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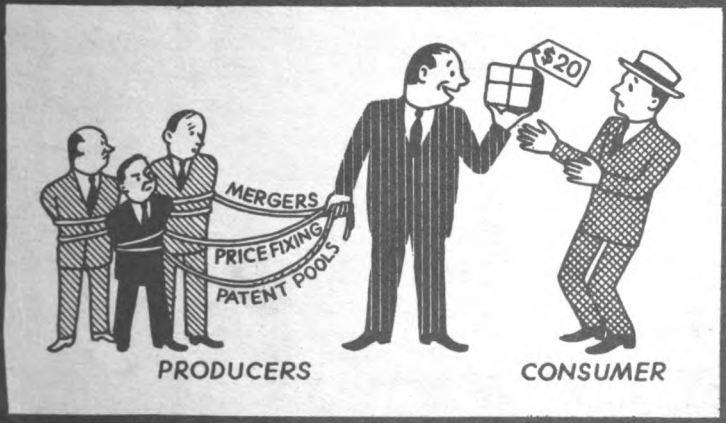
CARTELS OR FREE ENTERPRISE?

BY THURMAN W. ARNOLD



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CARTELS OR FREE ENTERPRISE?

By THURMAN W. ARNOLD

ON my desk as I write is a beautiful brochure issued by one of our large oil companies. The name of the company doesn't matter. Nearly every large company is issuing similar literature. It is entitled *America's Fifth Freedom is Free Enterprise.* It is a treatise on economic theory, profusely decorated with allegorical illustrations.

On one page there is a picture of a hundred-yard dash under the caption, *Man Never Runs as Fast Against Time as in a Race.* The conclusions drawn by the oil company read as follows: "Competition is the one incentive discovered so far that keeps him constantly striving to improve his products and lower his costs."

On the next page the idea that the oil company is owned by large capitalists is refuted. Its real control is said to be in the hands of simple and humble folk. You are asked to meet ten typical stockholders. There is Irma Norza, a pretty stenographer; Mrs. Karlton Koons, a housewife; John W. Brownlie, an op-

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tometrist; Dr. Thomas Holden, a Minister of the Gospel; Frank Pagone, a barber; and so on. These are the people who own the oil company and whose task it is to keep that company highly competitive, in line with our great American tradition. The booklet points out that all American industry is owned by the same kind of plain, homely, honest people. "That way," says the booklet, "we preserve the economic freedom of the individual, the efficiency of a free economy, and that all-important human incentive—competition."

Free Enterprise and the Modern Corporation

This brochure is typical of the great advertising crusade now being conducted by big business organizations in favor of what they call "Free Enterprise" and away from what has been referred to as the "Road to Serfdom." In that crusade the following ideas are repeated over and over again:

1. The management of our domestic and international cartels is committed to the principle of competition in a free market and may be expected to follow that principle.

2. The great business concerns which dominate our market will never become monopolies because their ownership is scattered among the millions of plain, simple people who own stock.

The democratic character of stockholder control is supposed to be an assurance that the concentrated economic power of the modern corporation will not be used to interfere with free enterprise. We are further assured that our corporate managers have no desire to make profits except by greater efficiency and lower prices. Men of such convictions would not impose artificial handicaps on independent competing production even if they had the power to do so.

In the dizzy period between 1920 and 1930, ideas like this did not need to be bolstered by slick colored advertising. The American public accepted them without argument. Small communities rushed to take their money out of local investment and share in the profits of huge business combinations whose management was located thousands of miles away. In those days America was a land of opportunity for every stenographer. Every barber hoped to be an independent capitalist, sharing the ownership

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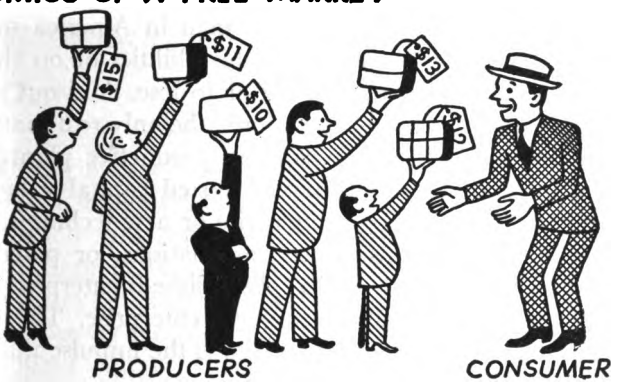
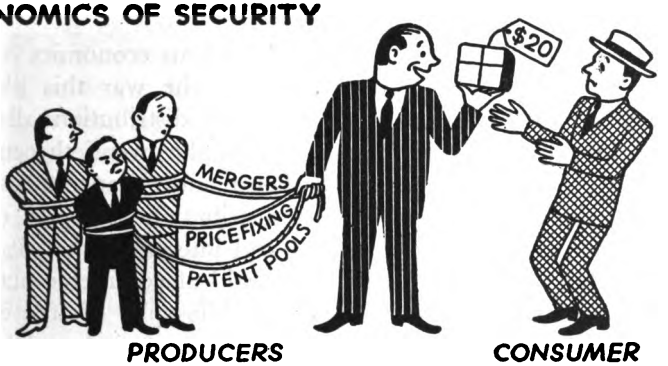
WHICH IS THE AMERICAN WAY?

ECONOMICS OF A FREE MARKET



ECONOMICS OF SECURITY



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of great corporations with other independent capitalists in New York City.

Today many of us are frankly bewildered. We no longer share the simple faith of the 1920's, but we have never seen clearly the difference between free enterprise and the sort of organization described in these elaborate brochures. The difference is really rather simple. But it is fundamental.

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The American Tradition

The great economic tradition of America is that of industrial freedom—the freedom of every man to produce and sell in an uncontrolled market. This may be called the economics of opportunity. It assumes that every man in America must be free to take a chance, to gamble on his abilities or on the efficiency of his organization, and to win or to lose. And out of that race to produce and distribute will come the only real material wealth a nation can have—an expanding productive plant. If there is to be freedom of opportunity, invested capital values must not be protected against new enterprise or new techniques under the cloak of corporate franchises, associations, or patent pools, or any other organized device. Established enterprise must constantly meet the challenge of new enterprise. The opportunity to create a new business enterprise is the impulse that makes the profit system work.

