid in fines thousands upon thousands of dollars. Sometimes the monopoly has openly been accorded lower freight rates than its competitors, and sometimes it has paid the regular charges, and then received back a part of them as a refund or rebate. At one time the Standard Oil Company obtained rebates not only on its own shipments, but on those of its rivals! [2]

Special advantages of this sort necessarily involve injustice to the competitors of the monopoly. If the low rates given to the monopolistic concern are a sufficiently high price for the service of carrying freight, the higher charges imposed upon the competing concerns are extortionate; if the former rates are unprofitably low, the difference between sufficient and insufficient freight charges is made up by the independent concerns. In the former case the independents pay the railroad too much; in the latter case they bear burdens that should properly rest upon the monopoly. The monopolistic concern is partly responsible for this injustice inasmuch as it urges and often intimidates the railroad to establish the discriminating rates.

All three of the practices that we have been considering

[1] Final Report, p. 361.
[2] Report on the Petroleum Industry, pp. 22, 23.

are universally condemned by public sentiment. They are all likewise under the ban of statutory law. The first two have recently received detailed and explicit prohibition in the Clayton Anti-Trust Act.

Natural Monopolies

Up to this point we have been dealing with private and artificial monopolies. We turn now to consider briefly those natural and quasi-public monopolies which are either tacitly or explicitly recognized as monopolies by public authority, and whose charges are to a greater or less extent regulated by some department of the State. Such are, for example; steam railroads and municipal utilities. When the charges made for the services of these corporations are *adequately* regulated by public authority, the owners of such concerns will have a right to all the surplus gains that they can obtain. In that case a contract is made between the corporation and the public which is presumably fair to both parties, and which represents the social estimate of what is just. If the public authorities have not sufficiently safeguarded the interests of the people, if they have permitted the charges to be so high as to provide excessive returns for the corporation, the latter is under no moral obligation to refrain from reaping the full benefit of the State's negligence or incompetence. If, however, the unduly high rates have been brought about through bribery, extortion, or deception practiced by the corporation, the inequitable contract thus arranged will not justify the surplus gains thus produced. For example; if the corporation deliberately and effectively conceals the real value of its property through stockwatering, and thus misleads the public authority into permitting charges which return twelve instead of six per cent on the actual investment, the corporation cannot forthwith justly claim the surplus gain represented by the extra six per cent.

When the public authorities either fail entirely to regulate charges, or do so only spasmodically and partially, the

quasi-public monopoly will not necessarily have a right to all the obtainable surplus gains. In such cases the charges imposed on the public are not an adequate expression of the social estimate of justice, nor an adequate basis of legitimate surplus gains. In the absence of sufficient public regulation, a quasi-public monopoly is morally bound to fix its charges at such a level as will enable it to obtain only the prevailing rate of interest on the investment, and such surplus gains as it can produce through exceptional efficiency. In all such cases the public service corporation is in the same moral position as the artificial monopoly: it has no possible basis except superior efficiency for claiming or getting any returns above the competitive rate of interest on its capital.

Methods of Preventing Monopolistic Injustice

How shall the injustices of monopoly be prevented in the future? So far as quasi-public monopolies are concerned, all students of the subject are now agreed that these should be permitted to exist under adequate governmental regulations as to prices and service. The reason is that in this field successful and useful competition is impossible. Public utility corporations are natural monopolies, and must be dealt with by the method of regulation until such time as they are brought under the ownership and operation of the State. With regard to the great industrial combinations which have become or threaten to become artificial monopolies, there exists substantial agreement among competent authorities on one point, and disagreement on another point. All admit that the unfair competitive methods described in an earlier part of this chapter should be stringently prohibited. No possible reason can be found for legal toleration of these or any other discriminative, uncharitable, or unjust practices on the part of stronger toward weaker competitors.

The disagreement among students of monopoly relates to the fundamental question of permitting or not permit-

ting these combinations to exist. According to the first theory, no new industrial monopolies should be permitted, and those that we have should be dissolved. The basis of this theory is the assumption that all the economies and all the productive efficiency found in monopolistic concerns can be developed and maintained in smaller business organizations, and that the method of prevention and dissolution is the simplest means of protecting the public against the danger of extortionate monopoly prices. Attention has been called in a preceding paragraph to the impossibility of determining whether the great monopolistic combinations have on the average shown themselves to be more efficient than concerns subject to active and adequate competition. It is significant, however, that in the discussion of this subject which took place at the twenty-sixth annual meeting of the American Economic Association, at Minneapolis in 1913, the economists who participated were practically unanimous in holding that the superior efficiency of the trusts had not been demonstrated, but was a matter of serious doubt, and that the burden of proof of their alleged superiority had been definitely shifted upon those who maintained the affirmative.[1] Probably the great majority of the whole body of American economists share these conclusions to-day as they did fourteen years ago.

