

## TOWARD A NEW DECENTRALIZATION

by Robert Jawitz

While some centralization in business happened in the US in the late 19<sup>th</sup> century and early 20<sup>th</sup> century (the “robber barons”), most happened in the late 1920’s. This was entirely due to the market speculation and the introduction of margin purchases of stock that caused the hyper-inflation of the stock market in 1928 and 1929. According to John Kenneth Galbraith, in his classic “The Great Crash- 1929”, the market spurred consolidations (mergers) because of easy sale of securities to finance them. In those last years of the 1920’s, the US witnessed the creation of US Steel, International Harvester, International Nickel, and American Tobacco, just to name a few. According to Prof. Galbraith, “The primary motivation in all but the rarest cases was to reduce, eliminate or regularize competition” These mergers went beyond industrials and included electric, gas, water, bus and milk companies and then to food retailing, variety stores, department stores and motion picture companies. Thus, the primary impetus for centralization of commerce in America was monopoly.

To expand the base of participation in the stock market, the investment trust was born. An investment trust was a device where the unsophisticated investor can employ professional investors in the selection of their stocks and can, with one purchase of stock (those of the investment trust), have the benefits of a diversified portfolio. As an example of how this worked, Goldman Sachs & Co. (an investment banking and brokerage house) created an investment trust called the Goldman Sachs Trading Corporation in December of 1928. The initial stock offering was \$100/share. It sold the first day at \$104/share. On February 2<sup>nd</sup>, it sold at \$136.50/share. On February 7<sup>th</sup>, it sold at \$232.50: easy money. On July 26<sup>th</sup>, they started another one, the Shenandoah Corp. The stock was issued at \$17.50/share. It opened that day at \$30/share and closed that day at \$36/share: easy money.

This huge increase in the demand for stocks and bonds created a need for supply. Here’s where the centralization of commerce began. Some companies saw the opportunity to quickly raise large amounts of cash, usually at many times the prudent market capitalization, and use this money to purchase their competitors. The knowledge of how to do this made the purchasers smug. They felt justified because the local and small companies were “naïve or incompetent”. The truth is they were either too small to go public or they didn’t want to participate in this speculation fever that was raging across the country. Don’t forget, speculation is a form of gambling and money-changing was considered a sin. In any case, these large centralized regional and national companies were born out of a desire to monopolize, anathema to a healthy capitalist society.

The first day of a long market slide, was October 24, 1929. The Industrial Average started before that Thursday at 448. A big slide happened on October 29, 1929 (Black Tuesday) and by November 13, 1929 it was 224, half its value. On July 8<sup>th</sup> 1930, it was 58. The Goldman Sachs

Trading Corporation's stock which sold at \$232.50 on February 7<sup>th</sup>, 1928, was trading at \$1.75 in May of 1932. Those people who used margins to buy their stocks, when the stock went below its appraised value, got "margin calls". When they couldn't meet them they lost their bank accounts, their homes, their farms.

Now we are in the midst of another economic crisis. FDR coined the term "depression" because he thought it was less scary than "crash" or "collapse". Whether or not we are in a depression remains to be seen. But, already, we are seeing these large conglomerates getting into trouble. General Motors was created by William Durant in 1908 out of the stock market crash and financial crisis of 1907 (under the same circumstances that other large companies were created in 1929). Now General Motors, with the other two auto makers, are facing bankruptcy. These mega-companies represent an industry that supports 1 out of every 10 wage-earners in America. What would happen if this crisis mimics the other one? After the "crash", the US unemployment rate went from 3.2% in 1929 to 24.9% in 1933 (when FDR took office). According to the Bureau of Labor Statistics, unemployment in 2007 was 4.6% compared to the 3.2% of 1929. In October, 2008, the unemployment rate was 6.5% one point less than in 1930 when the unemployment rate was 7.5%. What would happen if these conglomerates, these merged companies, these centralized corporations were no longer able to service their debt and were to go bankrupt. People say that won't happen because Obama won't let it happen. Hoover tried to save the 1929 collapse and engineered huge bailouts (through "organized support"). But it failed. Hoover announced big cuts in taxes (2/3 to 1/2), but it was insignificant. FDR did his best with his New Deal but unemployment was still 17.9% in 1939. Galbraith said, "The singular feature of the great crash of 1929 was that the worst continued to worsen".

We have a very complicated economy and the collapse of these large companies would have ramifications throughout it. GM, as an example, may be large, but it supports a myriad of small businesses such as sales showrooms, repair shops, parts suppliers, advertising agencies, transport companies, etc. No one should wish this collapse to happen and our leaders should do all they can, (as they are), to prevent not only large companies such as GM from collapsing but to also support liquidity in the banking system so as to keep all companies afloat. But our government will be constrained by capacity. Somewhere in the scenario of acquiring more national debt to prevent these collapses there is a limit and if we can't prevent this collapse within the limit, the collapse will happen anyway.

Furthermore, we have other demands on our society. Fuel costs, while moderated lately, are destined to rise and stress our economy and the households within it. We have terrible environmental consequences if we don't change our habits of energy waste and energy sources, from fossil fuels to renewable fuels. As we discussed in our companion articles, "The 21<sup>st</sup> Century Challenge", "Where Do We Go From Here" and "The Post Industrial Culture", we need to advance beyond the oil and coal based industrial revolution.