The Economics of Security

Opposed to this idea is the idea of an economics of security for established organizations. Before the war this idea pretty well dominated mass production and distribution all over the world. As the industrial revolution of the twentieth century knit the world closer together with faster and cheaper transportation and with mass production and distribution of goods, commerce became more closely organized and integrated than it had ever been before. Vast areas of that world of commerce accepted an idea which is the opposite of the philosophy of free enterprise.

This idea has taken on various forms. It is based on the assumption that a few men in control of established business institutions must hold control of production and distribution in vast areas of the world's economy as benevolent trustees for the common good of all. It assumes that the machinery of modern industry is capable of turning loose such a flood of goods that it is no longer safe to leave it in independent hands. The individual producer, who was the unit in Adam Smith's economy, could never produce so much goods and sell them at such ruinous prices as to destroy investment and disrupt business. But the modern industrial organization can, if such action is to its interest. Its

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control of a large proportion of the productive capacity in its field gives it power to produce surpluses which the management of our great industries fears may bankrupt competition and create nation-wide unemployment. These great organizations, which are created to restrict competition, are often called—for want of a simpler word—"cartels" or monopolies.

What is a Cartel?

The term "cartel" is ordinarily used to describe a ring of producers or distributors who have acquired control over domestic or foreign markets by agreements to maintain prices or control production and distribution. In the United States the same result is more often accomplished by corporate mergers, consolidations, and holding companies. This is because certain big business groups by merging their interests into large corporations have sought to avoid the Sherman Act, which makes monopoly agreements illegal. Economically, however, it makes no difference whether a group of men control the market under the protection of an agreement or under the cloak of a corporate franchise. Therefore, for the purpose of this pamphlet, no distinction will be made between the two. Both of these types of combination will be referred to as cartels.

Often these cartels have agreements with similar producers abroad to control world production and distribution of their product. But for the sake of convenience we shall use the term "cartel" mostly for domestic combinations.

Confusion between Facts and Theory

No one can question that what I have called the economics of security—as reflected in the cartels—is opposed to every American tradition. The economics of opportunity represents our prevailing ideal. But that ideal, with our present concentration of economic power, creates a series of contradictions between economic facts and economic theory. Never in our history has so much been said in praise of free competitive enterprise. Yet never in our history has there been a greater concentration of economic power in a few hands. Our great sprawling industrial empires are afraid to compete with new enterprise to furnish goods at lower prices. They are even more afraid of the government inter-

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vention without which a controlled market soon becomes intolerable. One may compare our present confusion between our economic ideals and our business practice to the endless debates and continuous bewilderment of the old days when we insisted on having liquor and having prohibition at the same time.

For a while it seemed as though the great depression had destroyed our belief in an economy of great mergers. For a few years at least men turned to programs of government planning as a way out of their bewilderment. But government planning was new and terrifying to many businessmen. The more they saw of it, the more frightened they were. Today we are turning back to belief in big corporations controlled by little stockholders as the American way of economic life. We have been reassured by the ability of these business concerns to produce war materials under government direction. And so a great campaign has been started to convince us again to trust in their management to give us full production in time of peace. Tons of literature, like the oil company pamphlet I have just quoted, have been issued to preach this lesson to the American people.

Protection Against Another 1929

We think that we have learned from the depression a couple of lessons that we did not know in 1920. We now realize that government must insure everyone against unemployment, must see that farm prices do not fall again and thus disturb the ability of farmers to buy the products of industry. But with these safeguards against a new depression we are willing to try the economy of the 1920's all over again. We think that the government should act as a great insurance agency to provide the nation with every kind of insurance against a second economic collapse.

But if the government is to insure our present economic mechanism against a second depression, we need to understand just how that mechanism works and what we are insuring. It involves, for example, protecting the capital values of great corporate combinations so that the little independent barbers and ministers who own them will not lose their incomes. How are we going to do this, and at the same time obtain low competitive prices at a moment when these capital values are threatened by overproduction?

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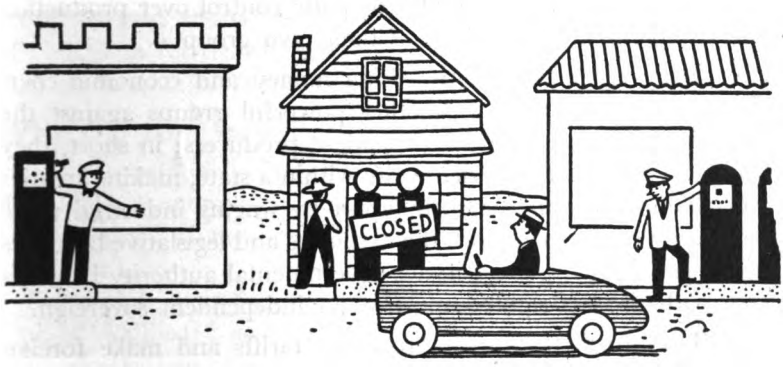
HOW CARTELS OPERATE

THE practices of the very oil company which issued the enthusiastic pamphlet about competition show the difficulties we face. That company was one of the group of major oil companies that kept independent producers from using the vast network of filling stations. It refused to sell its products to any independent dealer who carried the products of another company. Because most of the retail outlets were controlled by companies who followed the same policy, price competition was limited to a few struggling out-of-the-way stations. Unneeded filling stations sprang up all over the country for no reason except that some companies desired to gain further control over a distribution system from which independent competition was excluded. The final result was that before the war it cost as much to get gasoline through ten feet of rubber hose as the combined cost of refining and transporting the product.

Prices Pegged

The oil company that printed the pamphlet was one of the 123 refiners who accepted an illegal licensing agreement with the Ethyl Corporation. Thus the price of 85 per cent of all the high-grade motor fuel was fixed. Jobbers who had a tendency to



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reduce prices were refused licenses to sell. On the Pacific Coast an artificial differential of three cents between high- and low-test gasolines was maintained. Elsewhere, it was two cents. But neither differential bore any relationship whatever to the difference in cost or value of these two products.

Competition Throttled

I have no doubt that the officials of our great corporate empires believe in competition. But they believe in it in the same way that a heavyweight champion of the world, who is afraid to risk his title in a fight with some younger man, believes in prize fighting.

