PROGRESS REPORT ON CURRENT PH.D. DISSERTATIONS

ECONOMIC STABILIZATION BY AMERICAN BUSINESS IN THE TWENTIETH CENTURY

Evan B. Metcalf
University of Wisconsin, Madison

The quest for stability is a prominent theme in the history of twentieth century business. Historians have paid relatively little attention, however, to the business community's response to one of the most important types of instability, the business cycle. Beginning in the progressive era, there was a movement to promote company action to contribute to macroeconomic stability. It urged businesses to stabilize - or "regularize," as it was called - the employment, production, and investment of individual firms.

My thesis traces the history of the regularization movement, its influence on economic policy, and its relation to the development by modern corporations of means of dealing with the risks and costs of business fluctuations. The basic sources for the history of the movement are the books, pamphlets, articles, and correspondence generated by the individual and organizational proponents of regularization. Manuscript sources, particularly the Herbert Hoover papers and the records of the Department of Commerce, the President's Organization on Unemployment Relief, and the National Recovery Administration were vital in tracing the influence of regularization on policy.

The same literature provided information on company stabilization practice. Published sources in the business press on managerial developments such as cost accounting, personnel management, and sales forecasting helped elucidate the history of these organizational innovations, which directly affected how firms perceived and responded to business fluctuations. Available data from sample surveys by the NICB, the Bureau of Labor Statistics, and other sources, as well as analysis of statistical data on the behavior of industries as a whole, delineated the extent of regularization in practice.

Regularization advocates suggested that firms stabilize their operations by stabilizing the pattern of their own demand, through advertising, price concessions, diversification, and forward integration. They suggested that businesses train workers for more than one job within the firm, and spread work by varying hours. To stabilize production rates, they suggested that firms accumulate a backlog of unfilled orders during peak periods and produce for inventory during slack periods. Finally, businesses were urged to maintain investment in plant and equipment when sales turned down.

The business advocates of regularization expected the direct economics from a more stable rate of operation, together with the general improvement in the quality of management which went along with instituting such measures, to provide sufficient incentive for the diffusion of regularization. The major obstacles to this diffusion, they felt, were managerial conservatism in the face of a departure from traditional practice and ignorance of the true costs of fluctuating operations.

A central hypothesis in explaining the development of regularization is that it was an institutional response to changes in the costs to firms of fluctuating demand. A theoretical analysis of the cost of fluctuations shows that these costs are essentially due to investment in firm-specific fixed factors which must be made to meet peak loads, but which is not fully utilized in other periods. If expected fluctuations in operations can be limited, a firm will need a smaller quantity of fixed capital, salaried personnel, and firm-specific training of production workers in order to produce a given average level of output. Thus, it can more profitably adopt relatively capital-intensive (and overhead labor-intensive) techniques of production.

Regularization methods were most fully developed for dealing with <u>seasonal</u> fluctuations. Enough firms, however, had applied one or another of these methods to cyclical recessions to provide hope for their wide applicability. Stabilizing individual firms' demand or employment was, at best, likely only to shift demand among firms within the economy or redistribute income between workers. Stabilization of inventory and fixed investment might, in theory, favorably affect aggregate income. The risks to a firm of following such policies during a decline of uncertain length and depth made it unlikely that they would be widely practiced. Such company stabilizing measures, though, may have made fluctuations in aggregate income less severe than they would otherwise have been during short recessions.

The proposal that individual businesses should contribute to stability in the macroeconomy by stabilizing their own operations was advanced seriously for the first time during the depression of 1914-1915. Earlier discussions of the problem suggested the possibility that business employment and production-scheduling decisions contributed to unemployment; however, they had not considered it an area with much potential for increasing stability.

The timing of the emergence of these proposals reflected changes in the factors affecting the costs of fluctuations. They followed a period of rapid capital-intensification, growth of administrative overhead, and a shift toward semi-skilled labor. In some cases, such labor was more expensive for firms to train than either unskilled labor or all-around craftsmen with self-financed skills. The stabilizing practice of a few "progressive" businesses provided models for the early regularization proposals. The regularization proponents also took notice of the discussion by cost accountants and personnel managers of the costs of idle overhead and labor turnover. This literature provides evidence of a growing perception by managers of the relatively subtle costs of instability.

