CONTENTS

PREFACE

The ideas and themes that are outlined in this book are the product of twenty years of trying to explain the economic process of American society to students in introductory courses in economics and economic history. As a teacher of both economics and history, I have always been dismayed by the degree to which the two disciplines are separated. Economists tend to be too preoccupied with their theories to devote enough attention to history, and historians seem similarly reluctant to devote enough attention to the economic theory that might assist in explaining the historical development of our economic system.

Since I am myself an economist by training (that is, I pursued my graduate studies in a department of economics), I will not presume to assess the magnitude of the losses that this gulf between economics and history imposes on students of history. I can, however, attest to the void that is created by the paucity of history in the study of economics. It is my contention that we are entering a period when, more than ever before, it is imperative to understand the historical roots of the institutional setting that governs our economic activity. The past fifty years have been ones of unprecedented change. If we are to make sense of our current economic problems, we must gain a better understanding of the economic and social changes that have swept over our economic system since the outset of the Great Depression. For better or for worse, American capitalism today is not the same economic system that existed in 1933 when Franklin Roosevelt launched his "New Deal." It is not even the same system that existed when John Kennedy called for a "New Frontier" in 1960. Yet the events and decisions that occurred during the administrations of Roosevelt and Kennedy helped shape the situation we have today.

The process of economic change in the United States is the focus of this book. Because that process has not always proceeded at a steady pace, we will concentrate our attention on certain periods in which significant reforms were introduced—though not always accepted—into the economic system. The methodology I employ is that of an economic historian who wishes to illustrate how blending economics and history can shed light on the ways in which economic activity both shapes, and is shaped by, the institutional framework of our society.

Since I was trained as an economist, and since economists (as I note in chapter one, the introduction to this book) have a singular preoccupation with "models" of behavior, the temptation to construct such a model of economic change was overpowering. Hence arose chapter two. But that dream, as the reader will quickly see, proved illusory, and what emerged instead was a discussion of the process of economic change and some of the more obvious economic relationships it involves. Since I was concerned with melding economics and history, I chose to examine several periods of American development with regard to that change. Hence arose chapters three, four, and five, which touch upon four periods when the pressures for change in the institutional framework of our economy were particularly severe. Finally, since I was concerned with the implications of all this on contemporary economic problems, I could not resist making some comments on those problems, viewed from an historical perspective. Hence arose chapters six and seven.

In any work of this sort, the whole is equal to much less than the sum of the parts. I have liberally drawn on the ideas of others throughout this book. Though I have indicated those cases in which I used some specific work of an author, I am indebted to many people who are not adequately recognized in the notes or text of the book.

Foremost among these are my students. For two decades now they have, with their questions and responses to my questions, forced me to rethink ideas, made me search for better ways to express my thoughts, and insisted that I place my narrow economic ideas in some broader framework. Most of them were probably not even aware that they were doing this; they were simply trying to find some way to get through the final (or comprehensive) exams. I thank them all.

I also have accumulated some more specific debts in preparing this manuscript. Professors Michael Moore of Bowling Green State University and Robert Craig West of Drake University each provided detailed and insightful criticisms which (I hope) substantially improved the manuscript. My erstwhile colleague at the University of California at Riverside, E. Kay Hunt, provided an exchange of ideas over many years which helped me to develop the themes expressed in the book. I benefited from the suggestions offered by Howard Sherman and Nai Pew Ong, who read early drafts of the manuscript. Finally, it has been my good fortune over the past decade to work closely with Richard Sutch of the University of California at Berkeley. Though he had very little to do directly with the writing of this book, Richard's influence surfaces in many places and in many ways. It was our work together on the postbellum South that first shaped many of the thoughts on institutional change which appear in this volume.

I have two very personal thanks to extend: to my brother, David, who constructed the "word processing machine" on which my manuscript was written; and to my wife, Connie, who never lost faith that my "BIP" (Book In Progress) would someday progress to the point of publication.

I will close this preface with a word to the reader about the style of the book. In its initial version, the text of the book was drafted from lecture notes. In an effort to retain the flow of ideas presented in those lectures, I have suppressed the urge to reproduce the many charts, tables, and graphs which are the staple diet of economists and economic historians alike. I hope the result will be a more readable book, a book which both economists and lay people can enjoy.

Roger L. Ransom

1 INTRODUCTION

There appears to be an increasing interest in the "dismal science" of economics lately. That is not surprising; a significant part of our lives is taken up by economic matters. Every day, Americans are bombarded with economic analyses in the morning papers, in the evening newscasts, in the weekly magazines. National economic policy, which has been front page news for years, has been joined—and often even pushed aside—by state and local economic news. The inside pages are filled with advice on how consumers and investors can best cope with the economic situation in our complex modern society. Even the sports pages have become filled with discussions involving the economics of tax shelters, deferred bonuses, and the capital improvements required to ensure the continued presence of the local football or baseball franchise.

Whether we like it or not, the economic system determines most of the choices available to us. It would be nice to understand a system that so permeates our day-to-day existence. Ironically, at the very moment when people are eager to hear what economists have to say, economists themselves are becoming less and less certain about what to say. This has not led them to say less. It has, however, created a situation in which both the producers and the consumers of economic theory are becoming more and more dissatisfied (or at least increasingly uncomfortable) with the existing explanations of our contemporary economic problems.

Economics as an academic discipline is almost exactly two hundred years old. During that period, economists have struggled—with mixed success—to provide insights into contemporary economic and social problems. The cumulative effect of these efforts has been to develop several analytical approaches to the study of economic institutions in our society today. Each of the major paradigms which currently are part of the science of economics is constructed around a logical framework which the economists call a "model." The assumptions built into these models are intended to reflect the salient features of the economic system in a manner calculated to demonstrate how the system works.

These economic models are, for the most part, deductive in nature. That is, they begin with some highly simplified assumptions about the nature of economic institutions and the behavior of people within that institutional framework, and then proceed to infer some logical consequences of those assumptions. If the economist is so inclined, he may then go back to the "facts" (or "data") to see if the conclusions of the model seem consistent with the results produced by the economic system itself. This testing of the economic model reassures the economist that the theory does (or does not) provide results that are a close enough approximation to the real world.

This approach has proven fruitful in producing insights into how various economies—particularly market economies—function. Working from a very abstract picture of the institutional framework and the way people behave, economists have been able to explain how the market system allocates resources and distributes income. They have also developed some important implications of how market behavior will affect not only the economic system, but other aspects of our society as well.

