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Commentary

Title:

"Everything Wrong with the Economic Policies of Theodore Roosevelt"

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Through executive orders, "crises," and quick power grabs, Theodore Roosevelt transformed the American presidency. A coal strike in Pennsylvania became the first "crisis" that Roosevelt used to increase executive power. Coal miners with the United Mine Workers union went on strike in 1902 for higher wages. When the mine owners refused the union demands, Roosevelt intervened and insisted they negotiate. In fact, he threatened to send in federal troops to run the mines if an agreement wasn't reached. Roosevelt's threat was clearly unconstitutional and his cabinet told him that. But the mine owners were bluffed; they gave the miners a 10% raise and they all went back to work.

Roosevelt invented a "stewardship theory" of the presidency to defend his bold actions. "Occasionally great national crises arise," Roosevelt argued, "which call for immediate and vigorous executive action, and that in such cases it is the duty of the President to act upon the theory that he is the steward of the people, and that the proper attitude for him to take is that he is bound to assume that he has the legal right to do whatever the needs of the people demand, unless the Constitution or the laws explicitly forbid him to do it."[1] Of course, in the coal strike, Roosevelt's actions were unconstitutional. But since the case was resolved before the courts could rule on it, Roosevelt escaped censure.

Roosevelt continued to expand executive power on economic issues. Unfortunately, he had almost no training and no helpful economic or business experiences to guide him. His parents bought him what he needed, gave him money to spend, and paid for his education at Harvard and at Columbia Law School. At age 25, when his young wife died, T.R. left New York for North Dakota to become a cowboy and rancher. He bought land and cattle, but in less than three years he had squandered most of his family's fortune. He didn't have the savvy or the attention to detail to buy and sell successfully.[2]

Once in politics, Roosevelt made even worse investments—this time with taxpayers' money. In 1898, for example, as Assistant Secretary of the Navy, Roosevelt backed a federal subsidy for scientist Samuel Langley to invent the airplane. But Langley's two flights crashed into the Potomac River. Nine days after Langley's second crash, the Wright Brothers, with only $2,000 of their own money, made the first airplane fly.[3]

Once in the presidency, Roosevelt faced the issue of railroads, which had become the largest business in America. In fact, by 1900, the U.S. railroad system had become the largest and best operated transportation network in the world—with the lowest costs per mile for its customers.

The key principle about railroads is that they are a "fixed cost" business that operates most efficiently through "economies of scale." What that means is that a railroad's costs to operate are mostly fixed. It has to pay for equipment, track, rolling stock, fuel, and the conductors and employees before any freight can be transported. But once those fixed costs are paid, a railroad can transport high volumes of freight without incurring much more expense. Therefore, as a railroad carries more volume, average costs decline rapidly. If the New York Central Railroad, for example, carried sixty carloads of wheat from Chicago to New York, its total costs would be not much more than those incurred by the Erie Railroad, which might only be carrying six carloads of wheat on the Chicago to New York route. Under these circumstances, railroads had huge incentives to give discounts, or rebates, to large shippers because each new carload of freight added very little to total costs. Railroad companies also had incentives to expand through mergers to reach more cities, and gain even more from economies of scale.[4]

By 1900, the U.S. had seven or so very large railroad corporations that all did huge volumes of business and gave large rebates to the customers who gave them the most carloads of freight.

Not surprisingly, from 1870 to 1900, the costs for shipping on railroads had plummeted by almost two-thirds.[5]

Most Americans welcomed having the cheapest and most efficient railroad network in the world. They were pleased to receive low cost oil, lumber, food, and clothing via railroad from hundreds of miles away. The progressives, however, led by President Roosevelt, became the exception that changed the rules. Roosevelt believed that the railroads posed a moral problem in America for at least two reasons. First, their size and power posed a threat. Some railroads were near monopolies in their regions; perhaps they had the potential to crush competitors, restrain trade, and jack up prices later. Second, and more important, Roosevelt thought the system of rebates was immoral and unfair. Railroads, for example, gave John D. Rockefeller, the first billionaire in U.S. history, huge rebates to ship his oil but gave his smaller competitors fewer and lower rebates. Why not charge all shippers equal rates? Smaller shippers all over the United States cheered on this thinking. If rates were somehow averaged out, the many thousands of smaller shippers would pay less and the fewer number of large shippers would pay more. Of course, if Rockefeller's rates were raised he might shun the railroads entirely and transport most of his oil in pipelines—an option that critics of rebates rarely considered.[6]

At the political level, Roosevelt believed there were votes to be gained by attacking rebates and supporting the smaller shippers. At the economic level, he had little interest in the economies of volume traffic that were inherent in the railroad industry. At the moral level, Roosevelt believed that all rebates were unethical, and he wanted to make them illegal.

