GOVERNMENT REGULATION OF BUSINESS

In addition to the government-business cooperation symbolized by the associations, new forms of federal regulation of business characterized the Progressive Era. Sometimes this regulation came from administrative agencies in the executive branch, such as the Bureau of Corporations, but more typically it involved some form of independent commission that combined the functions of policy making, administration, and adjudication. The first commission, as we have seen, was the Interstate Commerce Commission. In the years between the turn of the century and World War I, Congress expanded the powers of the ICC and created two important new agencies, the Federal Reserve Board and the Federal Trade Commission. Each was created to deal with specific industries or specific problems, and thus, although their impact was sometimes widespread, none was responsible for the overall regulation of America's business system.

Each specific area of government regulation that emerged in the Progressive Era had complex sources within American society, but in general they were a response to three trends we have already noted as characteristic of the period: the idea of carefully observing economic activity and thereby deriving policies in the public interest, the reassertion of the power of the government to watch over the commonweal, and the growing conviction of the desirability of developing new avenues of government-business cooperation so that America would become more efficient and harmonious. Each area of government regulation was also a product of associational activity—of business people, farmers, and workers expressing their needs and interests and pressuring government officials through associations of various kinds. Finally, the growing role of the federal government in supervising business affairs meant that the tradition of localism, so powerful during the nineteenth century, was beginning to diminish.

Railroad Regulation

The railroad industry was the first recipient of this new form of government regulation in the 1880s, and in the Progressive Era the revival and redefinition of railroad regulation led the way toward establishing what became the fourth branch of government, the independent regulatory commission. Legislation in the Progressive Era enlarged the Interstate Commerce Commission and made it powerful enough to enforce railroad rates and to adjust them after careful investigation.
The growth of the American economy in the Progressive Era complicated railroad politics. Prosperity meant that the carriers faced heavier demands for service, demands that required them to modernize their tracks and equipment. At the same time that the carriers were facing a larger volume of business, price inflation made it more difficult to raise the necessary capital for improvements. While the carriers’ costs were rising, the opposition they faced from the powerful shippers’ associations made it difficult to raise freight rates and thereby either to generate capital from internal savings or to borrow it in financial markets. The result was a kind of impasse with the railroads, especially after 1908, seeking higher freight rates, and with the farmers and business people, themselves facing higher costs, trying to hold down the carriers’ charges.

The Progressive Era legislation regarding railroads initially helped the carriers but then was revised to grant considerable power to the business owners and farmers who depended on railroad service. In 1903, the Elkins Act, written by Senator Stanley B. Elkins, in effect legalized “pooling.” The law required the railroad companies to adhere to their published rates and punished railroads and shippers who gave or received rebates. The creation of a rational, administrative—as opposed to market—price structure pleased the railroad corporations but was not satisfactory to shippers, who could exercise little control over the charges. The complaints of business owners and farmers, especially in the South and West, led Congress in the Hepburn Act of 1906 to enlarge the Interstate Commerce Commission to seven members, empower it to control the carriers’ bookkeeping, and permit it to set maximum freight rates. This situation still pleased many railroad executives, however, because the law allowed them to set rates administratively. Moreover, the railroad officers could raise charges and collect higher revenues until the ICC rescinded their rates.

Congress completed the Progressive Era system of railroad regulation in 1910. That year saw two important events in railroad politics: the passage of the Mann-Elkins Act and the insistence by the ICC on scientific management before the railroad firms could raise their freight rates. The Mann-Elkins Act made a basic change in the regulatory system by requiring the railroads to demonstrate the necessity of higher freight rates prior to their imposition. This provision pleased shippers, for the burden of proof was now placed on the railroads, and the shippers were convinced that they could persuade the Interstate Commerce Commission to act reasonably and take local and regional interests into account in its decisions.

The result of this legislation was that rates were still set administratively, but the carriers’ actions were now supervised by the federal commission. Railroad executives expressed pleasure over the construction of a rational system of ratemaking, but they were displeased by some of the Interstate Commerce Commission’s most publicized decisions. When the Panic of 1907 threatened railroad revenues, George W. Perkins, representing the
Morgan bank and investor interests, negotiated an agreement among eastern railroads for a general freight rate increase of 10 percent. Shippers were alarmed, both at the prospect of having to pay higher charges and at the inequities in competitive relationships among industries, regions, and communities that such a general increase threatened.