Unfortunately, the world is not a simple, abstract concept. It is possible to imagine an almost infinite variety of economic "models" which reflect "reality" as viewed by different economists. And the views of reality which economists have incorporated into their models have been varied indeed! This variety in approaches may, in part, account for why economists put forward so many divergent views on just about every subject. Economic models differ in the assumptions they make, the scope they establish for the analysis, and the style in which they present the analysis. To illustrate this variety, we need consider only a few of the possible ways in which economic models differ. Some models focus their attention on decisions made by individual groups (these are called "microeconomic models"); others concern themselves primarily with the outcome of many decisions on an aggregate level (these are called "macroeconomic models"). Some models are presented in a descriptive (or narrative) form; others employ sophisticated mathematical techniques for their exposition. Some models are primarily concerned with establishing the validity of empirical measurements of effects; others look for properties of the economic system which do not lend themselves to empirical measurement. Small wonder that lay persons are convinced that economists are confused. As George Bernard Shaw once noted: "If you laid all the economists in the world end to end, they would not reach a conclusion."

In view of the combinations and permutations of economic models available to explain what is supposedly a single set of problems, even the professional economist is at times hard pressed to recommend one model as "best." Yet amid all this variety there is at least one common thread. Virtually all the economic models built since Adam Smith started all this in 1776 have been formulated with a fixed set of postulates which define the institutional setting and the way people behave. And once this institutional setting is fixed, it is not allowed to change substantially as the story unfolds. As the group of economists who currently represent the dominant view put it, economic analysis is conducted subject to the caveat of *ceteris paribus,* or "other things equal."

Of course, other things do not remain equal over time. Indeed, the very process of economic activity, which is the focus of the economist's model, brings about significant changes in the structure of the economy and of society itself. In other words, change is not something external to the economic system; it is an integral part of the economic system. It is this feedback between the process of economic activity in one period and the institutional arrangements which govern that activity in subsequent periods that confounds the economic "models" predicated on a static institutional framework, making them of limited value in explaining events in an ever-changing world.

This is not to say that economic theory is of no use and should be abandoned altogether. Whatever their shortcomings, contemporary models of the marketplace have proven to be extremely valuable in examining the problem they purport to address: the allocation of scarce resources in a market society. We would be foolish to ignore this usefulness and not incorporate economic theory into our analysis of economic change.

In fact, to a considerable extent, people do behave as the economist presumes: They take their institutional setting as given, and not subject to drastic or sudden changes. However, whether or not they are always aware of it, people are also constantly working to change their institutional environment. New forms of activity, changes in the legal structure, and a myriad of other factors work to gradually alter the economic structure. That change is a *historical* process, a process which, with very rare exception, builds on the existing economic structure. Understanding the institutional environment at any point in time—and the direction of forces working to change that environment—requires a view that incorporates not only economic theory, but historical perspective as well. That is the aim of this book: to examine the process of economic change in the United States, utilizing both economic theory and perspective provided by the historical record. In doing so, I hope to present more than just the cold analysis of how economic forces or historical laws operate. I have tried to capture, at least in a small degree, the frustrations and successes of those who have had to cope with our economic system for the past two hundred years.

2

THE PROCESS of ECONOMIC CHANGE

Among the many challenges which confront every society, none is more pressing than the need to overcome scarcity. Conquering the "economic problem" (as economists have ingeniously labeled it) is vital to the smooth functioning of any social system. Somehow the scarce resources must be mobilized and employed in a manner which produces enough food, clothing, shelter, together with all the other goods and services desired by people. Through most of written history (and undoubtedly through all of unwritten history) there was a pronounced tendency for societies, once they developed a feasible solution to the problem of scarcity, simply to stick with the proven method. As long as it continued to prove a successful way to produce enough output and distribute that output among the members of society, the "traditional" method was likely to experience very little revision over successive generations. Indeed, there was likely to be strong resistance to even the suggestion of change.

This conservatism had a practical basis. Early societies were able to provide for themselves only by the barest of margins—margins which at times disappeared entirely. As a result, there was little room for the errors (and potential losses) that might accompany the trial period in which some new technique was first introduced. The consequences (whether good or bad) from any major "experiments" would affect not only the innovators, but others as well. Not surprisingly, individuals in "primitive" societies were seldom encouraged in any quest for new solutions, and when novel ideas did emerge, they typically consisted merely of revisions in the techniques already in use. Change was rare and seldom very "radical" when it did occur. Nevertheless, even very small changes can eventually produce significant alterations in the institutional arrangements and technology of a society. Towards the end of what we call the "Middle Ages," the economies of Northern Europe had progressed to the point where, in any given year, there was likely to be at least a small surplus which could provide a margin for experimentation.

As the fifteenth century drew to a close, this slow pace of economic growth was suddenly accelerated by the discovery of "new worlds." The potential for experimentation (and possible increases in the surplus available) was greatly expanded by the discovery of new routes to the Orient and the acquisition of territory in Africa and the Americas. The vast, uncharted areas of these new continents promised to free European economies from a dependence on the limited land of their own countries, offering new opportunities to their crowded populations. New resources meant that economic activity could expand, and expand it did. Great colonial empires were carved from virgin lands, or, where a desirable area was already occupied, by wresting land from its former owners by force.

The utilization of these new resources posed problems at the same time as they brought benefits. Europeans discovered that the rapid increase in economic activity which accompanied the development of colonial territories produced strong pressures for economic change. Traditional arrangements, with their reliance on replicating past situations, could not keep pace with the complex pressures that arose from the need to cope with the rapidly changing colonial activities of the sixteenth, seventeenth, and eighteenth centuries.

THE CHANGING ECONOMIC PROBLEM

By the end of the eighteenth century, the economic systems of several Northern European nations had been reorganized into a combination of individual property ownership and a system of market exchange which has come to be called *market capitalism*. In this institutional arrangement, the economic problem is solved through the actions of individual producers and consumers exchanging their products in impersonal marketplaces. Traditional methods of production could only survive if they were able to compete successfully with new alternatives introduced by entrepreneurs who hoped to gain an advantage in the marketplace.

Gradually, it became clear that successful invention brought rewards, rather than the threat of punishment, to those who discovered and introduced them. As a growing share of economic activity came under the influence of these market forces, the pressure for competitive behavior throughout society increased. The three centuries following the discovery of America saw a persistent increase in production and exchange among countries such as Great Britain and her colonies, the Low Countries, and a few other enclaves on the European mainland. These areas developed economies which depended upon the use of money and employed a capitalistic method of production. By the end of the eighteenth century, these economies had reached the threshold of the Industrial Age.

The changes which have occurred in the two hundred years since the American Revolution make the progress of the previous three centuries seem agonizingly slow. The European living in 1500 would have found much that was familiar had he been transported to the Europe of 1775. By contrast, an American of 1775 who was moved forward to the present would feel totally lost. Even if he were able to understand the miracles of present day technical developments, he would still be astounded at the social changes which 200 years of economic change had produced. One of the ironies he might notice would be the extent to which the process that freed people from the uncertainties of eking out a subsistence living with only a few crude tools has left us today entirely dependent upon an impersonal economic system which most of us do not understand and which we seem unable to control. A visitor from two centuries past might ask whether or not increases in economic security had kept pace with increases in physical comforts.