The fact is that no entrenched bureaucracy, whether political or industrial, is ever willing to risk its power on the gamble that it may be more efficient than new groups which are beginning to rise in society. It follows that whenever private groups have acquired control of the market these results occur:

1. They seek to consolidate industrial power by destroying existing independent enterprise.

2. They prevent new enterprise from entering the field.

3. Having accomplished these objectives, they restrict production and raise prices.

4. They stop the introduction of new and more efficient methods in order to maintain obsolete ways of production, in the continuance of which they have a vested interest.

5. They set up arbitrary and despotic control over production and exploit weaker members of their own group.

6. They enter into politics using money and economic coercion, making alliances with other powerful groups against the interest of consumers and independent producers; in short, they become a sort of independent state within a state, making treaties and alliances, expanding their power by waging industrial wars, dealing on equal terms with the executive and legislative branches of the government, and defying governmental authority if necessary with the self-righteousness of an independent sovereign.

7. They form their own protective tariffs and make foreign economic policies for the nation.

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The Public Pays the Bill

This stage of industrial development of a nation may be compared to old age in an individual—a period of caution, fear, and restricted activity. Established industry is afraid of overproduction, surpluses, and excess plant capacity. And so its business policies are devoted to destroying real wealth instead of producing it. These restrictive policies, in turn, create a crisis in agriculture because the farmer increases his production without getting a proportionate increase in industrial goods in exchange for his products. And so the farmer demands that government assist him in restricting production in order to raise farm prices to parity by making agricultural products scarce. Unemployment grows, and labor—seeking to stabilize jobs—boycotts more efficient methods.

These restrictive practices, if uncurbed, spread over all production. They compel government to pour out subsidies, unemployment relief, and money for public works to maintain a minimum of production at the artificial prices that an unsubsidized market cannot support. And at this point hopeless confusion of both political and economic policies begins. Irreconcilable pressure groups spring up, each seeking a larger share of the diminishing national income, each destroying purchasing power in order to maintain artificial prices for itself. And the increasing numbers of unorganized and insecure compel the government to provide subsidies and relief out of the same diminishing income. The end is hatred of government by big business, distrust of big business by little business, hatred of all business by those who are insecure, and finally the use of power politics by each warring group to gain special privileges. We suffered through this sort of confusion for ten years until the war forced us into full production in spite of ourselves.

Why You Lose from Restrictive Practices

An oversimplified illustration will show how restrictive practices block economic progress. It does not accurately reflect the complications of the real industrial situation but it is useful as an illustration.

Suppose it costs $500 to plaster your house. Suppose a new type of wallboard is discovered, stronger and more permanent than plaster and costing, in labor and materials, only $100. It

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is easy to see that this new type of wall threatens investment and labor in the plaster industry. Assume that because of it $200 in securities held by widows and orphans becomes worthless, and $300 in wages of plasterers is no longer paid. As a result of the new discovery $500 in purchasing power is gone. To take its place there is $100 in new investment and in new labor, leaving $400 of what we call technological unemployment and technological destruction of investment.

If this new wallboard is sold on a competitive market, some manufacturers will make money and others will lose, but the price will be about $100. The home builder will save about $400. With these savings he can buy a bigger house or more clothes for his family, or enjoy a better diet, or spend his money any way he wants. Industry will shift to meet these new consumer demands. Technological unemployment will be only temporary.

In the nineteenth century such displaced labor was left to shift for itself. Today it is to be hoped that the gap in employment will be bridged by measures of unemployment relief and social security. If this is done, there is $400 in savings in the home builder's pocket which can be taxed to pay for that government relief, and the displaced workmen will spend the money instead of the home builder. Under such circumstances, unemployment relief will actually prime the business pump. The government can insure that kind of economy.

HIGHER PRICES

But suppose that the new discovery is controlled by a combination of industries which already dominate the plaster market through a patent pool or some other such device. Once that control is acquired, they may put the new wallboard on the market for $450—a price low enough to drive out all the remaining independents who make plaster, and thus insure the maximum profit. This is only following sound business principles. The investment of the combine's stock will rise tremendously because their profit on the new board is $350. The power which enables the combine to keep others out of the business and thus make that profit will be called private property. Stocks may be issued on this kind of property and sold to widows and orphans—and others—as a high-grade security.

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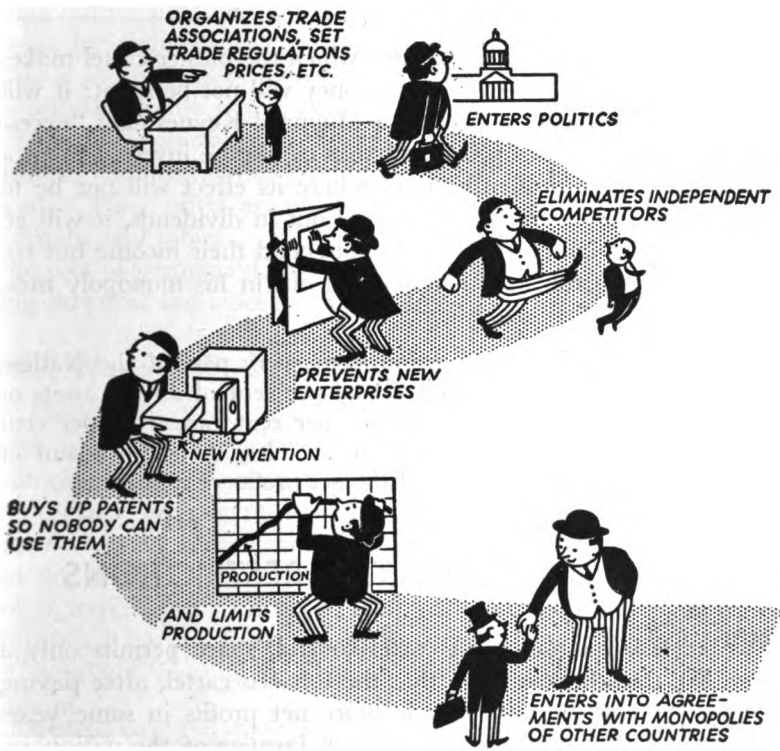
LESS BUYING POWER

But in the meantime it takes less labor and materials to complete the house, in an amount representing $400 for each housing

EVOLUTION OF A CARTEL



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unit. The consumer has saved $50 in building his house. But if he spends that $50 for a bigger house or for anything else, it will take up only a small portion of this $400 worth of technological unemployment. The $350 of displaced labor and lost purchasing power will create a permanent demand for relief which can be supplied only by the government.