The war, by focusing attention on labor relations, the use of statistics for rational management, and the general possibilities of economic control, greatly enlarged the potential audience of businessmen receptive to the idea that economic instability could be reduced through better management. Secretary of Commerce Herbert Hoover capitalized on this opportunity during the 1920-1921 depression. Hoover's approach essentially aimed at increasing the social rationality of business action by improving the informational premises of decision makers. The inauguration of the Survey of Current Business in June, 1921, brought to fruition the intense post-war pressures for a current statistical service. Through a series of study committees dominated by prominent businessmen, Secretary Hoover attempted to mobilize the expertise of industrial engineers and economists to make business stabilization into a standard feature of good management.

By the end of the decade, regularization had become widely accepted in principle as a means of mitigating economic instability. In practice, it was much less widely diffused than its rhetoric. The evidence of a few hundred cases cited in the regularization literature, however, indicates that it was not solely a rhetorical phenomenon. On an aggregate level, the behavior of manufacturers' orders and inventories indicated that many firms did utilize order-backlogs and inventories to stabilize their production and employment. Although they were widely distributed by industry, firms which claimed to be taking steps to stabilize their operations were found more frequently in relatively profitable industries. This was in contrast to those trade associations most actively promoting antitrust revision, predominantly those in industries with low profit rates.

Large companies predominated among regularizing firms. The costs of fluctuations tended to be proportionately higher for large firms, and they were better able to utilize formal managerial tools for perceiving the costs of irregularity. Large and financially liquid firms were also better able to apply many of the stabilization methods. In some cases, then, regularization was part of the process by which the large firms, in what Robert Averitt has called the "center economy," shifted some of the risks of fluctuations in demand to smaller firms on the "periphery."

The influence of the regularization movement on economic policy was evident in the early response to the great depression. President Hoover's call on business leaders to maintain their wage rates, employment, and investment after the stock market crash, can be better understood in the context of the apparently successful application by many firms of increased economic knowledge to the stabilization of seasonal and minor cyclical fluctuations during the previous decade.

As the depression deepened, voluntary action by individual businesses proved not merely ineffectual, but in some instances positively detrimental. This was the case with inventories which manufacturers accumulated early in the depression, in expectation of a quick upturn. The NRA provided an opportunity to remove competitive constraints on company stabilization. Maximum hours regulations, in particular, were a potentially effective measure for spreading peak loads. Most industries, however, succeeded in securing Code provisions allowing averaging of hours over some long period, or peak period tolerances which allowed considerable short-run fluctuation in employment.

The slackening of interest in regularization manifested by business during the NRA is explicable as more than just a general resistance to restrictive regulations. The positive costs of irregular operations are those associated with peak-load capacity. At the depth of the depression, even peak seasonal demand created no pressure on available capacity. Thus, the incremental benefits to be gained by smoothing out peaks in production generally were too small to outweigh the gains in competitive position or the reduction of risk achieved by bunching production close to shipment.

Contrary to the expectation that the depression would effectively demolish the regularization movement, it proved remarkably resilient. Changed conditions after World War II provided the setting for a major revival of the idea. Governmental fiscal policy provided a more effective guarantee against major collapse. Many more businesses used long-range forecasting and capital budgeting. Regularization advocates argued that these changes made business actions aimed at reducing the volatility of investment more feasible than they had been before the war.

The perennial appeal of the idea that individual business action could contribute to aggregate economic stability, despite its apparent lack of success in controlling economic vicissitudes, was in some respects a monument to the tenacity of the "fallacy of composition" in business thought. On the level of the firm, the development of means for reducing fluctuations in a company's own operations was significant. Whether or not aggregate stability was increased, it was an important part of the process by which modern corporations learned to deal with the risks they assumed when they adopted relatively inflexible technologies and forms of organization.

Finally, we must remember that the diffusion of organizational innovations and the learning-by-doing which marked the development of modern management did not occur in an ideological vacuum. Among the factors instrumental in the spread of modern management methods was the steadfast proselytizing for them by vocal industrial engineers, businessmen, and government officials. These people drew their indefatigable enthusiasm for promoting more systematic management not only from the gospel of efficiency, but also from a desire to bring the economy as a whole under conscious control and to reduce unemployment, which they considered the greatest waste of all. Economic statistics had utility for a wide range of business (not to mention historical) problems. Their wider collection since World War I owes much to the belief of the regularizers that to enlighten businessmen's self-interest was the way to eliminate economic fluctuations, the greatest threat to the survival of the capitalist system.