This increased importance of markets for both labor and the fruits of its production has created an interdependence among groups (and individuals) which has necessitated a complete restructuring of social as well as economic institutions. Whether we call it the Industrial Revolution or refer to it as a case of rapid industrial evolution, the transformation of America from the rural, agrarian society of the 1770s to the urban, industrial society of the 1980s involved enormous changes. Just how complete the transformation was can be seen by comparing the situation of the typical American family in 1775 with that of a family of today.

In the late eighteenth century, most families lived on farms which, by modern standards, were quite small. Social contact between families was, for the most part, confined to rather infrequent meetings with people who lived within a vicinity of only a few square miles. A trip of more than twenty miles over the "roads" of that time was a fairly strenuous undertaking for even a single person and horse; any significant baggage or freight greatly impeded the journey. Contact between persons and families did take place, of course. There were occasional community gatherings at church, and town meetings. From time to time some significant social event—a marriage, a funeral, or some special holiday—provided an occasion when news which had been gleaned from various visitors passing through the area could be exchanged, along with the usual local gossip.

The isolation of this life was evident in the economic situation of the family. Apart from the all-important role of the weather, the income of a colonial family depended primarily upon the size of their farm, the quality of their land, and the labor available from the family members living on the farm. The diet was monotonous, consisting of cereal, corn, and whatever fresh vegetables could be grown on the farm. The limited supplies of meat from animals slaughtered in the fall or spring might be supplemented from time to time by wild game or fish caught nearby, but, as areas became more settled, such opportunities became increasingly limited. Most of the utensils in the house and around the farm were made on the premises, as were all but the fanciest of clothes. Life on a colonial farm—and nine out of ten colonists lived on farms—was largely free from influences other than the forces of nature. In a normal year the bulk of the family's labor effort would go simply to maintain their modest material comforts. In a good year there would be a greater abundance of food and an opportunity to improve their situation; in a bad year the meals were smaller and more monotonous, clothes would be worn for an extra season, and any thoughts of luxuries had to be put aside.

Small though it was, the surplus wrung from the farm was important. It provided the family with the means to trade for those items which had to be purchased rather than made on the farm. Some of these were necessities such as salt, spices, gunpowder, and a few metal utensils; others were luxuries such as fine-spun cloth, tailored clothes or shoes, books, tobacco, and jewelry. Shopping trips more often involved a visit to the farm by some itinerant peddler selling his wares than a trip to the nearest village store by the farmer or his family. Still, the gains from trade were evident enough that most farmers were induced to expand production in the hope of increasing the surplus for the next year. Rudimentary though they were in colonial times, markets for farm products offered a strong enticement not only to increase production generally, but to concentrate on the most marketable crops. From the earliest years of settlement to the present, the American farmer had an eye on the market prices of his farm produce. The small surpluses of colonial times were the forerunners of the huge cash crops harvested on farms today.

The bleak existence of rural life in colonial America should not obscure the fact that, compared to most people in the eighteenth century, American colonists were extremely well-off. Our typical family enjoyed a diet and material comforts shared by very few in the world at that time. Yet, judged by conditions in contemporary America, their standard of living seems almost primitive. In terms of our present concept of income, it is doubtful that the average colonial family received more than $1,500, and it was denied such modern necessities as indoor plumbing and electricity. Commonplace luxuries of today, such as automobiles and television, were not even imagined back in 1775.

Obviously, any comparison of income which spans 200 years will reveal little more than an order of magnitude of the differences between the two eras. Colonial farm output, valued at prices of the time, was probably not much more than \$75 per capita, so a farm family of five would have produced about \$375 in cash output. To this must be added the value of any home production of items, and the rent of the farmhouse(s). Prices since 1775 have risen considerably for those few items (food, clothing, and shelter) that still comprise a common basis for comparison in both periods. But, of course, both the quality and range of items available to people have also vastly increased. Hence my "guestimate" that a colonial living would be equivalent to about \$1,500 today is only a very rough approximation of the change in economic well-being between 1775 and the present. Notwithstanding these difficulties, the order of magnitude revealed by my calculation indicates an enormous increase in economic welfare. By this accounting, a family in the United States today receives about ten times as much income on the average as did our colonial stereotype.

That, of course, is only the most obvious change in the situation of the typical American family. In 1975 the median family income in the United States was just under \$14,000. In contrast to the colonists, only one out of four families today live in what can be termed a rural setting. (Colonists might have trouble understanding our definition, since a town of 5,000 inhabitants was an urban environment to them.) The colonist would be even more dumbfounded to discover that eight out of ten families today reside in a city of at least 50,000 people—or about twice the population of New York during the late colonial period. In contrast to earlier times, the modern family depends on an income earned as wages for their support. Shopping trips today are hardly a luxury; Americans purchase all of their needs—luxuries as well as necessities—at the local shopping center. The variety of goods offered there, and the means with which to purchase these goods and services, would stagger the imagination of any colonist. Furthermore, this increase in material well-being—vast though it is—still pales in comparison to the total increase in general welfare. Improvements in diet and medicine have greatly extended the life expectancy of the average American.

But to focus on this well-known result of economic progress is to miss a major portion of the entire picture. Not all of the changes that have occurred have proven favorable to individual welfare. In the world of colonial America, with farms scattered over the landscape, the actions of one family seldom affected others. But in contemporary society, as people press closer and closer together in cities (which in turn seem to be pressing closer to one another as the suburbs of one city run into those of another nearby), it becomes more and more the case that one person's actions directly affect his neighbors. Life is not as simple as it used to be.

Market systems create other interdependencies as well. Individuals are confronted with some very direct economic relationships which cause us to depend on one another in an impersonal way. Virtually everyone who lives in America today relies on the smooth operation of markets to provide their income and to make available the goods and services that income will purchase. A sudden (and, from the standpoint of a single person, wholly uncontrollable) shift in the demand for labor can cut off a family's income and wipe out much of its wealth. Consumers are, to be sure, free to shop around for the best buy in most transactions. Yet, for the vast bulk of purchases made by individual consumers, the desires of a single purchaser have little or no effect on the price offered by the seller. The same is true for people seeking jobs; they accept or reject the wage offered. It may be true that (as economists constantly remind us) individual decisions on whether or not to work for the wage offered, or whether or not to buy the product at the quoted price, will eventually produce cumulative effects on wages and prices. But such effects are seldom obvious to the person whose job has been terminated because of a deterioration of the economic situation, or to a consumer who insists that the price of meat is too high. Unemployment and inflation are such frustrating problems in our modern society precisely because individuals can, at best, only react to a situation over which they have no control. Our material well-being (and perhaps our peace of mind as well) is governed by the need to cope with *market forces*.

When things are moving smoothly, our dependence on markets does not trouble us; indeed, we welcome the chance to pass on to others those tasks which we are either unable (or unwilling) to perform ourselves. But when things are not moving smoothly, the extent of our dependence on outside forces is brought home with particular force. While modern Americans enjoy the enormous advantages afforded by specialization and the market system, they have lost a large measure of the economic independence their ancestors enjoyed.