The two sides were granted a hearing before the ICC that became known as the Eastern Rate Case of 1910. Midwestern shippers organized a new association, the National Industrial Traffic League, to represent them. New England shippers sent Louis D. Brandeis, a prominent attorney who had a reputation as a "people's lawyer," to represent their interests. Brandeis called Harrington Emerson, an efficiency engineer, as a witness, and Emerson testified that with the proper application of scientific-management principles, the railroads could save $1 million a day. This argument persuaded the ICC that no general rate increase was necessary pending a more thoroughgoing attempt to achieve cost savings. The decision, in effect, said that with the application of scientific and engineering principles to business, the public interest could be served and conflict between business firms, as here between railroads and shippers, could be resolved harmoniously.

This hope proved ephemeral. By 1913, it was apparent to the ICC that the carriers, which faced large traffic volumes and burdensome capital expenditures as well as higher operating costs, required additional revenue. Shippers began having to pay higher rates, but always as a result of a decision-making system wherein they had an important voice. By 1917, the railroad unions (called brotherhoods) were sending attorneys to commission hearings, allying with the railroads in the belief that higher rates would mean higher wages. Railroad executives voiced displeasure, of course, when they lost rate cases before the commission. But the railroads, on the whole, did not oppose this Progressive Era system of ratemaking, for it provided protection from the fierce competition that had damaged the industry in the late nineteenth century. The railroad industry set about the tasks of influencing the ICC and, by establishing a new science of public relations, of reaching the general public, the business community, and the politicians with their message of need.

**Food and Drug Regulation**

Railroad regulation concerned a broad spectrum of Americans, simply because anyone who wanted to travel or ship goods long distances was dependent on railroad service. Food and drug regulation also affected nearly every citizen, although its origins were less obviously rooted in business and farmer associations. Local regulation of foodstuffs extended back into the colonial period, but the modern movement for legislation requiring pure food and drugs stemmed from an increasing dependence on packaged goods sold through impersonal distribution systems.
The problems of adulteration and mislabeling were manifold. Traditional American medicine had not rid itself of quackery; the snake oil salesman with his traveling medicine show was a national institution. Entrepreneurs supplied the market with a large variety of nostrums, usually containing substantial proportions of alcohol, which were supposed to cure all ills. These "patent medicines" may have promised much, but they delivered nothing (except for hangovers and other alcohol-related diseases) and were an affront to the modern sciences of medicine and pharmacy that had emerged in the late nineteenth century. Similarly, food adulteration was a major problem. Some disreputable processors and packagers sought to deceive customers in the interests of quick profits; others who lacked technical expertise used harmful chemicals to preserve meats, fruits, and vegetables.

Harvey W. Wiley, who served as chief chemist in the U.S. Department of Agriculture after 1883, led the campaign for passage of a federal regulatory bill. Wiley conducted experiments that demonstrated the existence of undesirable impurities in foodstuffs and exposed the fraudulent nature of many packaged medicines. He also worked with manufacturers who wanted their disreputable competitors run out of business. By the early twentieth century, Wiley had gained the help of several popular writers, the best known of whom was Upton Sinclair. The 1906 publication of Sinclair's *The Jungle*, which contained graphic stories of noxious practices in the meat-processing industry, produced a public outcry strong enough to allow Wiley to push a compromise measure through Congress.

The 1906 Pure Food and Drug and Meat Inspection laws, which forbade interstate and foreign trade in adulterated and misbranded foods and drugs, were important regulatory achievements in the Progressive Era. The laws relied largely on the power of disclosure for their effectiveness; underlying the laws was the belief that once consumers knew the contents of a product, the good would drive the bad from the marketplace, but they also contained some stringent measures. Federal inspectors employed by the Department of Agriculture henceforth would grade meat before it went on the market. The large meat packers saw such activity as desirable, because it lent an assurance of quality that was especially important in export trade. Similar measures helped protect food canners with substantial investments in factories and brand names from fly-by-night operators. Although the system was far from perfect, its achievements were substantial. These laws seemed to prove that the application of scientific knowledge through government agencies could both protect the public interest and help responsible business firms.