On the other hand, the opponents of prevention and dissolution point to the obvious economies of large-scale over small-scale production, and contend that these are sufficient reason for permitting and even encouraging the great combinations. The power to oppress competitors by unjust methods of business, and the public by extortionate prices, should be kept under rigid control by supervision, and government regulation of maximum prices. But the arguments advanced in favor of this position are never conclusive. Most of its advocates fail to realize, or at least to take adequately into account, the

[1] "Papers and Proceedings," pp. 158-194.

difference between large-scale production and production by a monopoly. While the large plant and the large business organization have in many lines of manufacture and trade a considerable advantage over the small plant and the small organization, there is not a scintilla of evidence to show that the efficiency of magnitude increases indefinitely with magnitude. There is no proof that the maximum efficiency is reached only with the maximum size of the business unit. On the contrary, all the evidence that we have points to the conclusion that in every field of industrial and commercial enterprise, all the economies of magnitude and of combination are obtained long before the concern becomes a monopoly. There is not an industry of any importance in the United States in which all the advantages of bigness and concentration cannot be made operative in concerns that control as low as twenty-five per cent of the total product. The highest economy and efficiency can be obtained without monopoly.

Indeed, this is admitted by the more reasonable advocates of the regulation and price-fixing policy. While maintaining that "concentration must go far in order to give the maximum of efficiency," President Van Hise does not hold "that it should go to the extent that the element of monopoly enters"; and he would have the law "declare restraint of trade unreasonable that gets to monopoly," and fix the definite per cent of business control which constitutes a monopoly.[1] We are justified, therefore, in concluding that the theory of prevention and dissolution (providing that the competing units are not made so small as to destroy the certain economies of magnitude) rather than the theory of permission and regulation, indicates the sound policy of dealing with monopolies.

After Eleven Years

The foregoing paragraphs were written in the year 1916. At that time the Clayton Act and the Federal Trade

[1] Op. cit., pp. 20, 251.

Commission were still too recent to have received a fair trial. Subsequent experience has justified the statement that these agencies have considerably lessened those notoriously unfair business practices which are among the most effective means of creating and maintaining monopolies. Hence, it is safe to say that this particular cause of monopoly can be substantially eliminated. Governmental price-fixing has been discredited by war time experience and is no longer supported by a respectable body of competent opinion. The important question, therefore, is still whether monopolies ought to be prevented and dissolved.

A judicious consideration of all the facts seems to warrant an affirmative answer to this question. It is even clearer now than it was in 1916 that artificial monopolies are, with possibly very rare exceptions, neither economically efficient nor economically inevitable. "At first glance, the forces favoring monopoly appear very strong. There is first of all the well-known economy of large-scale production in many lines of industry. There are the economies which in certain cases appear to accompany the combination of separate business units under a single management. There is the occasional appearance of cut-throat competition, an unstable situation leading almost inevitably to monopoly. There is the constant effort of the captains of industry, when competition is especially keen and irksome, to find escape through some form of combination, making use of every possible device—pool, trust, holding company, and so on—which human ingenuity with billions at stake can devise."

And yet, "it is doubtful if the monopolistic combination is in many cases the most efficient form of organization. We have already learned that the efficienecy of large-scale production has very real limits. There are few important lines of industry in which this limit would not be reached long before the would-be monopolist had become great enough to absorb the whole. Even assuming the monopoly to become established, lethargy in manage-

ment and lack of progress in the technique of production and the methods of organization, will tend to appear, so that the monopoly which at the moment of its formation is representative of the most efficient methods of production carries with it no assurance of continued efficiency." [1]

Despite its economic inefficiency, men have always sought, and no doubt always will seek to achieve monopoly. Regardless of its effects upon the public, a monopoly is always a source of pecuniary advantage to its possessor. Can it be prevented? "So deeply ingrained is this desire to secure monopoly profits that we may safely say that it can never be eradicated, but there is reason to believe that here the power of organized society, acting through legislation and administration, is strong enough to cope with the situation." [2]

As a matter of fact this corrective and repressive power has never been fully utilized, at least in the United States. No Federal administration and few if any state administrations have ever consistently employed all their legal resources to prevent or destroy monopolies. If sustained earnest effort in that direction should prove inadequate, there remains the remedy of government competition with the most intractable concerns. In the words of the "Social Reconstruction Program" of the National Catholic War Council this proposal "deserves more serious consideration than it has yet received."

If all political measures should fail there would remain the resources of coöperative enterprise. Whenever the consumers are ready to organize and maintain comprehensive coöperative societies they can put an end to all forms of monopolistic extortion.

[1] "Elementary Economics," by Fairchild, Furness and Buck. Vol. II, pp. 68-69.

[2] Op. cit., p. 70.