Perhaps that is a trade-off most of us would freely choose even if we thought about it. The "good old days" always seem good partly because they are old. But there is still another way in which industrial society affects our freedom to determine our own fortunes. The process of industrialization acts to greatly concentrate economic power in the hands of those who direct the process of production. There is little assurance that this economic power will necessarily be wielded for the good of society rather than for private gain. When the power to control production is concentrated, the competitive pressures which are supposed to check abuse of economic power are greately diminished. Markets can be manipulated to the advantage of the controlling group, and such a group is likely to accrue these gains at the expense of others. Nor is the issue simply one of monopoly distortion through pricing; economic power can be employed in more subtle ways to obtain or enlarge market advantages which favor a single group of producers.

As long as economic power was diffused, markets worked well. But the market institutions which proved so successful in continuously expanding industrial production have been less successful in dealing with the consequences of the revolution they set in motion. Just as there is more to life than simply earning a living, so are there challenges to society besides just overcoming the problem of scarcity. The success of market organization in generating an improved level of material welfare at a time when the burden of simply making ends meet was the overriding concern of society helps to explain why those institutions that deal with the economic problem have played such a dominant role in fashioning change in our society. That success has also been an important force pressing for control of market forces since late in the nineteenth century.

It is important to note at this point that much of the change we are discussing was the result, not of a few large and sudden disturbances, but of small changes whose effects cumulated over a period of years. As our comparison of the way of life in 1775 and 1975 showed, the effects of even a small annual rate of increase can be enormous over a long period of time. If, for example, aggregate production grew by a modest 3 percent each year, what we call the gross national product would double every quarter of a century. As long as the annual increase in production is relatively small, the impact of growth in any given year can be absorbed rather easily by the system. Even those changes that involve some dislocation or readjustment because of new processes of production, new products, or changes in consumer tastes will represent a small enough change in the aggregate levels of employment and production that the disturbance is hardly noticed. Viewed in this fashion, the problem of growth is one of seeing that the economic system is able to maintain a small but steady addition to total output each year. Society can handle the market adjustments created by such growth readily enough. It is the larger effects, which may only become evident over a long period of time, that pose problems for the structure and performance of the economic system.

In fact, one might argue that the process of economic growth and change is going to create inevitable instabilities within the political structure. The market system is constantly adjusting to changes in taste, technology, unexpected events, and the like. In doing so, the economic system will impose costs on some and benefits on others. At any point in time, therefore, one might expect to find both "losers" (those who must bear the costs of adjustment) and "winners" (those who reap the gains from market change). Since these groups change over time, the political structure is pressured to adjust to the economic changes. The political process is caught, in this case, between those who seek institutional change to mitigate the effects of the market, and those who seek to pursue the market opportunities with even greater vigor.[1]

Americans have always been ready to turn to the government as a means of mitigating hardships caused by market forces, or of shaping market forces to their own advantage. But the past four decades have witnessed an unprecedented expansion of the role of government in the American economy. While there are relatively few areas in which government decisions have completely replaced the marktplace, the impact of government policy can be seen in virtually *all* market transactions. Government activity accounts, directly or indirectly, for at least a third of the total spending in our economy, and regulates in some fashion or another most market activity. The United States has become a "mixed economy," where government decisions and individual choices are mixed together, and we are still in the process of determining what the proper mix of government and private economic activity should be.[2]

This is not the first point in our history when Americans have pondered the question of rearranging those institutions that govern our economy. Both social and economic change have been integral parts of American development, and those changes have occurred both with and without governmental assistance. Nor have the changes always proceeded smoothly. Twice within the first hundred years of their country's existence, Americans waged war to secure major alterations in the institutional framework. The American Revolution established the United States as an independent nation, and the Civil War eighty-five years later struck down the legal basis for slavery in our society. While both of these conflicts involved much more than economic issues, the forces of economic change played a significant role in causing the frictions that led to conflict, and in shaping the reorganization that followed the end of fighting.

Since the Civil War, we have had no further restructuring of society involving internal conflict on the scale of these military episodes. However, the need to adjust to economic forces did not disappear. The problem of economic power being concentrated in the hands of industrial capitalists elicited a response on the part of people who sought to change the power structure which had been formed by the emergence of industrial

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1 This is a problem which will require a great deal of our attention later in this study. A very concise statement of the difficulties discussed in the text can be found in Douglass North, "A Framework for Analyzing the State in Economic History," *Explorations in Economic History*, 16 (July 1979), 255–59.

2 There is a considerable body of literature dealing with the role of government both today and in the past. On the willingness of Americans to accept government intervention and the changing role of government throughout the history of our nation, see J.R.T. Hughes, *The Governmental Habit: Governmental Control from Colonial Times to the Present* (New York: Basic Books, 1977).

capitalism. The economic reforms put forward at the end of the nineteenth century and in the first decades of the twentieth century tried to spread out the concentration of economic power and mitigate the impact of adjustments to industrialization in a market society. As we shall see, the reforms fell short of their goals and may have had only a minor impact on either the course of economic development or the redistribution of economic power. Still, these efforts reveal insights into the process of economic change. In the 1930s, the collapse of the American economy known as the "Great Depression" spurred new pressure for change, and this time the efforts at reform were more successful. Franklin Roosevelt's "New Deal" ushered in a new view of the economic system, and began a process of reform which fundamentally altered the economic relationships within the United States.

ECONOMIC THEORIES AND ECONOMIC CHANGE

The changes that grew out of the development of capitalism and the expanding economic activity of the past two centuries brought drastic alterations in the thoughts of men as well as in their institutional surroundings. The development of economics as a social science has reflected the changes which have taken place. In the same year in which a band of American colonists proposed a revolutionary doctrine so that they might legitimately sever their bonds with Great Britain, a Scottish professor of moral philosophy named Adam Smith published in London a treatise called *The Wealth of Nations*.[3] Smith's book presented a very careful explanation of the manner in which markets offered great advantages for the organization (and, when necessary, the reorganization) of production and consumption patterns in a society. The logic of *The Wealth of Nations* remains the theoretical foundation for the analysis of markets today.

The work has also had a much broader impact on intellectual development since 1776. Smith intended his work to be more than a text which explained how markets worked: he wrote it as a spirited attack on the existing system of government regulations and interferences, commonly referred to as *mercantilism*. To Smith's way of thinking, these interferences by government were not only unnecessary, they were counterproductive. Left to its own devices, the marketplace would—through what Smith termed an "invisible hand"—produce that mixture of goods and services which would best satisfy the desires of the people.

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[3] *The Wealth of Nations* has been reprinted many times. The most commonly cited edition is the one edited by Edward Cannan: Adam Smith, *The Wealth of Nations* (New York: Modern Library Edition, 1937).

