

SCIENCE.—SUPPLEMENT.

On the freedom of contract.

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REGULATION OF CONTRACTS.

THE present age is fertile in economical problems, due, in the main, to the great improvements in production and distribution, and to the consequent changes in the organization of business enterprise. Among the questions that have thus arisen, and are now demanding solution, one of the most important is that of the regulation of contracts by state authority. It is held by some that the making of contracts should be free from legal control, and that the state should confine itself to enforcing the due performance of them after they are made. Others maintain that in the present condition of industry, with immense masses of capital concentrated in a single hand, or in a single board of control, the interference of the state is sometimes needed for the protection of the weaker party to the contract, or of the general public. We have witnessed in recent years an example of state interference with contracts on a great scale in the Irish land law. This measure not only released the tenants from some portion of their accumulated debts, after the manner of a bankruptcy law, but it also provided certain tribunals to fix rents for the future. No greater interference with freedom of contract has occurred in modern times, and the example thus set may have important results in the future. We Americans have not as yet any land question of this sort to deal with; but cases are constantly arising in which the question of regulating contracts appears, and the consideration of it, therefore, cannot begin too early. We bespeak our readers' attention to the accompanying essays and to the important subject of which they treat.

HOW FAR HAVE MODERN IMPROVEMENTS IN PRODUCTION AND TRANSPORTATION CHANGED THE PRINCIPLE THAT MEN SHOULD BE LEFT FREE TO MAKE THEIR OWN BARGAINS?

I.

THERE has been a time in the history of almost every civilized race when a man had a right to bargain himself into slavery, if he chose, and

this right was repeatedly exercised. But such bargains were so clearly against public policy that they were done away with long before slavery as an institution was abolished.

Where two parties to a transaction do not meet on equal terms, free contract may be the surest means of destroying freedom. Freedom, as far as it exists, is the right to do as one pleases with himself or certain objects: free contract is the right to limit that right. There are many instances in which more free contract now, means less freedom forever after. Self-enslavement was an extreme case, and belongs to past history; but there are many others which involve the same principles in practical shape to-day.

For instance: common carriers try to make special contracts which shall relieve them from common-law responsibility, and put the shipper at a disadvantage in various ways. The courts refuse to enforce such contracts. The law not only assumes that the parties to the contract meant a great many things which they never thought of: it sometimes insists that they did not mean certain things which they actually said and wrote. The courts are guided by considerations of public policy in interpreting transactions, and enforcing contracts. A right of every man to make his own bargains, apart from and above such considerations, never has existed, and in a highly organized society it is hardly possible to conceive how it ever could exist.

The practical question is, Where shall we draw the line? And the point with which we are immediately concerned is this, Have there been any industrial changes which make it seem desirable to draw the line differently to-day from what we should have done half a century ago?

To this question it is safe to answer, Yes. The growth of large permanent investments under concentrated management has developed a whole system of new conditions affecting liability, discrimination, and pooling. The old laws applied to the new facts produce in many cases an effect quite contrary to that which was designed: hence the demand for new laws, and for new interpretations of existing laws.

The growth of large investments of this kind dates from about 1815. Three causes combined to

favor this growth. The steam-engine gave the large establishment its motive power; the modern transportation system widened its market; the development of the joint-stock principle gave it the chance to secure the requisite capital from a number of small investors. Under these circumstances we have seen factories displace home industry, and large factories crowd out small ones; we have seen turnpikes give place to local railroads, and local railroads consolidate into vast systems. The factory or the railroad may be owned by a large number of stockholders, but it is controlled by a small number of managers. Each factory or railroad is managed as a unit, against a large number of employees on the one hand, or a large number of shippers on the other. This seriously affects the truth of the assumptions on which the system of free contract is based.

It has been assumed, that, under a system of free contract, competition would take care of prices, and responsibility would take care of itself. But, as a matter of fact, the large concerns have managed to lessen their responsibility as their power increased; while competition has become so uncertain or spasmodic in its action as not to do the work which was expected of it. Each of these points requires detailed explanation.

In the first place, the way in which these masses of property are held tends to lessen the responsibility of the management.

When a man manages a private business of his own, he is personally liable for all the debts which may be incurred. When he puts his money into the stock of a corporation, he is liable only to a limited extent. His personal risk is greatly reduced. But this is not all. As corporations grow larger and larger, the proportion of the stockholders who can take any active part in the management is constantly reduced. The managers become a distinct body, — an inside ring, whose interests may at times diverge from the true interests of the property. This is especially the case where most of the capital has actually been furnished by bondholders, to whom the management is not even nominally responsible. Where a man is handling property of his own, he may be trusted to pursue a more conservative policy: where he is handling property of other men, to whom he feels little or no direct responsibility, his policy will often be speculative in the worst sense of the word. While the railroad inflation schemes of 1882 are fresh in our minds, there is no need of going into detailed illustrations of this fact.