So what can we do when these large companies shrink or fold? What can we do if the collapse happens? What will happen if our unemployment rate doubles or triples as it did after 1933 and remained high until the 2<sup>nd</sup> world war. Certainly we don't want a war to get us out of a depression.

So let's try to formulate a scenario that can plan for our economic recovery as well as address the energy and environmental urgencies. Let's call it "The New Decentralization".

In the past, when large numbers of skilled and technically proficient people were laid off from big companies, they started their own companies. These small companies found themselves more productive than the original companies (not saddled with debt and labor commitments) and were able to compete with them. The mega-farms that have been created because corporations could buy the smaller ones (because of securities financing), if they fail, can be worked back into smaller farms. A typical 3-5 acre organic farm operated by a single family earns approximately \$34,000/acre now (far and above the average per acre yield of a large mega-farm).

Small business (if we define it under 500 employees) is already the major part of the economy. According to the US Census Bureau, in 2004, the latest year statistics were available, of the 5,885,784 firms in the country, 5,868,737 were of firms less than 499 employees (99.7%). Of the 135,400,699 people employed, 19,523,741 were self employed (14.4%), 59,399,486 were employees in firms under 499 employees (43.9%) and 56,477,472 were employees in firms over 500 (41.7%). In other words, only 17,047 firms (only .3% of the total) employ 41.7% of the workforce. It is this .3% of the businesses, these big regional, national and international conglomerates, that run the risk of collapsing our economy. Looking at the inverse, it is the potential of small business to absorb the anticipated unemployment caused by the collapse of the big firms and help save the economy. As Nydia Velázquez, Chairwoman of the House Committee on Small Business said. "We must continue to take actions to assist small firms, as they will ultimately be the drivers of the economic recovery." Small business development will be the cornerstone of the new decentralization.

It is appropriate that it happens this way in the 21<sup>st</sup> century. The demise of the oil culture, be it from supply, because of national security or the environment, will require us to drive less and transport goods shorter distances. We will need to decentralize commerce. The need to develop alternative sources of energy, like wind, solar, small hydro, geothermal and wave energy, will require us to change the grid from being supported by centralized generation plants to what is now called distributed generation (DG). We, therefore, need to decentralize the grid.

All economists are now looking to the "green economy" to save us from the effects of our dismal balance of trade and the loss of our industrial base. The collapse of the big conglomerates will add to the ravages to our oil-based economy. The green economy can be made up of hundreds of thousands of small businesses that build, install and maintain solar panels, develop the small hydro plants, the geothermal plants, the wind turbines, do recycling, insulate our buildings, make

the changes required to our electrical and fuel systems, grow, make, market and deliver biofuels, install the rail for our new transit systems, and, of course, grow the food when the large farms collapse.

But it still may not be enough. An additional 10% (from the existing 4.5% in 2004) to the unemployment rate in the US, would throw an additional 13,500,000 people out of work. In Germany, there were 38,300,000 people employed in 2004. Their green revolution, essentially developing wind, solar and small hydro companies, created 200,000 new jobs. That represents only ½% of its employment base. The US, with its employment base of 135,400,699, could expect a growth of jobs potential, using the German experience as a gage, of about 675,000 jobs from those three endeavors. A much greater job potential can be seen in the agricultural sector. In 2004, only 1% of the US labor force was involved in farming. That is down from 28% in 1920. An additional 5% of the labor force going back into farming, for both food and fuel, could add 6,770,000 jobs back to earning incomes. The key change, however, in a Post Industrial Culture is the return to a single wage earner per family. In 2004, of the 113,146,000 households, 77,010,000 were families. Of those, 58,109,000 were married with a median income of \$63,813/yr. Of those 70.5% had a spouse in the labor force for 1 or more weeks per year and 23.2% had a spouse working all 52 weeks. If half of those two wage earner families had their spouse stay home ( $23.2/2=11.6\%$ ), an additional 6,740,000 jobs need not be created. Those three actions alone, the development of alternative energy jobs, a modest return to small farms and a cultural change of the equivalent of one wage earner per family could absorb the loss of over 14,185,000 jobs. The key item in allowing the equivalent of one wage earner to stay home is the cost of the home. Our inflated housing market created the need for two wage earners to support the mortgage. The regulators allowed 40-50% of income to support a mortgage, when previously it was only 25%. If the government could assist in lowering the housing obligations of these families, then there is the possibility we can survive the collapse.

Government can play other roles in this transformation. It can stop subsidizing the oil and coal companies and, instead, encourage, educate and provide low interest loans to support small business. It can change the farm subsidy programs to favor small farms. It can support The Main Street Economic Recovery Act. It can support the SBA (Small Business Administration). It can support SBIR (Small Business Innovation Research), the STTR (Small Business Technology Transfer), and the TALF (Term Asset-backed Security Loan Facility). It can support alternative energy and conservation of resources by providing subsidies and loan supports until they can be market feasible. It can support the master planning for the decentralization of the suburbs and our new transportation network. It can support the transformation of our grid.

With this new emphasis, there is the possibility we can avoid “the worst continuing to worsen”. Of course, there will be pain. All change encounters pain. But, with a plan and a direction, we can have hope. This hope can be called the new decentralization.