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GOVERNMENT DEFICITS

When that unemployment relief and social security are provided, the consumer must pay the bill. But to meet this bill of $350, the consumer has only $50 savings in his pocket. And so we enter into an era of mounting government deficit, of attempts to prime the pump which always fail.

BUT MORE FOR THE FEW

What will become of the money which the plaster cartel makes out of the new wallboard? That money will not be spent; it will fall in the classification that John Maynard Keynes calls "excess savings." It will pile up in our banks or else be invested in production in some foreign country where its effect will not be to break domestic prices. If it is passed out in dividends, it will go to that very small group who do not spend their income but try to invest it. As the President pointed out in his monopoly message of 1938:

> Of all corporations reporting from every part of the Nation, . . . less than 5 per cent owned 87 per cent of all the assets of all of them, . . . one-tenth of one per cent earned 50 per cent of the net income of all of them, . . . less than 4 per cent of them earned 84 per cent of all the net profits of all of them.

EXAMPLES OF CARTEL RESTRICTIONS

OF the many instances of cartel control, space permits only a few. We find, for example, that the tobacco cartel, after paying heavy government taxes, made more net profits in some years than the entire gross price which the farmers of the nation received for their tobacco crop. Similarly, tin containers are responsible for about 15 to 25 per cent of the entire wholesale price of canned food. Fire and marine insurance companies in the United States receive from American property owners $1,000,000,000 annually in premiums, but they pay back less than $400,000,000 in losses. Consumers paid more for gasoline because of the misuse of the Ethyl patent. Magnesium, one of the lightest metals known, and stronger than aluminum, was restricted in

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production so that it would not break the price of aluminum. And only one hardboard manufacturer was permitted in the United States.

A small but amusing example of the result of this concentration is the price of false teeth. A cartel with domestic and international connections controls a substance called methyl-methacrylate. It has a variety of uses, including plastic glass. It is the best material for dentures. The cartel sold this product to commercial users for eighty-five cents a pound. The price fixed to dentists (prior to an antitrust investigation) was *$45 a pound.* By using a different trade name, the cartel pretended it was a different product. An official of the Imperial Chemical Company of Great Britain, discussing the possibilities of this scheme in England, said: "These prices are wholly artificial but nevertheless they are actually realizable. . . ." It is in this sort of control that we have the root of permanent technological unemployment and the shuting down of the wheels of commerce.

Will We Get the Postwar Goods We Want?

Only a short time ago, our magazines were filled with news and advertisements picturing revolutionary improvements in consumer goods. The threat which these improvements made to established investment was obvious. Today, cold water is being thrown on these predictions. There is even talk that various units in the automobile industry should agree not to use new designs or materials and thus waste their old machinery. The public is informed by prominent businessmen with an ax to grind that it does not want a new car, that it does not like changes in design.

Today rapid technical advances are threatening investments in old methods in the same way that they did during the depression. A letter from the Commissioner of the so-called Western Agreement showed how the railroads met that threat in the dark days of 1934:

> At a meeting of the Western Association of Railway Executives held on October 20 a resolution was adopted to the effect that air conditioning for 1934 would be restricted to observation, lounge, and dining cars. Subsequent to that time it developed

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> that one of the roads in Western territory would find it necessary to air condition combination sleeping-observation cars, inasmuch as full observation cars were not operated on certain of its trains. This action on the part of that carrier again brought the subject of air conditioning before Western roads for reconsideration and at the meeting of the Association held on Dec. 12, 1933, the action previously taken was rescinded and superseded by a resolution providing that no coaches, chair cars, or tourist cars will be air conditioned during 1934. . . .

This policy was pursued during the depression, when the manufacture of new equipment could have produced the employment that we desperately needed. Similar restrictions were put on freight and passenger service, and, of course, lower competitive rates were vetoed.

These railroad executives were willing to risk criminal indictment under the antitrust laws because they knew that uncurbed competition would force the railroads to modernize and give the public better service at lower rates. The same consequences would follow cartel control after the war.

Profits First!

The answer of the railroads to the competitive threat of air transportation before the war was to use the American Railway Express, which had a monopoly on the pick-up and delivery service of all air cargo, to put a floor under express rates by an illegal agreement with the principal air lines. As a result, air cargo was practically suppressed to protect railway investments. We had fewer than four hundred commercial planes when war broke out, and no cargo planes. Canada, with less than one-tenth our population, was carrying six times our air cargo. The nation which had invented the airplane was suppressing its use.

Our great communications systems dominate the growing business of manufacturing communications equipment. Our great oil companies can exclude independent enterprise from the great distribution systems which sell gasoline. None of these industrial enterprises will voluntarily surrender any part of its strategic position over the highways of commerce.

Every pressure is, therefore, going to be exerted toward the further concentration of economic power in all industry. Leo

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Cherne describes the industrial picture of today as follows:

> Free enterprise and unrestricted competition began to retreat a long time ago. Even before World War I it had all but disappeared in some of the heavy industries and in most of mining. The decline of competitive enterprise has been most marked in all forms of industrial production. Concentration has occurred in agriculture, in the service trades, and in retail distribution, but not in comparison to the absorption of industrial activity by large enterprise. During the twenties and thirties free enterprise began to lose its grip on the manufacture of much of the goods you buy.
>
> But it took the war to make a really striking change. In just two years, 1942 and 1943, the share of big business in the nation's total output grew faster than it did in the preceding twenty years. "By 1943, with the compressing force of war still gaining momentum, the hundred largest firms were already controlling about seven-eighths of the nation's war output, with approximately four-fifths of all prime war contracts in their hands."*

RESULTS OF THE CARTEL SYSTEM

Overproduction—Underconsumption

The first harmful result of cartels is an unbalanced exchange between organized industry which is restricting production and farmers and small businessmen who are unable to restrict production. The farmer becomes unable to buy enough industrial goods to keep factories running. Labor is laid off, thus cutting down buying power still further. Goods pile up in domestic markets because they cannot be distributed at the artificial levels maintained by the cartel. Thus we get overproduction of goods in the face of actual need for them.