As long as the chance for making money out of such abuses exceeds the chance for holding the management responsible, self-interest will furnish no cure. And these abuses are clearly fostered by

unlimited freedom of contract on the part of managers. The doctrine of *ultra vires* is a sound though somewhat clumsy protest against such freedom. The English principle, rigidly forbidding the directors to have a personal interest in contracts with the corporation, is equally sound. Even the most strenuous advocates of non-interference must recognize the necessity of some such restrictions on corporate management.

There are special reasons why it is easy for a large concern to evade much of its responsibility to its employees. The matter of accidents will serve as an illustration.

Fifty years ago it was usually not hard to place the responsibility, in case of injury, in the conduct of any business. The employer worked among the men. If he gave an order which resulted in injury, it was his fault; if he allowed the machinery to become grossly defective under his own eye, it was his fault. Otherwise the fault was with the men to whom the accident occurred. To-day all this has changed. The employer no longer works among the men. He no longer gives his orders direct. He no longer has the chance to see the defects as they arise. If an order results in accident, it is easy for the employer to shift the responsibility upon a subordinate. If the machinery becomes defective, it is easy to prove that the employee had the chance to see it when the employer was not within a hundred yards of the spot. Even when the processes are dangerous, and are known to be dangerous, the employer can frequently relieve himself of all responsibility. The time when the accident occurs will usually be determined by the negligence of some employee. A momentary inadvertence puts a special strain upon the already weakened machinery. A catastrophe follows, and a number of men are injured. But the employer can show that his machinery was no worse than that of other factories; that it was the negligence of some employee that occasioned the disaster; that the men knew what risks they were running, and must take the consequences.

This illustrates the danger of unrestricted bargain. It is held that the man who accepts employment in an industry which has been dangerously managed, tacitly bargains to take the consequences. The employer is practically relieved from legal responsibility. And yet morally he is the responsible party. To a far greater degree than the employee, he has the knowledge and the power which should prevent the disaster. The law enables him to shift his responsibility upon the weaker party. It will not do to say that the employee takes his own risks. It is not a question between employer and employee alone: it is a

question in which the whole community has an interest. If a man is morally responsible for the injury to another, and we allow him to be relieved of legal responsibility, we strain the basis of public opinion on which the enforcement of law rests. This fact is being gradually recognized. The English employers' liability act of 1880 corrects some of the worst abuses of the principle of 'negligence of fellow-servant'; and a recent decision of the supreme court does much the same thing for the United States.

It is not merely against their employees that large concerns can relieve themselves of responsibility. The case of carriers' contracts has been already alluded to. Were it not for the opposition of the courts, such a concern could throw responsibility for damage upon the shipper as easily as upon the employee. In spite of all the courts can do, the carrier's position is so much stronger than that of the individual shippers, that he can often dictate his own terms in this respect.

This brings us face to face with the other element in our position,—the fact, that, in the every-day dealings between a large concern and its individual customers, free competition does not and can not readily exist.

1. As a matter of fact, it does not. The local shipper, bargaining for rates with a railroad, has no help from competition to protect him against mistakes of the manager. In an indirect way he receives some help, because it is against the interest of the railroad manager to discourage business along his route by higher rates than his competitors offer. But practically this principle is violated in thousands of instances, and competition affords no relief. Unless the manager makes his rates so high everywhere as to tempt a parallel road into the field, no amount of individual injustice will work its own cure. The local shipper does not enjoy free competition. Even if the supply of transportation facilities is more than adequate to meet the demand, the supply is monopolized, while the demand is not. The competition is all one-sided.

It is much the same way with a large factory dealing with unorganized employees, especially if the employee is so situated that he cannot readily change his residence. And it is so, to a far greater extent than we are wont to suspect, in the production and sale of manufactured goods. A few instances, like the Standard oil company, have become notorious, and have withdrawn attention from the rest; but the number of industries where a pool or division of the field has been carried out is really very large. It is rare that for a weak individual, dealing with a strong organization, competition exists in any thing but name.

2. As a matter of theory, competition cannot produce the effects which have been expected of it. It tends to keep down profits, and limit average rates; but it does not prevent disastrous fluctuations, or protect the weaker individuals. Rather, it harms them by causing discrimination in favor of the stronger and more unscrupulous. This is one respect in which the industries of to-day differ from those of a century ago. The larger the permanent investment, the less good and more harm competition can do. What was nearly right for a bank or store, is partly wrong for a factory, and almost wholly wrong for a railroad.

