Class Notes: The Rise of Big Business

Section 1:

Between 1869 and 1910, the value of American manufacturing rose from $3 billion to $13 billion. The steel industry produced just 68,000 tons in 1870, but 4.2 million tons in 1890. The central vehicle of this surge in economic productivity was the modern corporation.

The transformations that took place in American business following the Civil War involved far more than a change in industrial techniques or productivity. Business organization expanded in size and scale. There was an unparalleled increase in factory production and mechanization. By the beginning of the 20th century, the major sectors of the nation's economy--banking, manufacturing, meat packing, oil refining, railroads, and steel--were dominated by a small number of giant **corporations**.

The emergence of the modern corporation was accompanied by many positive developments. Through mechanization, standardization, and economies of scale, economic productivity soared. Between 1890 and 1929, the average urban worker put in one less day of work a week and brought home three times as much in pay. The proportion of families confined to the drudgery of farm life declined by half. Families enjoyed comforts and conveniences that were unimaginable before 1890. By 1929, nine out of ten Americans had electricity and indoor plumbing; four-fifths had automobiles; two-thirds had radios; and nearly half refrigerators and phonographs. At the same time, infant mortality fell by two-thirds, and life expectancy increased by 20 years. In 1888, Charles E. Perkins, the president of the Chicago, Burlington, and Quincy Railroad asked:

Have not the great merchants, great manufacturers, great inventors, done more for the world than preachers and philanthropists? Can there be any doubt that cheapening the cost of necessaries and conveniences of life is the most powerful agent of civilization and progress?

Yet the rise of big business also produced many anxieties. Corporations were accused of abusing workers, corrupting the political process, and producing shoddy, unsafe products. Many feared that corporate power allowed companies to fix prices and influence government decision-making.

Section 2:

During the late 19th century, a radical transformation took place in the way in which American business was structured and operated. The most obvious contrast involved the corporation's larger size and capitalization. The typical business establishment before the 1870s was financed by a single person or by several people bound together in a partnership. As a result, most businesses represented the wealth of only a few individuals. As late as 1880, the average factory had less than $1,800 in investment. Even the largest textile factories represented less than a million dollars in investment. In contrast, John D. Rockefeller's **Standard Oil Company** was worth $600 million and **U.S. Steel** was valued at $1 billion.

Another contrast between the new corporate enterprises of the late 19th century and earlier businesses lies in the systems of ownership and management. Before the Civil War, almost all businesses were owned and managed by the same people. In the modern corporation, actual management was increasingly turned over to professional managers. Within corporations, a management revolution took place.
In the days before big business, business operations required little in the way of management and administration. Companies usually involved only a few partners and clerks. Usually, an owner oversaw all of a business' operations. To insure honesty in a distant office, a merchant might staff it with a relative.
As businesses grew larger, new bureaucratic hierarchies were necessary. A business' success increasingly depended on central coordination. To address this challenge, businesses created formal administrative structures, such as purchasing and accounting departments. Various levels of managers were established, clear lines of authority were devised, and formal rules were created to govern the company's operations. The managerial revolution helped to create a "new" middle class. Unlike the older middle class, which consisted of farmers, shopkeepers, and independent professionals, the new middle class was made up of white collar employees of corporations.

Yet another sweeping change in business operation was the corporation's increased size and geographical scale. Before the 1880s, most firms operated in a single town from a single office or factory. Most sales were made to customers in the immediate area. But the new corporate enterprises carried out their functions in widely scattered locations. As early as 1900, General Electric had plants in 23 cities.
In addition to carrying out business in an increasing number of locations, the new corporations also engaged in more kinds of business operations. Prior to the Civil War, merchants, wholesalers, and manufacturers tended to specialize in a single operation. But the late 19th century, greatly expanded their range of operations.

During the late 19th century, businesses typically grew as a result of **vertical** and **horizontal integration**. When a company integrated vertically, it brought together various phases in the process of production and distribution. Thus U.S. Steel took iron ore from the ground, transported it to its mills, turned it into steel and manufactured finished products, and shipped the products to wholesalers. Somewhat similarly, the great meat packing houses like Swift, which had 4,000 employees, and Armour, with 6,000, combined the business of raising, slaughtering, transporting, and wholesaling meat. Swift developed a fleet of refrigerator railroad cars, which allowed it to bring cattle and hogs to a central packing house in Chicago, where the company could make use of every part of the animal "except the squeal."