Control of Foreign Trade

Then, to make matters worse, the domestic cartels attempt to control foreign markets so that the nation can get rid of this so-called overproduction—this inconvenient wealth that endangers an artificial price structure. International cartels are formed, dominated by private groups who seek to control foreign eco-

**The Rest of Your Life,* by Leo Cherne, pp. 125–126.

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nomic policy in the interests of international scarcity. At the first period of growth of these international cartels, the ideal of free enterprise is exalted. Later, when it becomes apparent that the market is no longer free, a new political philosophy arises, justifying centralized planning of production and distribution. The competitive race for efficiency which goes with a young and vigorous commercial organization is denounced as waste.

The Defense of the Cartel System

The defenders of cartels insist that the alternative is "cut-throat competition, progressive deterioration of agriculture, disastrous declines in prices, foreclosure of mortgages, and ruin."* The same idea lay behind the establishment of the NRA in 1933. But conditions are not the same today as they were then. At that time, our banks and financial institutions were failing because of falling prices. Today, the danger of deflation is gone. War spending has created the danger of inflation. Therefore, the justification of delegating to private groups the power to strangle production at home and abroad today must rest on a different basis than the old NRA.

Lower Prices and Full Production?

That basis is found in the assertion that cartel management has learned its lesson; it is now interested only in stabilizing markets and eliminating unnecessary risks in business. Cartel policy is no longer biased by the advantages of short-run profits against long-run public advantage of lower prices and increased production.

Let us look into the files of cartel management over the past three years and see how well this argument stands up. The examples are endless and we have space here for only a few.

Recently, the world-wide arrangements between du Pont and Imperial Chemical Industries were disclosed in a complaint filed by the Department of Justice. The ambitious scope of this plan was described by Sir Harry McGowan to the du Ponts:

> Sir Harry explained that the formation of I.C.I. is only the first step in a comprehensive scheme which he has in mind to

*J. Anton De Haas, "Economic Peace Through Private Agreements," 22 *Harvard Business Review* 139 (Winter, 1944).

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rationalize chemical manufacture in the world. The details of such a scheme are not worked out, not even in Sir Harry's own mind, but the broad picture includes working arrangements between three groups—the I.G. in Germany, Imperial Chemical Industries in the British Empire, and du Ponts and the Allied Chemical & Dye in America. The next step in the scheme is an arrangement of some sort between the Germans and the British.

Restrictions Abroad

In fairness to both du Pont and Imperial Chemicals, it should be explicitly stated that the record does not show a lack of patriotism or a desire to trade with the enemies of their respective countries. The scheme was motivated solely by an attempt to stabilize production all over the world. Yet, in effect, it was an international alliance between British and American companies against their own countrymen to build up private protective tariffs, not to aid struggling industry but to crush it. Mr. Corwin Edwards, in a report to Senator Kilgore's Committee, cites the difficulties of the Dutch producer who thought he had the right to do business in Holland. A representative of du Pont reported as follows:

> As you will have seen from my cable, he is very stiff-necked about his position. He claims very low costs and is determined to export that portion of his production (which to him apparently means capacity) which he cannot sell in Holland. . . . I'm afraid you and your friends are going to find him a difficult problem. I used all the arguments you gave me and a few I thought up myself, but he is simply determined to sell his output.

Cartel policy is an endless succession of such incidents. Against this background, trade treaties are meaningless. Another example: Bunge & Born, a large Argentine concern, refused to accept a permanent restriction of its field of manufacture in its own country. In 1939, negotiations were undertaken by Duperial, a subsidiary of the du Ponts and Imperial Chemicals, "to call a halt to B. & B.'s further expansion in the chemical field or at least establish limitations to the rapidity of their growth." A representative of Duperial reported:

> From the beginning we have felt that our policy opposite Bunge & Born should be fixed, having regard more to future than our

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immediate profits. If we do not accept Mr. Hirsch's demands, we shall have to face a period of unsatisfactory earnings on our acid, refined sulphur and CS_2 investments, *but in the meantime we shall be making the chemical business most unattractive to Bunge & Born and this, in time, can only have the effect of removing all enthusiasm for their making further investments in our field.* By sticking to this policy, the logical outcome will be a general arrangement with B. & B.—maybe one or two years hence —but under conditions which must be distinctly more favorable to us than if we were to reach agreement today on the terms Mr. Hirsch wishes to impose upon us.

And thus, economic imperialism always follows cartel control. Artificial prices at home restrict the market and create a surplus. Foreign countries must then be prevented from producing so that the cartel can export that surplus. We can maintain neither a good neighbor policy nor a sound foreign trade with a country whose industries we are strangling.

Restriction of Production at Home

And let it not be forgotten that restriction of production at home always goes with cartel division of foreign markets. Standard Oil of New Jersey agreed not to produce rubber at home. The arrangement was described in one of the Standard Oil documents as follows: "The I.G. [I.G. Farbenindustrie] are going to stay out of the oil business proper and we are going to stay out of the chemical business insofar as that has no bearing on the oil business." That meant that others must be prevented from producing rubber in this country. And so Standard Oil proceeded to use its patent control to suppress rubber production in 1940, in the face of the emergency of national defense. Another Standard Oil document succinctly states how it was done:

> A high royalty rate (7.5¢ a lb.) is fixed so as to make the operation practical for the rubber company only so long as the product is used as a relatively high-cost specialty.

Wherever we turn in the jungle of cartel management we see the same policies pursued. Here is a document written in connection with a quota which a du Pont official was attempting to impose upon a competitor to keep prices of cellophane at artificial levels:

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Let us assume that the cellophane business is going to gradually increase and to an extent that additional plants will have to be installed from time to time to supply the growing market. Let us assume further that the investment required per pound of output per year is 70¢, and that over a period of years we should expect to make 15 per cent return on our investment, which would be the equivalent of a profit of 10.5¢ per pound. If we assume that money is worth 8 per cent, then the cost of money required for this investment would be 8 per cent of 70¢ or 5.6¢ per pound. On this basis the profit to us, over and above the cost of money, would be about 5¢ per pound and if, therefore, the royalty should be fixed at 5¢ per pound we would not suffer materially, if Sylvania's quota were somewhat increased over the original figure of 10 per cent.