*Banking and the Federal Reserve Board*

Other businesses also came under increased regulation during this period. Banking and currency policy disputes, as we have seen, had plagued the
American political system since the earliest days of independence. The Progressive Era witnessed the major resolution of those disputes with the creation of the Federal Reserve System in 1913. Bankers, other executives, and politicians reached agreement on the proper relationship between the government and banking and on a system for providing both a flexible currency and policies grounded in expert knowledge.

The legislation of 1913 came only after years of disagreement between bankers and other business leaders and among the bankers themselves over the types of assets acceptable as a currency base and the control of the banking system. The controversy over assets arose because the debt of the federal government was shrinking, while the volume of transactions in the economy was growing enormously. The system established during the Civil War had provided for banks to issue currency secured by federal bonds. But now that the number of bonds was shrinking, the bankers were pressing for a so-called assets currency, one in which high-grade corporate bonds, whose quantity enlarged with the economy's expansion, would serve as securities. Country bankers, from those thousands of institutions that had emerged to service the needs of the agrarian economy, insisted that the assets currency should include real estate securities, which were in plentiful supply in rural areas.

Complicating the matter still further was the issue of control. The banking system that evolved in the Gilded Age concentrated deposits in the huge
banks located on New York's Wall Street. In fact, this concentration of wealth was so great as to prompt widespread complaints about a "money trust"—the idea that a small, privileged, private group of men with offices in New York and an informal national and international network of communications controlled most of the nation's wealth. Such a concentration was disliked by many bankers and business people outside of New York, who believed that it should be federal policy to disperse control and allow greater influence to bankers in cities like Chicago, Detroit, and Cleveland.

These issues fermented as a result of the Panic of 1907. The banking system created in the Gilded Age turned out to be susceptible to occasions on which depositors withdrew their assets quickly, forcing banks to sell securities suddenly and threatening the entire financial system with collapse. In 1907, when withdrawal demand threatened to wreak havoc on banks and corporations, J. P. Morgan organized resources to shore up institutions faced with bankruptcy. Morgan saved the system but also confirmed the suspicions of the inordinate power enjoyed by a few financiers. The panic led to demands for change: first for an emergency measure to allow banks to issue currency secured by high-grade corporate bonds, and second for the establishment of a National Monetary Commission to study reform proposals and recommend a revamping of federal banking policy.

The studies of the National Monetary Commission, headed by Senator Nelson W. Aldrich of Rhode Island, eventually led to the creation of the Federal Reserve System, but only after a long, tangled political controversy. The commission consulted closely with Wall Street bankers and in 1911 recommended the creation of a central bank in New York City with fifteen regional branches. The private banks would control the central bank, which in turn would be authorized, among other matters, to issue a currency based on high-grade corporate securities. But these recommendations were unacceptable to many bankers and business leaders, for they failed to address the issue of the "money trust." They did not create a decentralized system that granted power to bankers outside of New York or to the business people who depended on banking services. And country bankers disliked the failure to recommend the use of real estate as a currency base.

Finally, Representative Carter Glass of Virginia arranged a compromise that pleased most bankers. The Federal Reserve Act of 1913 created a Federal Reserve Board with five members, each from a different district, appointed by the president. Instead of creating a single central bank, the law established twelve district Federal Reserve banks, each owned by the banks of its region. National banks were required to join the system; state banks might do so. Each district bank had a nine-member board; three members were appointed by the national Federal Reserve Board, three were bankers from the district, and three were nonbankers. The board in Washington directed overall policies. The law met the needs of the banking industry by allowing decentralization and an assets currency. The Wall
Street bankers were the most influential men in the new system. President Wilson made certain that they were represented on the Federal Reserve Board, and all foreign transactions were to go through New York's district Federal Reserve bank. The demand of country bankers for authorization to issue currency based on real estate assets was not met until 1917. Still, the system was so popular that almost all banks rushed to join it.

The Federal Trade Commission and the Antitrust Movement

In 1914, Congress created a new regulatory agency, the Federal Trade Commission (FTC), and passed a new antitrust law, the Clayton Act. Like other forms of regulation, both events involved compromises, and both were a product of agitation and associationalism among different sectors of the business community.