Adam Smith is generally regarded as the founder of the modern discipline of economics. The group of economists who enlarged on Smith's framework in the first half of the nineteenth century—particularly men such as Thomas Malthus, David Ricardo, and other members of the Political Economy Club in London—are usually referred to as the *classical* economists. Toward the end of the nineteenth century a new group of scholars refined the analytical tools of the classical economists and created what is now termed the *neoclassical* school of economics. The leading figure in this school was the English economist Alfred Marshall, whose *Principles of Economics* was first published in 1890 and subsequently went through eight editions (at a time when new editions were far less fashionable than they are today). Neoclassical economics remains the foundation of modern analysis of how markets work.[4]

The argument presented in *The Wealth of Nations* formed one of the intellectual cornerstones of the liberal movement which came to dominate the nineteenth century. The classical economists, and the paradigm of economics which they constructed, provided a philosophical defense for the industrial capitalism which emerged in the middle of the 1800s. That defense insisted that the government refrain from any interference in the operation of the market system. *Laissez faire* (French for "let it be") became the trademark of nineteenth century economics.

The theoretical arguments which so convincingly demonstrated the efficacy of allocating resources according to markets were reinforced by the economic growth that the American market system experienced after 1790. Because it offers the most obvious promise of material improvement for a population, economic growth has always been a primary concern of economists, and we shall begin our brief examination of the "economics of change" with some thoughts on economic growth.

For the classical economists of Smith's time, as well as for the neoclassical economists who followed later, expansion of output would be encouraged by two main forces: specialization and the accumulation of capital. The possibilities for improving efficiency (and thereby increasing output) through a greater degree of specialization and division of labor seemed almost endless. Indeed, Smith was confident that the natural propensity of people to "truck, barter, and trade" would encourage everyone to continually seek ways to take advantage of the gains that division of labor offered. These gains seemed self-evident. By organizing production so that each laborer concentrated on tasks which he or she could do best, the total product would be its greatest, and therefore the productivity of

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[4] Daniel Fusfeld provides an excellent synopsis of the development of economic thought in his book, *The Age of the Economist*, 3rd ed., (Glenview, Ill.: Scott, Foresman, 1977). For an interesting picture of the personalities behind the analysis, see Robert Heilbroner, *The Worldly Philosophers*, 3rd ed., (New York: Simon & Schuster, 1967).

labor would also be greatest. The only limit to the gains possible from such a division of labor was the size of the producer's market.

The second—and, in the eyes of later economists, more important—way to achieve economic growth was through the accumulation of capital. Increased capital meant additional inputs and greater efficiency of labor. Capital accumulation was the product of *investment:* the diversion of a portion of current effort towards the production of capital goods. The community that saved for the future would have more capital, and hence a greater productive capacity available. Like other facets of economic life, the process of saving and investment would be handled by the all-encompassing influence of the market. People would save because it was prudent (and rewarding) to do so; people would invest in capital goods because it was a remunerative way to use their (or someone else's) savings. Left to their own devices, an industrious population would tend to accumulate capital over time, and this investment would provide an impetus for economic growth.

Although they examined the sources of economic *growth* in some detail, the classical and neoclassical approaches to the economic problem did not devote much attention to the problem of economic *change*. Recently, there has been an effort to extend the economic logic of neoclassical thinkers beyond the confines of the marketplace. This *new political economy* has developed an analysis of the political process which treats political decisions the same way economists treat economic decisions. According to this approach, the question of whether or not any revisions to the existing system will be made depends on a comparison of the perceived benefits of any action and the costs associated with that action.[5] While the efforts of economists have been directed primarily toward analyses of contemporary issues of political economy, the analytical framework of the new political economy has been applied to the question of institutional change in a historical context by Lance Davis and Douglass North.[6] Institutional change, according to Davis and North, is the outcome of decisions reached by individuals who assess their own self-interest as it relates to the proposed change. As they rather succinctly state their thesis:

> An institutional arrangement will be innovated if the expected net gains exceed the expected costs. Only when this condition is met would we

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[5] Two of the early statements of this "new political economy" are James Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962), and Mancur Olson, *The Logic of Collective Action* (Cambridge, Mass.: Harvard University Press, 1964). Richard McKenzie and Gordon Tullock use the new approach to explore a variety of economic issues in *The New World of Economics*, rev. ed. (Homewood, Ill.: Richard D. Irwin, 1978).

[6] Lance Davis and Douglass North, *Institutional Change and American Economic Growth* (New York: Cambridge University Press, 1971).

expect to find attempts being made to alter the existing structure of institutional and property rights within a society.[7]

If people see net benefits to a proposed change, they will presumably join the group pressing for reform. This analysis has the useful feature that the investigator need not be concerned with the exact reasons why each person joined the group. People with diverse motives may band together as long as they feel that the objective of the group is one which will benefit them. As one would expect in an analytical framework patterned after an economic model which stresses the virtues of freedom of individual actions, the emphasis is on individual behavior. And, consistent with the neoclassical economic model, the Davis-North analysis of institutional change is pictured as a process of bargaining toward some equilibrium. Change, in this context, is seen typically as a gradual process, the result of continuous pressures from groups that seek to effect changes in the institutional arrangements.

As we shall see in subsequent chapters, the Davis-North approach provides valuable insights into certain types of proposed reforms of the economic system. It is somewhat less valuable as an analysis of institutional change outside the economic system. The narrow focus on economic motives as the basis for group action makes the analysis best suited for situations in which gains and losses can be readily measured by each individual and then translated into some meaningful group action. These turn out to be very restrictive conditions for the historical analysis of major institutional reforms, whose outcomes are uncertain and gains nebulous.

Even when the conditions of the Davis-North analysis are met, there is often an identification problem associated with the analysis of group action. Applying the "cost-benefit" logic to historical incidents involves the estimation of the expected gain or loss to individuals instigating the reform. The value of the outcome must be comparable to the value of the costs, and this can be most often approximated by using market prices. But what if this is not possible? Then we must assume that people have some way (unknown to us) of comparing the costs and benefits of their proposed reforms. There is a temptation in such cases to reverse the logic and assert that, in any case in which reform was actually instituted, the benefits must have exceeded the costs. By the same argument, those reforms that failed must have been instances in which the benefits were insufficient to cover the costs. Pushed to an extreme, this line of reasoning becomes tautological: Any action taken is explained as one in which the people in a group perceived a net gain; any failure to act is explained as an expectation that there would be net losses from the action. Failure to act is then seen as proof that the change was not really necessary in the

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[7] *Ibid.*, p. 10.

first place—at least from the viewpoint of participants at the time. Because it accepts the choices actually made as being the results of some assumedly rational choice process, such an argument is unable to provide insights into that choice process itself.