It occurs to me that Sylvania may be very much adverse to our clamping down the lid too tight on their quota. Might it not be possible for us to meet them part way in this matter by increasing the quota somewhat but providing for a larger royalty in the higher brackets in that quota? For example, we might place a quota up to 10 per cent on the basis of 3¢ royalty, from 10 per cent to 15 per cent on 4½¢ royalty, and from 15 per cent to 20 per cent on a 6¢ royalty. Understand that these figures are purely illustrative and require considerable study before final settlement.

The "Efficiency" of Cartel Management

The smokescreen behind which cartel management always hides is its supposed contribution to consumers. For example, it is often asserted that the electrical cartels gave us better lamps at lower prices. Let us glance at the record. In his report, Mr. Edwards shows how "the cartel arrangements concerning electric lamps illustrate the impunity with which quality may be degraded. . . . Protected from foreign competition, American manufacturers have attempted to increase their business by reducing the durability of their light bulbs." A memorandum written by a General Electric engineer to an executive of the company in 1932 reads as follows:

> Two or three years ago, we proposed a reduction in the life of flashlight lamps from the old basis on which one lamp was supposed to outlast three batteries, to a point where the life of the

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lamp and the life of the battery under service conditions would be approximately equal. Some time ago, the battery manufacturers went part way with us on this and accepted lamps of two-battery lives instead of three. This has worked out very satisfactorily.

In 1937, a General Electric official wrote to Tung-Sol Lamp Works:

1. The design life of the 2330 lamp has been changed from 300 back to 200 hours, the change to take effect as soon as manufacturing facilities will permit. It is understood that no publicity or other announcement will be made of the change.

When fluorescent lighting threatened to make the Mazda lamp obsolete because it required less current, a letter from an official of the General Electric Company suggested that articles that had to do with fluorescent lighting "minimize, for the present, the application of daylight fluorescent lamps for other than special applications which would mean plus installations and plus business for ourselves, as well as the utility companies." One wonders why any realistic observer would expect a different policy from men who are responsible for keeping up inflated capital values against the forces of competition.

Today, twenty-six billion dollars of railroad securities are threatened by the coming competition with the airplane. It is predicted that passengers can be carried from New York to Chicago in four hours for much less than the present coach railroad fare, and that airplanes will be able to transport fruits and vegetables from the Pacific Coast to New York at less than a third of railway express rates. We have the capacity to produce at least fifteen thousand cargo planes a year. It will take very little capital to buy and operate cargo planes if the industry is allowed to be free. This will mean that railroads must scrap the obsolete heavy equipment and give us the modern service of which American ingenuity is capable when forced into a competitive race. Transportation begets transportation, and the manufacture of equipment for a growing transportation service is a vast source of new employment. And cheaper transportation is the key to a vast development of industry in the West and South.

At present, the railways will provide cheap transportation, not for the sake of the public, but to extend their monopoly against

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threatened competition. A recent case before the Supreme Court, *Interstate Commerce Commission* v. *Inland Waterways Corp.*, 319 U. S. 671 (1943), gives us the answer. It shows railroads trying to prevent competition from water transportation even during the present war. They had proposed and secured rates which kept shippers from using inland waterways to ship grain through Chicago. Their purpose in doing so, as stated by their representative, shows the inevitable pattern of cartel management:

> We made this proposal, as I have stated several times, and filed these tariffs with the hope that we could drive this business off of the water and back onto the rails where it belongs. . . . We are not in love with water transportation . . . and we believe that we are entitled to that grain business.

This was at the very time when the public was asked not to travel because of the shortage of railway equipment.

More Luxuries and Fewer Necessities

It is high time that we abandoned the illusion that industry controlled by private agreement is capable of any other policy than that of restricting industrial progress.

It is true that the history of the development of the automobile up to the time the automobile became a necessity in American life followed a different course. From the time that Henry Ford broke into the charmed circle until the automobile finally became a necessity in American life, automobiles became cheaper and cheaper. The automobile industry prospered by a deliberate policy of unrestrained mass production, low costs, and low prices. Thus, it deserved its prosperity. But only a few industries which are introducing novelties or luxuries to the public have followed such a policy. If a man is to make a substantial investment in a new car when his roof needs fixing and when his family must go without a better diet in order to pay for it, as many Americans did, he must be offered a bargain. This was what happened with the automobiles. It is significant to note that after the automobile became a necessity, the models froze and no further progress was made except in luxury design. It is further interesting to observe that harvester machinery doubled in price while automobiles

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were going down, without substantial improvements or novel developments of any kind. It is characteristic of a monopoly economy that declining prices and increasing turnover appear only in novelties and luxuries.

Organizations Grow Old

The way that organizations change may be illustrated by a homely example. In a small town a lumber merchant through his own competitive energy built up a business which he thought was worth $100,000. But his sons do not have the same energy. They are afraid to pit the efficiency of their organization in a race with newcomers. Lower prices mean that their inventory and good will are no longer worth $100,000. And so they join with other old men in the community in making it impossible for a ruinous competition to appear in the town. The town begins to die.

Obsessed with the myth that the investments of the old concern must be protected because most of the leading citizens have acquired stock in it, people begin to talk about the great service of this aged institution, its humanitarian treatment of its employees, its contribution to the Community Chest. The business and social life of the community are thought to depend upon compelling loyal and patriotic citizens to buy from this concern instead of from the unethical outsiders who are destroying business confidence and imperiling the sound investments of the town.

The town becomes one big family preaching the ideal that the very essence of capitalism is the protection of old investments. The opportunity to build new wealth out of the energy of a new generation of businessmen is ignored. Houses cannot be built. Labor unions join with the decrepit old lumber company to protect the profits out of which they think their wages must be paid, stopping the building of homes. And this curious situation they identify with the symbols of capitalism and free enterprise to which they cling with religious devotion. And, incidentally, they keep on the statute books of the state a law against restraints of trade. But they also recognize that the kind of antimonopoly prosecution which frightens the investors in the lumber company is folly. And so the town slowly strangles itself.