When a company integrated horizontally, it expanded into related fields of business. In the 1850s, an iron furnace might produce a single product such as cast iron or nails. But U.S. Steel produced a vast array of metal goods.

During the last third of the 19th century, the American economy was dramatically transformed. After 30 years of periodic economic crises marked by high unemployment and large numbers of business failures, business began to consolidate into progressively larger economic units.

Mythmakers sometimes look back on the late 19th century as the golden age of free enterprise. But it is important to emphasize that the rise of a new economy did not take place easily. Working conditions in many factories were appalling. Labor conflict was intense. Businesses were accused of price fixing, stock watering, and other abuses.

In the end, these abuses would bring about a political reaction. To address the problems of corporate power, the federal government instituted new forms of regulation in the late 19th and early 20th centuries.

By 1906, six large railroad systems controlled 95 percent of the nation's mileage. As early as 1904, the 2,000 largest firms in the United States made up less than one percent of the country's businesses. Yet they produced 40 percent of the nation's goods. By the early 20th century, many important sectors of the American economy were dominated by a handful of firms, a condition that economists call "**oligopoly**."
Why did business grow bigger? The classic explanation stresses such factors as:

- the shift from water-powered to coal-powered factories, which freed manufacturers to locate their plants nearer to markets and suppliers.
- transportation improvements that meant that firms could distribute their products to regional or national markets.
- the development of new financial institutions--such as the stock market, commercial banks, and investment houses--that increased the availability of investment capital.

During the late 19th century, business competition was cutthroat. In 1907, there were 1,564 separate railroad companies in the United States, and two years later there were 446 companies manufacturing steel. The challenges of competition were compounded by frequent economic contractions, or **panics** as they were known. Violent contractions gripped the country from 1873 to 1878 and from 1893 to 1897. There were briefer contractions in 1884, 1888, 1903, 1907, and 1911. During the panic of the mid-1870s, 47,000 businesses went bankrupt. In hard times, the competitive marketplace became a jungle and businessmen sought to find ways to overcome the rigors of competition.

Faced with recurring business slumps, mounting competition, and declining profits, the boldest businessmen experimented with new ways of creating financial stability. The first attempt to overcome destructive competition was the formation of **pools** or cartels. These were agreements among competitors to divide markets and forbid price cutting. As early as the 1870s, pools were formed to divide markets, fix production quotas, and set prices. Over the years, pools became trade associations, which devised methods for dividing markets and assisting failing firms.

The problem with pools was that they rarely survived an economic contraction. Financial depressions tempted some firms to cut prices and seek a larger share of the market.

Pools were too weak to solve the problem of competition because they were voluntary agreements. An alternative was the **trust**, under which owners of rival firms assigned their stock to a single board of trustees in return for non-voting, interest-bearing certificates. The trustees then fixed prices and marketing policies for all the companies. John D. Rockefeller's **Standard Oil Company** was the first trust. Half a dozen industries followed, including alcohol distilling and sugar refining.

Trusts faced intense legal challenges on the grounds that they illegal restrained trade and violated the **corporate charters** of the participating firms. In 1890, Congress adopted the **Sherman Anti-Trust Act**, which declared trusts illegal. Trusts were then supplanted by a new legal entity, the **holding company**. This was a company with the power to purchase other companies. Perhaps the most famous holding company was General Motors, which purchased a number of automobile manufacturers.

A great surge in **mergers** took place in the American economy after 1897, when many of the largest corporations in such industries as steel and railroads were created. The number of mergers rose from 69 in 1897 to 303 in 1898 and 1,208 in 1899. By 1900, there were 73 combinations worth more than $10 million. Two thirds had been established in the previous three years.

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Section 3:

Earlier in American history, states attempted to keep tight reins over corporations. Corporations had to apply to a state legislature for a **charter**, which restricted the scope of the company's operations, limited the amount of investment, and even specified how long the charter would be in effect. But as the pace of economic activity quickened, it proved cumbersome for legislatures to grant individual charters. As a result, state legislatures adopted general incorporation acts which allowed any business to incorporate and removed limits on capitalization. Even in the 19th century, states, seeking revenue, competed with one another to get businesses to incorporate within their boundaries.

One source of public anxiety over corporations is summed up by a legal maxim, that "*a corporation has no pants to kick or soul to damn*." It was unclear what powers states had to regulate big business or who should be held responsible if a corporation committed a legal offense, such as fixing prices or polluting the environment.