By 1914, the business community had reached a general consensus on the desirability of having a Federal Trade Commission. Small business people—retailers, grain dealers, and the like—desired an agency with broad investigatory powers that could order a halt to the monopolistic practices by big companies threatening to bankrupt their small firms. Big business sought a depoliticization of the trust issue and a structure that would lend continuity to federal trust policy. Partners in the House of Morgan were particularly upset by the breakdown of the gentlemen's agreements they had arranged with the Roosevelt administration. In looking for new federal regulation, they were reacting against the policy of President William Howard Taft.

Unlike Roosevelt and Wilson, Taft was in fact a trustbuster. Under his administration (1909–1913) the Department of Justice launched many new prosecutions and brought others begun under Roosevelt to successful conclusions. In 1911, for example, the Supreme Court ordered the Standard Oil trust and the American Tobacco trust dissolved. Taft also launched a prosecution of United States Steel that especially enraged the Morgan interests. The House of Morgan had secured the approval of Roosevelt's Bureau of Corporations for the acquisition of the Tennessee Coal and Iron Company by United States Steel, an acquisition that gave the Pittsburgh-based firm a dominant interest in the southern steel industry. Taft dissolved the agreement and began an antitrust suit that accused United States Steel of unfairly monopolizing the industry because of this acquisition.

Executives of center firms and large banks wanted to remove such matters from the arena of informal private meetings with administration officials, who might change with the next election and who were always susceptible to the whims of public sentiment. Regulation of business, in their view, was best left to a nonpartisan body removed from day-to-day political considerations. Congress attempted to meet these wishes by creating the FTC in
1914. Each of the commission's five members was appointed for a seven-year term, and these staggered terms ensured long-running policies independent of shifting election results. Congress also granted the commission broad investigatory powers. When the FTC found violations of the antitrust law, it could order them stopped, subject to court appeals.

The Federal Trade Commission Act had a companion, the Clayton Act of 1914, which revised the antitrust laws. The Sherman Act of 1890 had proved to be too vague to satisfy either business or its opponents, so Congress tried to clarify matters in the new bill. The Clayton Act outlawed interlocking directorates in financial firms capitalized at more than $1 million; such firms were not allowed to own stock in other companies if the effect was to reduce competition. The law also forbade "tying contracts" in which large firms prevented their suppliers from doing business with their competitors. And it condemned price discrimination that tended to limit competition. Further, it declared that trade union activities and farm cooperatives did not constitute "combinations in restraint of trade."

Although the Clayton Act gave more clarity and structure to antitrust law, Congress, because of the great diversity of the business interests concerned, was unable to make the law as precise as some wished. The law did not affirm Wilson's earlier call for a "new freedom" for the individual from the center firms; nor did it forbid, as some reformers wished, any firm from capturing more than a specified share of an industry's market. Instead, Congress empowered the FTC to conduct the daily work of trust regulation and the attorney general to seek court rulings to clarify policy.

**Tariff Politics and Federal Regulation**

The tariff issue continued to plague national politics in the early twentieth century, but during the Progressive Era tariff politics became intertwined with the trust issue. Business associations and reformers began to call for a system of determining tariff rates "scientifically," apart from the pressures of special interests. At the same time, advocates of tariff reform interacted with those who were calling for vigorous antitrust prosecutions.

Some reformers insisted that the tariff was the "mother of trusts" and that adjustments in tariff rates could restore competition to the American business system. The tariff, in their view, contributed to inequities in the distribution of wealth in American society. Some industries that enjoyed protection from foreign competition seemed to enjoy high profits. In the meantime, American consumers paid high hidden taxes when they bought needed imported items. In the eyes of the reformers, a "scientifically" derived tariff schedule designed with the public interest in mind would lower if not eliminate these "regressive taxes" on American consumers. At the same time, the reformers argued that the federal government should
impose an income tax on wealthy Americans, a "progressive" tax levied according to the ability to pay.

The ideas of the reformers were not new to the Progressive Era, but they received more publicity and serious attention from politicians than before. The National Association of Manufacturers began pressuring for a system whereby a business-dominated commission would determine tariff rates flexibly, with promises to lower American duties when other nations allowed American goods to enter their markets freely. After it was organized, the United States Chamber of Commerce also took up the call for a flexible system of tariffs designed to ensure greater free trade for American exporters. Even the American Federation of Labor, no longer convinced that high American duties protected high American wages, supported tariff reform.