The Sherman Anti-trust Act became the first of two laws that Roosevelt would use against railroads. Congress had, without much thought, overwhelmingly passed the vague Sherman Act in 1890. The language of the Sherman Act outlawed "every . . . combination . . . in restraint of trade." No one knew what that meant because even a local grocer who discounted the price of oranges was restraining trade in oranges from another grocer two blocks down the street. Few cases came before the Supreme Court on the Sherman Act after it was passed because no one knew how it might be applied. Roosevelt wanted it defined and applied in a way he could use against the railroads. He wanted to create a legal case that would allow the Supreme Court to put teeth into the Sherman Act that he could use to bite large railroad combinations.[7]

Roosevelt's target was the remarkable James J. Hill, a rags-to-riches immigrant who rose to become perhaps the greatest railroad operator in the U.S. Hill was president of the Great Northern Railroad, which he ran with astonishing efficiency from St. Paul to Seattle. Under Hill's leadership, the Great Northern surpassed and almost sent into bankruptcy his two largest competitors, the Union Pacific and Northern Pacific Railroads. Since both of those railroads had been created through federal subsidies, their failure to match Hill, who had no federal subsidy, exposed intervention by the government in railroading as the source of more harm than good.[8]

In 1901, Hill joined forces with titan J. P. Morgan to form the Northern Securities Corporation, a holding company that operated three large railroads. Gaining greater economies of scale from combining three railroads into one holding company, Hill and Morgan further cut rates for customers in the years after their Northern Securities Corporation was formed.

Roosevelt, however, brushed aside the issue of economic efficiency. The proper question was a moral one: some corporations were "good," but the Northern Securities Corporation was "bad." He asked his attorney general to use the Sherman Act to split up Northern Securities into smaller pieces. The Supreme Court heard the Northern Securities case in 1904 and voted 5-4 to break it up. Justice John M. Harlan, who wrote the majority opinion, like Roosevelt did not consider relevant the economic record of Hill's company, only that it "tends to restrain . . .

commerce." Roosevelt was thrilled with the result and bragged that the Northern Securities case gave "complete control to the National Government over big corporations engaged in interstate business." At last, Roosevelt's view of morality, not the natural right to develop private property, would direct the future of railroading in America.[9]

With the power to regulate the size of corporations now centered in the executive branch, Roosevelt moved to control the power to set the rates railroads could charge. In this battle, Roosevelt's tool would be the Interstate Commerce Commission (ICC), a small federal agency created in 1887 to gather information about railroads and prevent abuses. Roosevelt, with full support of the bureaucrats running the ICC, hatched a plan to give the ICC new power to regulate railroad's rates. He openly campaigned for congressmen to pass the Hepburn Act, which would enlarge the staff at the ICC and give it authority to set "just and reasonable" rail rates.[10]

Railroad owners were appalled. They argued that their ever falling rates were already "just and reasonable" because shippers were using railroads more than ever to send larger amounts of oil, food, clothing, and lumber (for houses) to eager homeowners all over the country. In any case, what would a vague term like "just and reasonable" mean to the ICC members, who had no experience operating railroads and making the economic calculations necessary to cut costs and still make profits? But the Hepburn Act did become law in 1906. And it, like the Sherman Anti-trust Act, became another vague law that would be defined in a way to be used against the railroads.

Since the Hepburn Act demanded that railroads set "just and reasonable rates," the seven members of the ICC concluded that they needed to thoroughly investigate the financial records of the railroads. Therefore, in 1913 the ICC created the Bureau of Valuation, which hired a massive number of accountants to examine any and all financial records of railroads and their property. After almost twenty years of investigation, at the cost of hundreds of millions of dollars, the Bureau of Valuation concluded that railroads had in fact been charging reasonable rates the whole time. Put another way, the Bureau of Valuation spent an amount greater than 20% of the entire U.S. national debt in the year the Bureau was created to discover that railroad operators were using their own private property in a sensible manner.[11]