The expenses of a railroad (and the same sort of reasoning might be applied to a factory) are of two kinds,—fixed charges and operating expenses. Under the former head we include interest on the investment, deterioration, and the various administrative expenses which are involved in the conduct of the business as a whole. Under the latter head we include train and station service, fuel, and the various items of expense involved in doing each individual piece of business. Fixed charges, as the name implies, vary but little as the volume of business increases or diminishes: operating expenses are nearly proportional to the volume of business.

In order to attract new capital into the business, rates must be high enough to pay not merely operating expenses, but fixed charges on both old and new capital. But, when capital is once invested, it can afford to make rates hardly above the level of operating expenses rather than lose a given piece of business. This 'fighting rate' may be only one-half or one-third of a rate which would pay fixed charges. Pig iron in England in 1873 was three times as high as in 1878. Railroad rates, on the other hand, have varied as much as this within a single year.

The old theory of competition said, "Such fluctuations cannot take place, because new capital will come in when rates are above cost, and old capital will withdraw when rates are below cost." The trouble with this theory, as applied to modern industry, is twofold: 1. Where there is a great deal of fixed capital, it can only come in slowly, and only withdraw slowly; 2. More important still, the rate at which it pays to come in is very much higher than the rate at which it pays to go out. Cost of service is calculated on two distinct bases, one of which includes fixed charges, while the other does not. The former may be two or three times as high as the latter. The difference is sufficient to give the chance for a commercial crisis or for outrageous discrimination.

Competition, if it exists at all, must exist either everywhere or somewhere. In the former case

there is nothing to pay fixed charges, and it means ruin to the investors. In the latter case the points which have no competition are made to pay something toward the fixed charges, while the others do not. This is discrimination.

Wholesale discrimination, and wholesale sacrifice of interest, are both misfortunes to the community. The customers cannot endure the former; the investors cannot endure the latter; the community cannot afford to tolerate either. In each case competition is carried to the point where it encourages the unfittest rather than the fittest. Under a system of discrimination, it is the more unscrupulous man who gets the low rates. Under a system of cut-throat competition, it is the black-mailer who reaps the advantage. Capital is invested, not for the sake of its earning-power, but for the sake of speculative manipulation and fraudulent contracts.

Both these points have been to some extent recognized by the public authorities. The doctrine of the 'reserved police power of the state,' awkwardly as it has been sometimes defined, is part of the law of the land, and is unquestionably sound in principle. It is clearly recognized under this doctrine that there are many cases where competition either does not exist, or, at any rate, does not protect against abuses of industrial power, and that in such cases the state is justified in interfering. Of late, the interferences have been more and more directed against cases of discrimination as such, rather than extortion. For the protection of the investor, less has been actually established; but the events of the last five years have shown so clearly the danger of free competition of capital in the hands of irresponsible managers, that the necessity of some such protection is beginning to be quite generally admitted.

Most of the actual limitation of competition has been done without the aid of the law, and to a large extent in defiance of the law. A pooling contract, or, in fact, almost any combination of capitalists or laborers which may have the effect of limiting competition, has been placed on the same level with a gambling contract. It was void from the beginning: the law could not enforce it. Whatever may be thought of the desirableness of such combinations, there can be no doubt that this state of the law made them worse than they otherwise would have been. A combination to which the law will not lend its aid, almost necessarily pursues a short-sighted policy. The worst features of the system of combination are intensified.

That such combinations will exist, whatever our laws on the subject, has become quite obvious. That unregulated competition sometimes produces

the worst results, is also obvious. Why not allow voluntary regulation of such competition within certain limits, and hold the combination responsible for abuses which may arise? An open, responsible, perhaps incorporated combination of capital or labor is in many respects better to deal with than a secret and lawless one. Such publicity would increase the power of combinations for good; while the chance for evil, whether by a 'corner' or a 'boycott,' would be greatly diminished by responsibility. There is a clearly perceptible movement of public opinion in this direction. How far it will carry us remains to be seen. In England they have gone much farther than we have, and the results seem to be good. On the continent they have gone much further than in England. As far as concerns railroad policy, it is safe to say that the continental states have adopted the principle that the only way to prevent the abuse of free competition is to recognize combination, and hold each combination responsible for what it does.

The successive points may be summed up as follows:—

1. The present century has witnessed a rapid concentration of industrial power in a few hands.
2. Where power has been thus concentrated, responsibility has been lessened; where contract is nominally free, the stronger party can shift the responsibility upon the weaker.
3. An individual dealing with a large concern cannot rely on free competition to protect him. Sometimes it does not exist, and sometimes it can not.