Tariff reformers enjoyed some successes in the Progressive Era, although the tariff issue was, as always, embroiled in partisan politics. The Payne-Aldrich Act of 1909 provided little relief from existing protective measures, but it did contain some innovations, such as allowing the president to raise American duties by 25 percent when he determined that another nation was restricting American exports. The measure also called for a constitutional amendment to allow Congress to impose an income tax. The law failed to establish a tariff commission to advise the president, however, so President Taft appointed his own Tariff Board to give him expert advice. Congress was reluctant to cede authority over the tariff—and the potential favors to constituents—to a commission, however much the NAM and other business groups advocated the idea.

Tariff reform came only after Woodrow Wilson and the Democratic party assumed control of the government in 1913. Then Congress enacted the Underwood Tariff, which substantially lowered duties. Although it was not a free-trade measure, the Underwood Tariff did reduce rates to the lowest level since the Civil War. With the passage of the income tax amendment in 1913, Congress was able to make up for lost revenue by imposing taxes on the wealthy (the highest tax rate was 7 percent, and there was no withholding tax). But the law also took away the flexibility of the Payne-Aldrich Act, and Congress still declined to establish a tariff commission.

The final Progressive Era contribution to tariff politics came on the eve of the nation's entry into World War I. With the European war disrupting international trade and President Wilson pushing the measure, Congress finally created the United States Tariff Commission in 1916. As with the FTC, the terms of office of the bipartisan commission were staggered to ensure continuity of policy. Under the leadership of its first chairman, economics professor Frank W. Taussig, the commission pursued an advisory role. Taussig believed that elected officials should establish the direction of tariff policy and that the commission should ensure that the policy was put into practice fairly and dispassionately. Congress allowed the commission to work on lowering or raising duties, but elected officials always retained final authority over the tariff.
State Regulation of Business

The creation of the Tariff Commission at the end of the Progressive Era was the last instance before World War I whereby reformers turned to the federally organized commission format for the regulation of business. The use of commissions as responses to the wishes of business associations, the findings of economists, and the complaints of reformers during the Progressive Era also, however, occurred at the state level, where many political leaders looked for fresh ways to shape local business environments.

In the period before World War I, almost all state governments used the commission as a device for regulating business, especially railroad freight and passenger rates and utility rates. By the second decade of the twentieth century, in fact, railroad managers were complaining about their "forty-eight masters." Prior to 1914, state commissions sometimes set rates to benefit local shippers at the expense of distant competitors, but in that year the U.S. Supreme Court clearly forbade states from controlling freight rates so as to have any impact on interstate commerce. After this ruling, the states limited themselves to local rates—some also served as advocates of local shippers before the ICC.

Many national corporate leaders disliked state regulation, not because it was directly hostile to business interests but, first, because it was difficult for a firm doing business in several or even all states to conform to regulations emanating from many different state capitals at once. This was the source of the railroad managers' complaints of "forty-eight masters." And second, state regulation was usually designed to foster the interests of local, and usually smaller, firms and to protect them from competitive pressures from large, vertically integrated, efficient manufacturers and distributors. This situation was particularly acute in the South and the trans-Mississippi West. Up to the middle of twentieth century, those regions suffered from a kind of colonial dependency, sending agricultural goods and raw materials to the cities and factories of the North and East in exchange for finished products. Southern and western entrepreneurs interested in boosting local manufacturing allied with local politicians in attempts to use state regulation to redress the balance.

The use of state antitrust statutes demonstrated this approach clearly. Texas was active in the antitrust field because many of its business and political leaders were convinced that eastern interests were thwarting local development. In the nineteenth century, Standard Oil enjoyed a near monopoly in the oil industry. But subsequent to the opening of vast new oil fields in Texas after 1901, Texas law restrained Standard's activities in the state and promoted the development of two new major oil companies, Gulf Oil and The Texas Company.

State Regulation of Working Conditions

State governments also regulated working conditions during the Progressive Era. The Supreme Court maintained that conditions inside a factory
Bad working conditions—here small boys separate slate from coal—prompted state regulation of work in the Progressive Era. (Library of Congress)

were a local concern, outside of Congress’s power to regulate interstate commerce. When Congress outlawed the employment of children, for example, the Court ruled the measure unconstitutional. Nevertheless, many Americans considered unregulated factories undesirable places for the employment of both children and women. Northern states passed laws, for instance, restricting the hours and regulating the working conditions of female employees. They also forbade the hiring of children under the age of fourteen and under the age of sixteen for night work.