The shortcomings of the individualistic approach in explaining the success or failure of group actions can be traced in part to a problem inherent in any theory of group action that postulates democratic or individualistic choices. Economist Kenneth Arrow has convincingly demonstrated that reliance upon a majority voting rule within a group may produce results that are arbitrary in the sense that they cannot be derived from a given set of circumstances. According to Arrow's "impossibility theorem," even if everyone in society makes rational choices, the outcome of the voting process could depend on the order in which alternatives are presented, and therefore we can never be certain that the alternative selected is in fact superior to all the others. Arrow's proof, for which he was awarded the Nobel Prize for Economics in 1972, is a complex one. In effect, he showed that majority voting could produce results that violated the condition of "transitivity." In such a situation, the group might vote to prefer situation A over situation B, and situation B over situation C, and still vote to prefer C over A—which would not make sense in the cost-benefit analysis of Davis and North. Institutional change, in this perspective, will conform to economic rationality only by chance. One could, of course, devise voting rules that might avoid the particular paradox posed by Arrow. However, the group decisions still might not follow the cost-benefit pattern, depending on which particular rules were followed. Certainly there would be no assurance that the "best" (in a cost-benefit sense) solution would be chosen.[8]

There is, moreover, another problem with the use of voting systems to make collective choice. Voters will be induced to vote only if they expect that their vote will affect the outcome of the election. In a large group it is unlikely that a single vote will decide the outcome; hence, voters have very little incentive to vote. Requiring people to vote will not solve this problem; it will simply make the effect more subtle. Voters may vote, but they will be unwilling to make an effort to become informed on the issues of the election. As a consequence, the resulting vote will not necessarily reflect the "best" solution.[9] This problem is particularly important to the

[8] An excellent discussion of Kenneth Arrow's theorem and the paradox of group choice is in Norman Frohlich and Joe A. Oppenheimer, *Modern Political Economy* (Englewood Cliffs, N.J.: Prentice-Hall, 1978), Chapter 2. Arrow's initial exposition of the problem is in *Social Choice and Individual Values* (New Haven, Conn.: Yale University Press, 1951).

[9] The difficulties surrounding voter incentives and the information on which their votes are based have been examined in detail by Anthony Downs in *An Economic Theory of Democracy* (New York: Harper & Row, Pub., 1957). Also see Buchanan and Tullock, *Calculus of Consent*.

issue of institutional change, where the difficulty of making voters aware of the benefits and costs may significantly affect the way in which people vote. There have been countless reform movements which failed to get off the ground because they were unable to overcome public apathy. And, as we shall see, a major challenge to those who are successful in launching a reform is to maintain the support to press the program to a conclusion.

The Davis-North view of the capitalist industrial society is one in which individual choice remains the basis for economic and social actions. It evolved out of an approach to the problem of economic change that followed the economics of Smith, Marshall, and others. There was, however, another approach to economic change that had evolved much earlier from a rather different perspective. In the middle of the nineteenth century, the classical economists' view of society had been challenged by the man who gave capitalism its name: Karl Marx. One of Marx's great insights into the economic system and how it worked was his recognition that the consequences of industrialization in a capitalist system would fundamentally alter the entire social system through a redistribution—indeed, a redefinition—of economic power.[10]

Marx insisted that the entire framework of social action must be examined around the emergence of two new classes: *workers,* who hire out their labor and who have no control over the process of production; and *capitalists,* who control the means of production (that is, capital) in the industrial system. When Marx spoke of the capitalist "mode of production," he was referring to a *social* arrangement, rather than to some set of techniques which organize production. Marx saw this division of society into workers and capitalists as the basis for a continual struggle of opposing economic interests, and he envisioned the entire social system in terms of this struggle. Capitalists, through their control of the means of production, held enormous economic power which would permit them to control the direction of change in society to their own advantage. Workers, because they lacked the power individually to combat this tendency, were urged to band together in a common cause to resist the capitalists. The individualistic motives which dominated the Davis-North model are replaced in Marx by a "class" consciousness which becomes the basis for seeking institutional change.

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[10] It is impossible to do justice to Marx's work in a few paragraphs which touch on only a part of the entire Marxist framework. Marx's well-known (but seldom read) *magnus opus* is *Das Kapital,* which was published in three volumes between 1867 and 1895. *Capital,* (New York: International Publishers, 1967), 3 volumes. Even in a translated version it is hard reading, and not recommended for any but the most dedicated of scholars. A useful summary of Marx's thought which stresses the aspects touched in the present discussion is E.K. Hunt, *Class Conflict and Social Harmony* (New York: Wadsworth, 1978).

It is hardly surprising that Marx, writing in the middle of the nineteenth century, felt that the capitalist mode of production and the industrial system with which it was associated had come to dominate society. He was reacting to his environment in much the same sense that Adam Smith was reacting to the mercantilism of an earlier time. And one of the more obvious reasons that Marxism has survived as an economic paradigm in the United States—and exerted a much more powerful influence elsewhere—is the simple observation that a great deal of economic power remains concentrated in the hands of a rather small group of people who fit the description of "capitalists" rather neatly. The unequal division of power in society has been a consistent theme of Marxist writers, up to the present.[11]

While this point is well taken, the presence of capitalists is hardly a sufficient condition to ensure that the conclusions drawn from Marxist analysis are correct. Non-Marxist economists object to a dichotomy that divides society into only two broad classes, particularly when class distinctions are based on rather narrow economic grounds—the ownership of capital. Neither the working class proletariat nor the capitalists seem as monolithic as Marxist analysis tends to portray them. Moreover, as the modern industrial state has emerged, many would argue that the class distinctions have, if anything, become *less* distinct. The contrasting economic situations and the solidarity of purpose attributed to the two groups by Marx in the 1860s seem misplaced in the affluent American society of the 1980s.

Nevertheless, Marx's contention that the creation of a capitalist "manager" class permanently altered social relations in Britain and other western economies cannot be so easily brushed aside. Control of capital does carry with it economic power, and concentrations of wealth based on the control of capital have been a fact of life in industrial societies since the end of the nineteenth century. To pretend that these concentrations of power are disappearing, or that they have no effect on the political and economic life of the society is naive, and to formulate a notion of economic change which fails to consider the distribution of power is not likely to prove fruitful. Somewhere between the individualism stressed in the neoclassical analysis and the heavy emphasis on class distinctions of Marxist analysis lies the approach which can best reflect the American experience.

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[11] Writings on Marxist thought have been given a boost by the "radical" movement of the past two decades. For a view of contemporary Marxist thought which illustrates the points of the text, the reader should consult Michael Harrington, *The Twilight of Capitalism* (New York: Simon & Schuster, 1976), or Howard Sherman, *Radical Political Economy* (New York: Basic Books, 1972). Marxists are not the only economists to stress the concentration of economic power in a broad social context. See, for example, John K. Galbraith, *The New Industrial State* (New York: Houghton Mifflin, 1967), for a distinctly non-Marxist analysis of economic power in an industrial society.

The two polar cases can reveal important elements of the process of change, but their overemphasis on one facet or another of human economic behavior tends to distort the analysis.