And the practical conclusion is, that it is a great deal more important to put the responsibility upon the shoulders of the men who have the power, than to insist upon a nominal freedom which does not correspond to the facts.

This paper is not intended as a plea for extension of government activity. Such extension is threatened from every quarter, and it involves the most serious dangers, both political and moral. To argue in favor of unrestricted freedom of contract is simply to court such danger. Allow the employer to exempt himself from responsibility, and you drive the community into a system of factory inspection. Allow the railroad to make arbitrary differences in its charges, and you furnish the most powerful argument in favor of state railroad ownership. To try to preserve freedom by chafing at the restrictions of public policy is simply suicidal.

For a nation to enjoy political liberty, it was necessary for its members to resign some of their former lawless independence: the alternative was despotism. To enjoy industrial liberty, it will be

necessary to resign the claim to industrial lawlessness : the alternative is socialism.

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II.

THIS is a question in speculative jurisprudence. In old times we never should have thought of debating such a question. It is, however, far from being a silly question in the times on which we have fallen. It brings out, upon the arena of debate, the major premise of a number of projects and doctrines which are now advocated ; and we know that the fallacies lurk most in the assumptions of the major premise. It is also a significant fact that we are forced to discuss speculative questions where speculation has no business, just when speculation is condemned in its proper domain, and when the true uses of history are ignored by those who want to use history out of its sphere.

Status and contract, regulation and freedom, combination and competition, are the jurisprudential, the constitutional, and the economic facets of the same thing. Each couplet is complete in itself, and its parts are entirely complementary, as much so as heat and cold. Hence, if we narrow the field of contract, we shall extend that of status. We shall create new rights derived from the new status, either for all citizens or for the classes affected (e.g., the poor, debtors, employees, tenants), to which there will be no corresponding obligations ; and we shall correspondingly extend the range of torts. We shall in like manner shift the adjustment of freedom and regulation now existing in our constitutional law, diminishing individual responsibility, and increasing collective responsibility, in the same degree.

What, then, are the facts upon which we are invited to enter upon such a reconstruction of the whole body of jural relations on which our society is built ?

For the last three hundred years the best thought and labor of civilized men has been devoted to the effort to produce civil institutions which would guarantee to each individual the exclusive use of all his own powers for the pursuit of his own ends ; i.e., happiness, as he understands it, and the equality of all before the law. Such a thing as an economically free man cannot exist, because our life on earth is held in conditions which we can modify only within narrow limits at best. The last hundred years, however, have seen a growth of our power over the harsh conditions of life by a development of the arts, which we never tire of glorifying. This development of the arts has made necessary a new and very wide

organization of mankind for industrial purposes : it has produced a great demand for talent in the way of organizing and executive ability, and it has given enormous importance to capital (plant, tools, and machinery). The new organization is necessarily impersonal, automatic, and mechanical. The effect of liberty, combined with the new development of the arts, has been to surround every man in our society with a great range of new chances, from the chance of becoming a gang-boss to that of becoming a great captain of industry. Formerly a man might rise, it is true, but the chances of doing so were limited to soldiers, priests, and royal favorites. A century ago, of two weavers, one might be a better workman than the other. He could profit by his superiority only within narrow limits. To-day one might remain an operative, and the other become a great manufacturer. The modern state has, in effect, thrown open the chances of success to all, in the faith that thus the maximum of industrial power would be developed for all, and that the maximum of individual happiness would be attained for each.

In large measure the aim of fifty or a hundred years ago has been realized ; but when we aim to go on and realize it still more completely, by a fuller realization of liberty to win, and security to have and hold, we are met by a reaction. We are told that liberty does not produce an ideal society, and that there are yet thousands of poor, unfortunate, and unhappy. There are no pure and unalloyed results of this so much boasted progress. If liberty has opened chances of wide improvement and advance for the better and the best, it has opened chances of deterioration for the weak and unfortunate, equally great and as terrible as the others are glorious. If society has offered chances and given security to the captains of industry, it has only created a new order of nobles — plutocrats, in fact ; and the effect of the development of talent has only been to bring control of the industrial organization into the hands of a few powerful men, who can readily combine to seek selfish ends, and supplant competition by combination.

Everyone knows that there is some measure of truth in all this. It is by no means strange that it should be exaggerated and enhanced by the partial interpretations and incorrect generalizations which are sure to be made under such circumstances. How could it be expected that the world should go on at the rate of the last century, and that some should not get dizzy and frightened at the speed ? How could it be expected that all should keep their heads cool, and their judgment sound, so as to interpret correctly all