True, the Bureau of Valuation was created after Roosevelt left office, but in a regulatory agency that he had first empowered. The consequences of his activist presidency were often like that. His military interventions in Panama and the Dominican Republic were precedents for interventions later in the 1900s in Korea, Vietnam, and Iraq. Roosevelt supported a progressive income tax because he thought the wealth of rich people was not entitled to equal protection of the law. Such wealth, "by the mere fact of its size," Roosevelt believed, made it subject to a higher rate of taxation. But just thirty-one years after the income tax became law, the U.S. had a 94% tax on all income over $200,000. The Hepburn Act of 1906, a landmark law that greatly empowered the federal government, was followed later: by a landmark federal program for farmers that paid them not to grow crops; by the first federal welfare program, which gave almost one-third of its funds to Illinois and Pennsylvania, but none to Massachusetts and Connecticut; and by a program of federal aid that subsidized near illiterate students to go to college.[12] Roosevelt himself probably would have abhorred all three programs, which were passed by three different presidents, but he had made the arguments that opened the door for the federal intervention that helped make these programs a reality.

In Roosevelt's last year in office, he wanted to help ensure that his precedents for a stronger presidency continued long after he was gone. To symbolize this permanent shift, Roosevelt changed American coins to reflect the decline of liberty and the rise of the presidency. Usually, Lady Liberty adorned the front of American coins. In 1909, however, T.R. maneuvered to put an

image of a past president, Abraham Lincoln, on the U.S. penny. In the next decades, the nickel, the dime, the quarter, the half dollar, and the dollar coins all discarded Lady Liberty for images of American presidents. The circulation of all American coins today, then, reminds us daily of the transition of power to the presidency and the continuing influence of Theodore Roosevelt.

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[1] Theodore Roosevelt, *An Autobiography* (Boston: Da Capo Press, [1913] 1975), 479-93; Lewis L. Gould, *The Presidency of Theodore Roosevelt* (Lawrence, Kan.: University of Kansas, 1991), 66-71.

[2] Edmund Morris, *The Rise of Theodore Roosevelt* (New York: Ballantine Books, 1979), 372-73; and William Henry Harbaugh, *Power and Responsibility: The Life and Times of Theodore Roosevelt* (New York: Farrar, Straus and Cudahy, 1961), 51.

[3] Burton W. Folsom, Jr. and Anita Folsom, *Uncle Sam Can't Count: A History of Failed Government Investments, from Beaver Pelts to Green Energy* (New York: HarperCollins, 2014), 117-38.

[4] In my analysis of railroads, and Roosevelt's attack on them, I am especially indebted to Albro Martin's two books, *Enterprise Denied: Origins of the Decline of American Railroads, 1897-1917* (New York: Columbia University Press, 1971) and *James J. Hill and the Opening of the Northwest* (New York: Oxford University Press, 1976).

[5] Martin, *Enterprise Denied*, 18-21, 36-45; and Jim Powell, *Bully Boy: The Truth about Theodore Roosevelt's Legacy* (New York: Crown Forum, 2006), 130.

[6] Roosevelt, *Autobiography,* 448-52; Martin, *Hill*, 512-15; Ari and Olive Hoogenboom, *A History of the ICC* (New York: Norton, 1976), 4-5, 46-52.

[7] D. T. Armentano, *The Myths of Antitrust* (New Rochelle, N.Y.: Arlington House, 2006), 50-55; and Jean M. Yarbrough, *Theodore Roosevelt and the American Political Tradition* (Lawrence, Kan.: University Press of Kansas, 2012), *153.*

[8] Martin, *Hill*, 513-15; Roosevelt, *Autobiography,* 442-45; Hoogenboom, *ICC,* 46-47.

[9] Martin, *Hill*, 514-20; Armentano, *Myths*, 58-62; and Roosevelt, *Autobiography*, 444.

[10] Roosevelt, *Autobiography,* 449-52; Hoogenboom, *ICC*, 12-27, 50-59.

[11] Martin, *Enterprise Denied*, 177, 228, 268-69, 306n; Hoogenboom, *ICC*, 61-64, 68, 100.

[12] U.S. Department of Commerce, *Historical Statistics of the United States: Colonial Times to 1970* (Washington, D.C.: Bureau of the Census, 1975), II: 1095; Edward A. Williams, *Federal Aid for Relief* (New York: Columbia University Press, 1939), 50-51.