Directions in Business History: Comments on Dissertations

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Business history claims, to put it simply, that business matters. This entails, first, that businesses have consequences for economic growth, public policy, social movements, the future structure of business, and so forth. Second, businesses are not mere conduits for the play of economic forces but instead shape themselves and their consequences. Research in business history can be evaluated by how it forwards this claim. With this purpose, I shall evaluate the four dissertations included in the dissertation session.

Good research requires a theme that makes it unique and significant. Each of the dissertations has such a theme. Three stand at the intersection of business and economic history. Of these, Anthony O'Brien's dissertation is the widest ranging. He attempts to understand the severity of the Great Depression in the United States in terms of changes in the decision rules (or operating procedures) used by businesses. Against neoclassical economics, he argues that firms do not optimize because they cannot know the optimal choice without information that is not readily gained. Instead, firms follow decision rules--accepted ways of responding to typical events. In this behavioral theory, rules are relatively stable, costly to change, and alter when environmental shifts are sufficiently large and protracted, most commonly following steep downswings. Economic action is inherently historical; past decisions of the firm establish a structure that conditions future choices.

O'Brien applies this notion to account for the severity of the Great Depression. Firms concluded that money wage cuts were responsible for the steepness of the 1920-1922 recession and altered decision rules so that they would not cut money wages in downswings. This change had a fundamental macroeconomic impact; money wages were not cut for two years after the 1929 crash, and recovery was delayed until firms revised the decision rule.

Willis Emmons concentrates on a single important issue: whether and how the state can overcome market failure--the scale economies, uncertainty, and externalities that in neoclassical theory lead to competitive imperfections and suboptimal welfare. These imperfections result in a dilemma: unregulated firms can get substantial rents, but public regulatory agencies can be captured by those they regulate and made impotent or, worse, instruments of rent extraction. In a study of U. S. electrical utilities through 1942, Emmons shows that the dilemma was real; firms gained substantial monopoly rents (1930 prices some 15 percent above competitive prices), and regulation by individual states was ineffective. Yet government often overcame the dilemma and reduced utility prices by fostering competition among private firms, organizing public utilities, and threatening new competition. Public policy, and especially public enterprise, was strongly welfare-enhancing.

Daniel Barbezat also focuses on barriers to competition, for him the formation of cartels. The originality of the thesis lies in challenging the presumption that the international economy limited cartelization. He shows that for the European steel industry from 1926 through 1938, international cartels fostered domestic cartelization. The effectiveness of domestic cartel quota and price arrangements grew when domestic firms were more similar, especially in integration into basic steel. Finally, changing conditions led to innovations in cartel structure. The price reductions of the Depression made it painfully clear that a single quota on total steel production could not control prices; export cartels that set prices and export shares on individual products were the chosen solution.

The fourth dissertation ties business to social and cultural history. Richard John examines a much neglected but most significant institution: the postal system. Focusing on the U.S. system from 1823 to 1836, he identifies several dimensions of its importance. The post office was by far the period's biggest business, and he argues--against the work one of his committee members, Alfred Chandler--that it formed a managerial hierarchy prior to private firms, thus raising the possibility that public business led the managerial revolution. By organizing flows of money and market information, it helped shape a national market and settle new regions. For John, like Emmons, public enterprise had a powerful, positive economic impact.

The importance of the postal system did not stop there. Its value in informing the citizenry and uniting the nation was a tenet of public policy expressed in much lower newspaper rates. It became engrossed in the spoils system, and the appointment of postmasters helped to develop mass parties. It was a locus of powerful social contention over its operation (the opening of post offices on the Sabbath) and the legitimate content of the mails (the delivery of abolitionist material to the South). Its communication function put the early post office at the intersection of business history and the history of economy, polity, society, and culture.

Good research is more than an important theme; it must also skillfully choose materials and craft them into the desired product. Each thesis employs--often after painstaking archival work--appropriate sources and infuses them with meaning for the problem addressed. John uses an extremely wide range of sources, including literally dozens of sets of manuscripts, to explore such central historical issues as business enterprise, nation building, and republicanism. The result is fine narrative.