Neither Marx nor his critics were able to provide many insights into another element that has had a profound effect upon the economic development of the past two centuries: technological change. Both schools of thought note that a characteristic feature of market capitalism has been the continual and pervasive pressure for the introduction of new and better techniques of production. Producers are induced—some would say they are forced—always to seek more efficient ways to produce their products in order to gain an advantage (or to prevent some rival from gaining an advantage) in the market. The progress induced by this process is a major source of economic growth, and Marx in particular placed enormous emphasis on the impact industrial technology had on the mode of production. Yet he said very little about the sources of inventive ideas which developed the techniques responsible for the transformation of Victorian England into an industrial society. Only after an idea has developed have most economists considered the impact of that idea on the process of production.[12]

Economists have recognized, however, that the manner in which technological change altered the process of production over the past 200 years posed an unfortunate dilemma—a dilemma which represented a severe threat to competition among producers. Whenever a new process required expansion to a larger scale of production by each producer, there was a limit to the extent to which the existing market was able to absorb the additional output generated by the expansion of all firms. The price of the output was, typically, driven down by expansion of the industry, and at some point firms were unable to recoup their costs. In such a situation, it was the smaller (and less efficient) firms that were unable to sustain a competitive position in the marketplace with the new technology.

The small firm had three options:

1. The firm could expand its own production.
2. The firm could cease production and go out of business.
3. The firm could join with other firms to create a larger unit of production.

Any of the three options will result in the elimination of smaller units of production. (Economists call this situation one of *increasing returns*. As

[12] The problem of technological change and its role in the economic process has been receiving more attention from economists lately. See, for example, Warren J. Samuels, "Technology vis a vis Institutions in the JEI: A Suggested Interpretation," *Journal of Economic Issues*, 11 (December 1977); and Howard Sherman, "Technology vis a vis Institutions: A Marxist Commentary," *Journal of Economic Issues*, 13 (March 1979). Both articles discuss the interaction of technology and institutional change.

long as the firm's costs per unit are falling, it can increase its profits by continuing to expand output.) Such a situation has long been recognized as a threat to competitive markets, particularly in areas such as manufacturing, where the impact of technology on the structure of firms has been enormous.[13]

One of the few economists who did pay considerable attention to the role of innovation and technical change was Joseph Schumpeter. To Schumpeter, the root of progress in an industrial society was the continual influx of new ideas, which were encouraged by the capitalist system. He termed the process of innovations and economic change *creative destruction*. His choice of this term reflected on the one hand what Schumpeter saw as the positive influence which new processes of production had in creating economic opportunities, and on the other hand the dislocation and disequilibrium which the new ideas produced on the existing system.[14]

Schumpeter argued that there was a constant search for new ideas on the part of entrepreneurs who sought the rewards which the market system offered for successful innovations. In their eagerness to reap these gains, entrepreneurs would be drawn to the areas of monopoly by the lure of higher profits. Monopoly, to Schumpeter, was a dynamic phenomenon; it both rewarded those who temporarily gained an advantage and punished those who failed to change in response to threats to their market position. Described in the Davis-North approach to economic change, monopoly was one of those imperfections which entrepreneurs ("groups") were constantly seeking to turn to their own advantage. Economies of scale were one of the more obvious phenomena which encouraged entrepreneurs to expand their markets and seek changes in the economic system which would facilitate their expansion.

Schumpeter's ideas combined the technological imperative which Marx saw as a source of growth with the role of individual entrepreneurs which was emphasized by Davis and North. In doing so, he was able to deal with another feature of capitalist economic growth that has caused problems for economic theorists: the apparent tendency for the activity level of the economy to widely fluctuate. According to Schumpeter, periods of exuberant growth were a consequence of entrepreneurs rushing to cash

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[13] For a statement of the problem as it was posed in neoclassical theory, see William Breit and Roger Ransom, *The Academic Scribblers: American Economists in Collision* (New York: Holt, Rinehart & Winston, 1971), pp. 24–30. An excellent statement of the dilemma posed by the efficiency of large scale enterprise on the one hand, and the monopoly power with which large size provides the firm on the other, is available in William N. Leonard, *Business Size, Market Power, and Public Policy* (New York: Harper & Row, Pub., 1969), Chapter 1. Also see Davis and North, *Institutional Change*, Chapter 8.

[14] Schumpeter wrote several major works on economic development, economic change, and the capitalist system. The most comprehensive summary of his thinking is in his last major work, *Capitalism, Socialism, and Democracy* (New York: Harper & Row, Pub., 1947).

in on the introduction of some new idea, thereby creating a wave of investment. When this "herdlike movement" (as Schumpeter termed it) caused the economic system to be overextended, a crisis resulted, bringing on a period of reduced economic activity. Economic growth, in the Schumpeterian model, consisted of two steps forward and one step back.

The process of creative destruction is important to our story not only as an explanation of monopoly and growth, but also as an explanation of the sources of institutional change. By its nature, the process of creative destruction was one which wrenched the economic system. New firms arose from the ashes of the old. Some people won; others lost. Schumpeter saw the problem this created; he believed that the economic instability the capitalist system produced in its creation of progress would ultimately create pressures to curb economic activity and stifle the innovative spirit which was the root of economic growth. The demise of capitalism would come not as Marx insisted, from an inexorable tendency towards collapse; it would come because the entrepreneural spirit would be stifled. Socialism would emerge as bureaucratic managers replaced the entrepreneur, not as a product of a workers' revolution.

Despite their different emphases, some common themes emerge from these theories of economic change and the process of industrialization. In all of the approaches the economic system—more specifically the market system—is viewed as the originator of many changes. The process of technological change, fostered by the incentives offered in the marketplace, is an important element in shaping economic development. And, at least to Marx and Schumpeter, the ebb and flow of economic activity—the presence of economic cycles—plays an important role in shaping change in the long run. Finally, the exercise of economic (or political) power plays a prominent role in determining the outcome of particular struggles over the exact nature of institutional change.

THE POLITICAL ECONOMY OF ECONOMIC CHANGE

The problem of economic development in a capitalist system seems to center on the fact that the economic pressures which are produced from within the market system threaten to overwhelm every other facet of society. This is not to say that economic forces alone are responsible for institutional change. It is a recognition of the extent to which the market system, while it is geared to economic behavior, permeates all of the institutions of an industrial society, and responds to stimuli which may originate anywhere in society. On the one hand, the effects of change generated within the economic system may have ramifications far beyond the marketplace. On the other hand, changes that do not originate within the economic system are nonetheless reflected in market behavior. While in some cases the impact of change may be dampened by market responses, in others the effect will be magnified.

This pervasiveness of market influences means that decisions to effect changes in the institutional framework must be considered in the context of market forces. If proposed alterations in the structure of the economic system run counter to prevailing market pressures, then collective action based on some incentive other than the market will be required. In a society which has become geared to market behavior, such action may prove difficult to sustain. Throughout the nineteenth and twentieth centuries, those arguing for economic reforms have been confronted with the problem of coping with the argument that their suggested reforms might stand in the way of progress. Whether it involved dissolving economic and political ties with Great Britain, giving freedom to slaves, obtaining better working conditions for industrial workers, or providing greater economic security for families in an industrial society, reformers have always encountered resistance because their proposals threaten to place limits on economic efficiency. It has been an uphill battle, but not a hopeless one. The Revolutionary War was won in spite of the fact that there were strong economic forces favoring a continuation of British rule. Blacks were freed from slavery despite the vested economic interest their owners had. The plight of workers has been improved and progress made in providing economic security for Americans despite the revisions in economic power involved in such reforms.