In an 1877 case, Munn v. Illinois, which is also known as the "**Granger Cases**," the Supreme Court had ruled that a state law setting maximum rates for grain storage was constitutional, establishing the principle that states have the power to regulate businesses with "a public interest." In subsequent cases, the court retreated from this ruling. In an 1886 decision, **Santa Clara v. Southern Pacific Railroad Company**, the court held that the 14th Amendment's guarantee of due process applies to corporations. In another decision that same year, in the case of **Wabash, St. Louis & Pacific Railroad v. Illinois**, the court ruled that Congress has an exclusive right to regulate interstate commerce. The court subsequently invalidated a number of state attempts to regulate business operations.

In 1895, in the case of **U.S. v. E.C. Knight**, the court held that the Sherman Antitrust Act, adopted five years earlier, did not apply to companies located within a single state. This decision severely weakened the ability of the federal government to enforce antitrust laws.

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Section 4:

A great debate over big business took place during late 19th century. Among the issues that Americans debated was:

- whether wealth came from exploitation or from patience, frugality, and virtue;
- whether bigness was the result of conspiracy or of pressures of blind economic forces;
- whether men of wealth and power were free to use their riches as they wish or whether they should be taxed to support the public good.

Henry Demarest Lloyd, a precursor for the muckraking journalists of the **Progressive Era**, considered the lords of industry monopolists and profiteers, who blocked the road to success for those who tried to compete with them. Others, like Edward Atkinson, a successful investor and businessman, asserted that the great business titans made all Americans better off through their innovations in management, finance, and production. Lloyd and Atkinson helped set the terms for a long lasting public debate: Were the business leaders of the Gilded Age robber barons or creative industrial pioneers?

There can be no doubt that the late 19th century business titans were business innovators, who, through their technical, administrative, and financial skills, achieved economies of scale, eliminated waste, and brought order and stability to large sectors of the American economy. In large part, their wealth was the product of innovations that transformed business practice. Rockefeller developed the oil tank-car; Swift the refrigerated rail car; and Montgomery Ward the mail-order catalog. As philanthropists in later life, some also served important welfare and educational functions.

But big business' critics accused the captains of industry of financial trickery, such as cornering and watering stock, and of political corruption and the bribing of legislatures. They attacked them for the inhumane treatment of labor--including the imposition of heavy hours, wage cuts, lockouts and the suppression of trade unions. They also condemned them for using cheap immigrant contract labor to undercut wage rates and defeat **strikes**, as well as for imposing monopoly prices. Above all, they were condemned as sinister monopolists who engaged in ruthless competition - choking off rivals by use of railroad rebates and kickbacks, control of raw material supplies, industrial espionage, and the forced purchase of competing firms.

Many people likened J.P. Morgan, Jay Gould, and other business leaders to the "robber barons" of the Middle Ages, who set up barriers across rivers and forced boats to pay a toll in order to navigate the waterways. A U.S. Senator described Morgan as a "*thick-necked financial bully, drunk with wealth and power, [who] bawls his orders to stock markets, Directors, courts, Governments, and Nations.*"

<u>**Section 5:**</u>

In 1895, an attorney named Joseph H. Choate persuaded the U.S. Supreme Court to declare an income tax approved by Congress unconstitutional. Choate told the court that:

The act of Congress which we are impugning before you is communist in its purposes and tendencies and is defended here upon principles as communistic, as socialistic, what shall I call them, as populistic as ever have been addressed to any political assembly in the world.

As a result of the court decision in the case of **Pollock v. Farmers' Loan and Trust Co**., the United States did not institute an income tax until the 16th Amendment was ratified in 1913.

Choate rested his arguments partly on ideas associated with Charles Darwin, who published his theory of evolution in 1859. Darwin had argued that within nature, there was a process of competition within and between species, and that, through a process of natural selection, the fittest organisms prevail. Closely associated with the English theorist **Herbert Spencer** (1820-1903) and the Yale sociologist William Graham Sumner (1840-1910), Social Darwinism sought to apply the Darwinian principles of survival of the fittest and the struggle of existence to economics, ethics, and other realms of life. Social Darwinists like Spencer believed that this theory of evolution gave scientific validity to the notion that government should keep its hands off the economy.

Critics of Social Darwinism, including John Dewey and William James, rejected the notion that the process of social and economic change should occur unregulated, arguing that government should intervene to address the social ills that accompanied industrial development.