Barbezat bases his arguments on extensive use of company and cartel records. These sources give him firm-level price, sales, and, to a lesser extent, cost data. Such detail allows him to distinguish between announced cartel prices and prices that firms received, including rebates and cartel payments. Whatever their economic significance, cartels, to the extent that they must keep records to realize their goals, are a boon for historians. He uses Joe Bain's idea of an imperfect cartel to interpret cartel structure, cartel cheating and nonmember policy, and the complementarity of international and domestic cartels.

The Emmons dissertation is a model of clarity. He forms hypotheses about price formation from the historical literature, develops an econometrically testable model of prices and output levels, and derives persuasive conclusions. His formulation has several advantages over related studies. It chooses variables to separate costs and rents, which entails abandoning such variables as the book value of assets that may involve capitalized rents. By employing firms rather than states as units, it more finely discriminates among market and ownership structures. It also examines statistically the interdependence of prices and output.

One is struck by the comprehensiveness of O'Brien's thesis. It begins with cogent judgments against optimizing forms of economic argumentation and in favor of more historical forms. To apply its argument to the Great Depression--a problem that every economic theory has to confront--it identifies deficiencies in Keynesian, monetarist, and rational expectations interpretations. It then marshalls a wide array of well-digested macroeconomic and firm-level evidence to support its institutional view.

Good research occasions good questions, questions that lead the reader to learn even in disagreement. Each dissertation succeeds by this criterion. How are decision rules determined? Rules for O'Brien take two logical forms. In one, firms improve individual profitability, such as when, in response to the downswing of 1920-22, they altered inventory control to more quickly cut output when sales fell. The second, illustrated by the high wage rule, is more central but less convincing. Consider the logic. Firms perceived that money wage cuts would reduce product demand. Firms wanted to maintain demand. Hence, they did not cut money wages. This argument conceives firms to act in their collective self-interest, when individual interest might lead each to reduce wages, increase profit margins, and hope that no others do so.

To justify so radical a notion of firm behavior, O'Brien must show that the high wage rule had this collective goal and was widespread. Neither is persuasive. If demand maintenance were the goal, one would expect other demand-sustaining measures, but the inventory adjustment rule had just the opposite effect, and there surely was no rule to maintain investment spending. A wage maintenance rule may have had purposes that did not require firms to act collectively. It might have aimed at stabilizing prices and markups, as some of O'Brien's citations suggest. Or it may have maintained productivity levels at a time when a work force with less turnover could better enforce workers' wage-productivity expectations. Rules form a system, and wage rules should be tied to pricing and productivity rules.

Moreover, how could a high wage rule be policed? O'Brien suggests that cartel-like mechanisms operated among large manufacturers. But effective demand maintenance would have to be economy-wide. If, as Barbezat shows, highly organized cartels had major problems administering relatively simple quota policies in one industry, imagine the difficulty of enforcing a collective policy across the far greater diversity of firms in a whole economy. Surely there was no such system.

The central question concerning the Emmons thesis is whether adequate welfare standards follow from the static analysis of perfect competition. Here, too, firm behavior is key. Monopolies can impair efficiency and at the same time, as Schumpeter argued, have positive dynamic effects. Their profits may foster growth and innovations; to assess welfare effects, these would have to be considered. Falling prices and monopolies may go together; would we say that because Samuel Insull was a monopolist, his aggressive pricing and growth policies did not improve welfare?

The basic problem is that prices are taken to have only an allocation role. But they surely have functions in financing growth and innovation. Prices can play a strategic role when used to penetrate new markets or take away market shares. Of course, prices may not have all these functions all of the time, but this poses a historical question: how over the evolution of an industry do pricing policies vary?

Similar issues are involved in understanding whether cartels succeeded. Barbezat correctly conceives cartels as means to profitability (and, I would add, growth). He contends that the cartel was successful because the Lerner monopoly power index (the ratio of prices minus marginal costs to prices) was positive.

This contention is dubious for static and dynamic reasons. The divergence from perfect competition, which the Lerner index measures, provides little insight into cartel success. In the absence of cartels, steel prices would hardly equal marginal costs. Barbezat uses unit prime costs (which, because cartel records are of little help, he draws from firm data) to measure marginal costs. Nearer in principle to average variable costs, unit prime costs in practice may have been constant and thus equal to marginal costs. If so, firms would price above marginal costs to cover overheads and make profits, and comparisons with perfect competition are irrelevant. When costs typically fell up to capacity, markup notions of pricing--in terms of which firms thought--are more useful in evaluating cartel success.