In each of these cases, the collective action which helped to produce major reforms involved changes in the ideas of Americans. Proposals for reform must always contend with resistence from those with vested interests in the status quo. But there is another, more subtle, factor that reformers must also consider: Their ideas must be broadly consistent with the corpus of commonly held economic beliefs within society—what John Kenneth Galbraith calls the "conventional wisdom." [15] In the sphere of economic change, the conventional wisdom is often a conservative, rather than a progressive, force. It may be, as John Maynard Keynes believed, that our lives are ruled by "little else" than the "ideas of economists and political philosophers." But, as he went on to note, those ideas were likely to be from "a few years back." [16]

As we shall see, the role of ideas has not been confined to the realm of economics. Reforms of any sort which run counter to widely held ideo-

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[15] John Kenneth Galbraith, *The Affluent Society* (Boston: Houghton Mifflin, 1958), p. 9.

[16] John Maynard Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt Brace Jovanovich, Inc., 1936), p. 383.

logical views are unlikely to prevail in the long run unless the mainstream views can be changed. While this is a rather obvious point, it is important to stress that the role of ideology in assisting or preventing institutional change can be very subtle. Ideology affects the ease with which groups can be organized to act as agents of reform. Proposals for significant alterations in institutional arrangements invariably involve a host of complex issues, many of which are very subtle (indeed, so subtle that they are not even noticed by the advocates of the reform). To muster sufficient pressure for change, the intricacies and subtleties must be expressed in simpler terms. Ideology offers a way to do this. Ideological beliefs create a view of the world which is accepted without questioning the logic of the explanation. Economic or political ideologies (for example any of the "isms" such as capitalism, socialism, or communism) rest on values or norms (such as freedom, individual liberty, class solidarity). On issues of major social policy, it is often easier to rank alternatives by using the value of benefits weighed in ideological preferences rather than trying to compare the estimated dollar value of benefits from each program. Ideology thus becomes an important vehicle for disseminating information.[17]

The rhetoric of reform campaigns in the United States has seldom failed to take advantage of ideological factors. Voters have been encouraged to make their decisions on the effects of some economic program based on an appeal to ideology as much as reason. As an example, we might note how President Franklin D. Roosevelt handled the issue of bank reform in 1933. He pointed out the obvious economic interest everyone had in restoring some form of order to the financial chaos. But he did so using rhetoric which was aimed at the ideology of the man on the street. Consider the following excerpt from his first inaugural address:

> Stripped of the lure of profit by which to induce our people to follow their false leadership, [the money changers] have resorted to exhortations, pleading tearfully for restored confidence. They know only the rules of a generation of self-seekers. They have no vision, and when there is no vision the people perish.
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> The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than monetary profit.[18]

As an economic analysis of the then–recent financial collapse, that passage leaves much to be desired. But as an indictment of the banking community aimed at those who already believe that banks control our eco-

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[17] On the use of ideology to influence information to voters, see Downs, *An Economic Theory of Democracy*, Chapter 7.

[18] Mervin Hunt, *The Public Addresses of Franklin Delano Roosevelt* (Los Angeles: De Vorss & Company, 1934).

nomic destiny through their profit-seeking manipulation of others' money, it conveys an effective message. As Roosevelt himself noted several days later, there are "comparatively few who understand the mechanics of banking." He was not the one to teach voters those mechanics. It was easier simply to assert that the government should take drastic steps to offset the selfish interests of "money changers" who controlled the system up to that point. The appeal to ideological prejudices against the banking community was an effective way to gain an audience—and eventually to gain support at the polls as well—for the bank reforms of 1933 and 1935.

Rhetoric and ideology aside, we shall discover that new ideas regarding social or economic change which challenge the conventional wisdom have seldom triumphed solely on the intellectual merits or ideological appeal of their arguments alone. They have required assistance in the form of some event that produced an atmosphere in which people were willing to experiment with new and somewhat radical ideas. In the United States there have been at least three occasions when such an atmosphere was created by crises of considerable proportions.

1. The American Revolution offered a chance to experiment with a new form of government.
2. The Civil War offered a chance not only to eliminate slavery, but to introduce other changes intended to facilitate the adjustments to industrial capitalism as well.
3. The Great Depression of the 1930s offered a chance to modify the economic and social setting in response to the collapse of the financial system and the realization of just how fragile economic security in a modern industrial society can be.

In each case, the reforms introduced—the Constitution, the Thirteenth and Fourteenth Amendments, the New Deal—would probably not have been accepted by Americans only a short time earlier. Most scholars agree that the faction supporting a break with England in the mid-1770s was barely a majority of the population, and the popular support for the Constitution may not even have been a majority. Certainly the abolitionists crusading for the elimination of slavery were a small (albeit very vocal) minority in the 1850s. And it is hard to imagine that the administrations of Presidents Hoover, Harding and Coolidge might seriously consider the legislation Roosevelt proposed in the mid-1930s. Yet, in the context of the more pressing needs of the economic crisis, the reforms were speedily enacted.

Our interest in this book concerns those instances in which the pressures for change—both economic and otherwise—became severe enough to create a crisis, as well as those instances in which more gradual pressures for change produced movements for reform which, while less dramatic (and sometimes less successful), still managed to effect some changes in the economic system. In general, our purpose will be to investigate the sort of changes in the economic system sought as a means of alleviating the problems that the existing system seemed incapable of handling. In so doing, we shall focus on those elements which were highlighted in this discussion of the process of economic change, but we shall also pursue some themes which emerge from the story itself.

Among the more prominent of these emerging themes is the constant friction between the market and nonmarket institutional arrangements. The market society of the United States provides, as we noted above, an incredible abundance of goods and services to Americans. For that reason Americans have been more than willing to accept the whims of the marketplace in the search for higher levels of output and consumption. But, as we also noted, markets expose people to risks—economic security is constantly threatened by the possibility of changes in prices, wages, and the availability of both goods and jobs. If the story of nineteenth century American growth and development seems a chronicle of the emerging dominance of market forces, then the twentieth century might be described as a gradual—but very steady—retreat from that dominance as people sought to protect themselves from the marketplace.

Finally, we should note at the outset of our journey that an investigation of what is changing will also reveal what has *not* changed. Most obvious of these constant elements is the fact that two hundred years of economic change have not caused Americans to abandon their commitment to private property. This deep commitment to individual property rights (even if the "individual" is General Motors or IBM) was a major factor in all of the reform movements we shall examine in this book. Despite the prominence of the public sector in our modern economy, the United States remains an essentially capitalist society. For better or for worse, Americans have elected to cope with capitalism rather than to restructure their economic life around some other institutional arrangements.

How they coped provides the theme for this book.