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OUR PRESENT DILEMMA

TODAY we are on the horns of a dilemma. Our traditions and ideals demand less and less government control of business. But if a system of cartels is to work, government direction is necessary. The magnificent contribution of our concentrated industries to war production shows that if the government rations materials and directs the distribution of the product, cartel management may accomplish miracles. But we are desperately tired of a war economy. We want free enterprise back again. And at the same time, we do not want to disturb the vast investments in great corporate mergers on which so many millions depend.

Economic policy is not the product of economic logic. It is, rather, the result of the aspirations and ideals of ordinary people who have only the haziest conception of economic theory. Today, these ordinary people are trying to escape from the dilemma of choosing between a cartel control and a free economy in the following way: (1) They want to pretend that our great business combinations are free enterprises competing on an open market and allowing equal opportunity to all; (2) They want to escape from their fear that opportunity is actually gone by having government write a vast insurance policy against a second breakdown of our present system.

Sooner or later we must face the dilemma presented by the conflict between our ideals and our actual business structure. Until we do, we are going to continue in utter confusion.

The Postwar Problem

Today America is again confronted with the struggle to create the free markets of industrial freedom and independent opportunity which has only been postponed by the present conflict. That struggle must be won if we are ever to escape from the confusion and bewilderment of the past decade. Every problem which faced us during the depression will again be on our doorstep. Today we are ignoring these problems.

The central economic issue of a free market is often forgotten in our emphasis on humanitarian measures such as social se-

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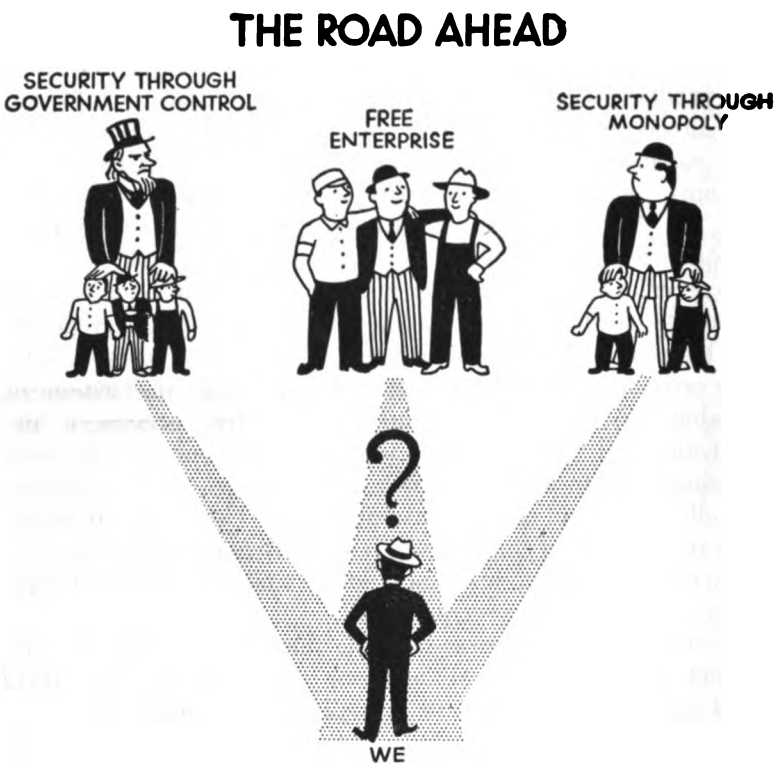
curity, stabilized farm prices, and unemployment insurance. But it cannot safely be ignored. Our great cartels have done a magnificent job in the war effort under the direction of a central



government which controlled and rationed every industrial material. They want to be turned loose again on the theory that they are free and independent enterprises. Small businesses are going to demand special privileges and protection against competition. Reconversion plans seem to follow no discernible principles except to put big business back in the same position it was in before the war. The problem of market control by private groups is not being treated as an important economic issue. The word "free

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enterprise" still holds its magic for the American, but in political and economic debate it has become meaningless.

No one likes to go to the dentist until his tooth aches. No nation with a real economic problem wants to face it until compelled by stern necessity. Why quarrel with great organizations of capital about their domination of the market when everyone has a job and when everything sold on that market has to be rationed anyway? Why quarrel with labor about its prohibition of the use of new methods and materials in housing when the public can't build houses?

Some statisticians tell us that there are now more workers than there ever were before, and that in some fields it takes about 30 per cent less labor to produce the same products that we had before. They figure that this means that we shall have to produce at present prices $170,000,000,000 in gross national products in order to get full employment. This must be done with the same industrial organizations which were unable to produce half that income during the depression. No one can quite figure out how this miracle is going to come off. Farmers want to forget their worry about it in the comfortable assurance that, whatever comes, their prices will be stabilized at parity. Labor wants a guaranteed annual wage. Its leaders argue, plausibly enough, that if dividends must be protected in order to give capital the incentive to invest, wage rates must have equal protection. As Louis Stark puts it:

> Expressing it at its simplest, the problem runs like this, "How can I, a wage-earner now paid fifty-two hours' pay for forty-eight hours' work, get along if cutbacks reduce my earnings to pay for forty hours at straight time?"
>
> The unions contrast the "human side of reconversion" with items of "depreciation," "obsolescence," "reserves," "tax refunds" and similar devices which they maintain the laws permit corporations to apply to their finances.
>
> The labor argument is that "unemployment compensation" for corporations is a fixed fact under present legal procedure while unemployment compensation for wage-earners during the reconversion period will be wholly inadequate as a result of adoption of the George bill in Congress and failure to pass the Murray-Kilgore bill.*

**New York Times,* Sunday, October 1, 1944.

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Taking the Risks Out of Economic Life

Great corporations assure us that they must also have cushions against the hazards of the future. First, they want to be in a liquid position so they will have plenty of money to invest without borrowing. Second, they want corporate taxes to be repealed so that they may have an incentive to invest their liquid capital in new production. Third, they want patent protection so that the new arts of the coming industrial age will not fall into the hands of reckless people who will use new techniques to produce surpluses.

Farmers don't want government control. They only demand that farm prices be kept up by government aid. Labor rejects government control. It only wants enough special privileges so that labor will not be subject to the hazards of competition. Big business wants no government interference. It demands only enough protection so that it can pay higher wages and higher farm prices and still make higher profits. With these safeguards, everybody is in favor of free enterprise and the abolition of government control.