Dynamically, current profits might undermine future cartel arrangements. Reinvested profits might increase capacity, reduce costs, increase profit margins, differentiate profitability among firms, and--even in the absence of entry--threaten cartel success. The dynamic consequences of present price and quota policies must be examined to understand continued cartel success.

John's finely detailed narrative addresses issues essential to historical development, but he is too hesitant to say how. He says that the establishment of administrative networks including the post office might thematize the 1790-1830 period like Samuel Hays's technical system does the decades around 1900, but he never develops this suggestion. He dates a postal managerial hierarchy some 30 years before the railroad hierarchies of the 1850s. I would like a fuller comparison of the two. The postal system had two features of Chandler's modern business enterprise, many units and a hierarchy of salaried executives. But Chandler wrote about the Jacksonian post office without conceiving it to be fully modern; there were few middle managers and no problems of building, maintaining, and operating transportation equipment.

Or take the spoils system. Can one not be intrigued by the claim (p. 269) that Southern secession rejected "the mass-based political order that had made Lincoln's victory possible, and which the partisan removal of postmasters had done much to create"? Given other sources of the party system and Lincoln's victory, one yearns for an argument in favor of the thesis.

Research can also be judged by the agenda it sets for further research, and each of the dissertations suggests fruitful directions for understanding historical change. We would like John to flesh out his tantalizing claims. Mail flows are a potentially decisive quantitative historical source. Interpreted as a measure of the content and direction of communication, mail flows could shed light on such critical issues as the level of commerce between and among regions (as measured by the flow of letters), the existence of a national or regional culture, of one society or two (as reflected in the flows of newspapers between or within regions), and the process and content of frontier settlement (seen by the timing and usage of new routes).

The dynamics of cartel formation ought to be more fully understood. Barbezat argues that international steel cartels had to reorganize to maintain their effectiveness, but did this innovation result from inadequacies in earlier structures or from environmental changes? The thesis that business matters implies that cartel restructuring must involve more than adaptation to altered demand patterns. The historical quality of cartels is deepened by showing both how past innovations in industrial structure, such as the integration of German steel firms, affected cartel structure and success and, looking forward, how prices influenced reinvestment, capacity, differentiation of costs, market share, and the continuing viability of the cartel.

Emmons too could usefully examine the relation of prices, firm growth, unit costs, and industry structure. Did firms with higher profit rates grow more rapidly in the 1930s? Did they reduce unit costs more? Did unit cost reduction depend on aggressive expansion strategies and falling prices, perhaps led by the example of the TVA? Answers to such questions depend on the stage of industry development; innovation may have declined when established firms faced slower growth. If so, welfare in the 1930s was determined by earlier innovations, innovations for which rapid cost and price reduction may have eliminated competitors and led to what in the 1930s appeared as monopoly.

The alteration of decision rules forms a broad and important sphere for research. A typology of such rules as articulated in the business history literature would help clarify their meaning. O'Brien largely puts the impetus for change in the firm's environment, but it may as well come from inside pressures, including the limits to growth analyzed by Alfred Chandler and Edith Penrose that lead to changes in structure, scope, and product line. Furthermore, rules, like production techniques, form an interdependent system; changes in some occasion changes in others. The organization of the firm may influence the generation of new rules by affecting the perception and communication of limits and the resources needed to innovate.

Attention also should be directed to the ways decision rules spread among firms and industries, varying from diversification, commodity sale, labor markets, and industry associations, to professional organizations, publications, business and engineering school training, and public policy. Workers and their organizations may have their own rules, which can influence the operating procedures of groups of firms. When the diffusion of such rules within and between countries is understood, the macroeconomic effects can finally be assessed.

For all their differences, the dissertations share features of import for all business history. In examining how businesses matter, they all look at relations between units--competitive and cooperative, intended and not--without losing sight of the internal structure of these units. Relating businesses to private firms, public enterprise, cartels, labor, and governments makes the subject matter more interactive. Each thesis also ties business history to other fields. This cross-fertilization has potential pitfalls; in the extreme it can threaten the integrity of business history. But used selectively, the conceptions, sources, and methods of other fields can be of real benefit. And the benefit is mutual; business history can enrich other sorts of history and also help lead to more historical social science.