Reformers enjoyed notable successes in furthering the cause of industrial safety by the end of the Progressive Era. Economists and other observers wrote about the rates of injury, which were high during this period, and the harmful effects of injuries not only on individual workers but on their families and communities as well. They also worked for systems of state regulation that would effectively force employers to improve safety conditions in plants. The result was the creation of state systems of workers’ compensation, either through private insurers or as pioneered by Ohio in 1911.

The workers’ compensation reform tied the economic interests of business firms to programs to improve industrial safety. Before the reform, when a worker was injured on the job, he or she could sue for damages in the courts. Businesses were usually able to rebuff their complaints by citing the common law argument that the injured worker had accepted the possibility of injury as part of the job and was therefore responsible for his or
her injury. Nevertheless, juries sometimes granted large awards to injured workers. Led by the new-school economist John R. Commons, the reformers created a program designed to give workers a safer environment. Under workers' compensation, the state government insured workers against injury and adjudicated damage claims through an administrative agency (not the courts) according to a schedule of payments rated by types of injuries. Workers' compensation required employers to purchase state insurance, but their premium costs went down when they cooperated with government experts to devise safer working conditions. This program appealed to business as a practical solution to a real labor problem, and associations like the NAM promoted the idea in many state capitals.

State regulation thus became an important factor in the daily lives of many employers and their workers. The problem, from the point of view of business, was that passage of a law in one state could work to the competitive disadvantage of local firms in another state. Federal measures were unlikely to survive a Supreme Court test, given the judicial climate of the day, so the only alternative seemed to be uniform state legislation. One important activity of business associations, thus, was to attempt to have states enact "model" regulatory laws. The idea behind the movement for uniform state legislation was simple: if each state passed the same law and imposed the same regulatory costs, no firm would have a competitive advantage stemming from the fragmented nature of the American governmental system. Business associations spent much time and energy on this matter, but uniform legislation was difficult to achieve in the face of the multitude of special and local business interests characteristic of American society.

The Supreme Court and Reform

The business firms and associations that wanted to resist the efforts of reformers and regulatory agencies often found an ally in the federal courts. Court actions, in fact, had a profound impact on the regulation of business. In the early twentieth century, the Supreme Court often ruled against regulatory measures, especially, as we have seen, those concerning labor. Between 1899 and 1937, the Court used the doctrine of "substantive" due process to strike down state regulatory measures in 184 cases. When the Court found that the "substance" of a law was to deny a corporation its right to life, liberty, or property, it declared the law invalid. This doctrine discouraged both federal and state attempts at regulation.

The Court had an especially profound impact on the antitrust movement. As we saw in the case involving the American Sugar Refining Company in 1895, the Court ruled that a monopoly in manufacturing was not a restraint of trade under the Sherman Act. The Court asserted that a manufacturing monopoly enacted in one state did not "directly" affect interstate commerce even though the factory's products were sold across state borders. This decision caused a furor, and Theodore Roosevelt warned that it would effectively nullify the antitrust law. Not long thereafter, in 1899, the Court
ruled that small firms in the same industry could not arrange contracts to control interstate sales. The net effect of these two decisions was to encourage the late-nineteenth-century merger movement, for though it seemed legal for one firm to dominate an industry, it was clearly illegal for smaller firms to control an industry through some arrangement of private associations.

In the Progressive Era, the Supreme Court still retained its prerogative of deciding what "trusts" were legal. In the Northern Securities case of 1904, the Court dissolved the combination of three railroad systems in the Pacific Northwest and thereby asserted the supremacy of federal power. In 1905, the Court ruled against practices of integrated meat-packing firms that amounted to collusion and price fixing. Most dramatically, the Court ordered the Standard Oil and American Tobacco trusts to be dissolved into smaller units in 1911. Rockefeller's firm was required to split into seven smaller oil companies. In these cases, the Court enunciated a "rule of reason" doctrine under which it declared that large firms that did not have an undue impact on competition were allowable. When it applied its "rule of reason" to Standard Oil and American Tobacco, the Court found that those combinations were illegal, because they were so large as to prevent competition. This doctrine allowed the Court flexibility in future cases, and in the 1920s it refused to dissolve other large integrated firms when they operated without monopoly control over pricing in their industries.