This is about what the economic objectives of all our great pressure groups add up to when put together. The political power of these organized groups to obtain these objectives is about equal, as even the Republican Party which used to hate New Deal measures has finally discovered. And so the nation appears about to unite in a gigantic effort to lift itself by its own bootstraps.

Security for All

It is not surprising that the great mass of Americans—puzzled by this picture—want to forget the whole problem by being assured of old-age pensions, unemployment relief, and medical care supplied by the government. Thus, many Americans have been forced into the hopelessly contradictory position of saying at the same time that our vast government expenditure must stop, and that the government must spend enough money to insure against the poverty and unemployment which follows when government spending stops.

And so, measures for relief against poverty, stabilization of farm prices, and unemployment insurance have become a major

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economic program. This new responsibility of government has come out of the growing realization of the infinite productive capacity of the coming industrial age. No tradition of *laissez faire* is going to be strong enough to permit human want and unused goods to exist side by side. Social security measures are here to stay.

Need for More Dynamic Incentives

But the point I wish to make here is that America cannot build a dynamic and expanding economy out of cushions against insecurity. That ideal is the antithesis of the psychological forces which built a dynamic America in the past. Indeed, according to nineteenth century liberal theory, fear of poverty and want was the mainspring of industrial energy. The economic philosophers of that day were convinced that any sort of security against individual economic disaster would destroy man's incentive. That same idea, carried over into the depression, caused substantial groups in this country to denounce social security as a violation of our constitutional guarantee of liberty and property and as a tendency which would create in America the psychology of beggars.

It is fortunate that a humanitarian revolution arising out of the vision of our vast productive capacity has jolted us out of that sort of nonsense. Security against economic disaster will never affect the individual incentive of Americans because their wants are far above any minimum standard of living, however high. But it is equally true that while security may not destroy incentive, it neither creates nor stimulates it. Security measures cannot provide for Americans the dynamic force which gives them confidence in their economic future.

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Comments

It is significant to note that on an issue that is as close to the center of the present-day struggle for economic and political power as that of cartels, expert opinion tends to be divided not only on the issue itself but on such essentials as definition of terms and interpretation of facts. Consequently, objective criteria are extremely difficult to determine. This is illustrated in the following diverse comments with respect to Judge Arnold's basic argument.

My foremost reaction to Thurman Arnold's manuscript is that he has laid out a terrific dilemma and has not presented an equally convincing solution. His picture makes it seem that the pressure to "take the risks out of economic life" is likely to be irresistible. He would accept this security psychology for workers and farmers, but not for industry and business. More specifically, he looks to giving employees some degree of security of income, but not security against such technological unemployment as is bound up with unchecked progress in techniques. But organized labor wants both kinds of security; and Judge Arnold has had experience with their resulting resistance to technical progress. The line he proposes will not be easy to draw.

The net effect of his picture is to make the prospects for the surival of competitive enterprise look extremely dark, if one accepts it without reservations. Perhaps the saving factor is that the picture may be over-accented. Particular generalizations are open to question, and the reader should be warned that particular hypothetical cases do not present all aspects of a complex industrial structure. There may be promising policies which Judge Arnold has not specifically outlined.

JOHN M. CLARK
Professor of Economics
Columbia University

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Judge Arnold's article contains the clearest presentation of his point of view about monopolistic practices which I have yet seen. He argues brilliantly the need to make programs of restraining output hazardous and the importance of not pursuing security down paths which lead to stagnation. The article is a discussion of the significance of monopolistic phenomena rather than a summary of facts. It is a case for the prosecution rather than a dispassionate analysis. Doubtless it will be challenged on these grounds as well as for a few inaccuracies of detail.

CORWIN D. EDWARDS
Professor of Economics
Northwestern University

My main criticism of the article is directed not to the substance of the thesis presented but to the manner in which it is developed. Repeatedly Mr. Arnold concedes, or at least appears to concede, more than he needs to, thereby weakening his argument. I refer especially to his frequent assertion that unrestricted competitive production would result in a "ruinous" surplus. All that he really means, I take it, is that unrestricted competitive production would jeopardize, perhaps even wipe out, the inflated capitalization of what, for short, we may, with him, call the cartels. The unwary reader, however, is very likely to take Mr. Arnold's assertions at face value and to conclude, as Mr. Arnold seems to concede, that the removal of various trade restrictions imposed by cartels would lead necessarily and unavoidably to a repetition of the 1930–32 debacle.

MYRON W. WATKINS
Research Director
Twentieth Century Fund Survey
of Cartels and Monopoly

The more discussion on the cartel vs. free enterprise issue today, the better. I feel it is one of the most important, one of the key stories of our era. I feel this so strongly that I urge you to publish Judge Arnold's manuscript. As a financial commentator and observer, I have read so much on the pro-cartel side that any word from Judge Arnold's group is illuminating and provocative indeed.

SYLVIA F. PORTER
Financial Editor
New York Post

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Like so many other public statements on "cartels," the article deals with a highly important problem without defining terms. His treatment is particularly vulnerable to this criticism because he does not distinguish between national combinations in violation of our antitrust laws and international cartels whose operations may not be subject to our laws. He apparently would nevertheless apply the same criteria in either case—if indeed any fixed criterion is given. It is noted that his criticism is not restricted to combinations in restraint of trade but includes all "large corporations," regardless of any violation of the antitrust laws. He seems to use the term "cartels" merely as an epithet, failing to recognize, as the Supreme Court has frequently done, that there may be many agreements between business corporations which restrain trade to some extent (as in fact every business agreement does) without violating the antitrust laws.

If Judge Arnold's conclusions are that we should attempt so far as possible to retain within the United States the principles of free competition, I feel there are few who will take exception. Nor do I believe many will dispute his apparent conclusion that artificial aids to particular groups, such as floor prices for foreign products, are contrary in principle to the competitive system. However, I cannot concur either that the alleged evils in conduct of industry are as generalized, or that industry is solely to blame for the economic problems of today, as Judge Arnold suggests.

CRESSWELL M. MICOU
Curtis, Mallet-Prevost, Colt & Mosle

So far as I can tell Judge Arnold has been essentially accurate in his facts and I think he has stated his case fairly. . . . I think it is a highly significant paper and I believe that you would be rendering a great public service in publishing it.

WENDELL BERGE
Assistant Attorney General
Department of Justice

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FOR FURTHER READING

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