Managerial Capitalism and Public Policy

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Business historians know that public policy--the mix of law, public administration, and politics--has had an important impact on the development of the American business system. The scholarly issue, of course, is how important, and in what ways in particular. Business and economic historians have produced a rich literature on the place public policy had in building a transportation infrastructure in the nineteenth century. And there is a growing literature on the role of government in regulating (and promoting) the important transportation, communication, energy, financial, agricultural, and defense industries in the twentieth century [28, pp. 33-55; 40, pp. 10-35; 29].

The role of public policy in the origins and development of the largest 100 or so professionally-managed industrial corporations--the epitome of managerial capitalism--has not until recently been accorded the same degree of attention that these other sectors have received. This paper is directed to the impact of federal antitrust and labor policy on the largest industrial corporations. The focus will be on the 1890 Sherman and the 1950 Cellar Kefauver antitrust acts, and the National Labor Relations Act of 1935 [6, 32, 15, 9].

Examining the extent to which public policy has affected the development and behavior of industrial corporations has taken on some urgency as the past successes of corporate America have been dimmed by almost two decades of troubling economic change in the face of sharp German and Japanese competition [8, 43]. Why the United States lost its competitive edge in leading firms in critical industries is a large topic that will occupy business historians for some time. In view of the urgent interest in competitiveness, it should be clear that understanding the impact of past public policy on the largest industrial corporations is not a limited academic exercise. To make intelligent recommendations about what, if anything, government can or should do to affect corporate managers' short or long-term behavior, those who make policy should have a good sense of how public policy has affected the professionally-managed industrial corporation in the past.

To be sure, unlike Japan, Germany, and France the United States did not develop a capitalism marked by frequent direct intervention in the industrial sector by a powerful professional civil service, removed from the

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wrangling of legislative politics. Nevertheless, the American system of government and its courts have had an important role in defining the rules by which key markets were organized. In the United States policy toward industry was often made through highly partisan political exercises, which turned to judicial processes--either through the courts or regulatory agencies--to help rationalize and interpret what Congress wrought. The result was a highly legalistic and adversarial relationship between government and big business, which all too often obscured the economic realities confronted by managers building corporate enterprises.

The antitrust laws governing how major firms were to treat competitors and what kinds of firms they could merge with, and the equally important labor legislation of the 1930s guaranteeing workers the right to organize, have influenced the strategic behavior of the largest industrial firms. The legislation helped shape key market relationships among competitors in leading industries and between managers and workers in major firms. By establishing in law rules of behavior toward competitors and workers, public policy over time affected major corporate strategic decisions about such central issues as mergers, diversification, foreign expansion, and research and development expenditures, as well as the way in which workers were to be motivated and utilized in the process of production.

A stringent policy against cartels is a peculiarly American phenomenon. At the turn of the century, Britain and especially Germany took a comparatively lenient attitude toward cartel behavior [21, pp. 59-64]. In contrast, in the United States antitrust policy evolved out of the sharp political reaction to industrialization, a response complicated by a weak national government and traditional constitutional concerns about the separation of powers between the states and the federal government [18, pp. 226-67; 11, pp. 12-27].

Judicial interpretation and administrative application of the Sherman Act had two substantial consequences for the development of managerial capitalism. First, it stimulated the turn-of-the century merger movement. And, second, it created oligopolistic markets in a few industries, and sanctioned such arrangements in many others. This legislation and the judicial interpretations it inspired occurred just at the time that some of the most innovative builders of industrial capitalism in the United States were structuring their own enterprises to take advantage of high fixed costs to produce goods at low unit costs. The political and judicial turmoil over antitrust led to uncertainty that resulted from the federal courts' inability to clarify quickly what Congress intended in regard to large industrial corporations. And the judicial situation was compounded by frequent political partisanship on the issue. The public sphere demanded managers' attention because corporate strategy could easily have to be made in a political environment in which judges grappled with arcane issues of procedure, jurisdiction, and precedent, while politicians intent on winning elections attacked concentrated economic power, and government bureaucrats concerned themselves with building their own agencies [1, p. 37].

By the end of the 1890s, the Supreme Court had ruled cartel-like arrangements illegal under the Sherman Act. It was in dealing with "tight

combinations," however, that the Court had to struggle with more complex legal and constitutional issues. In a controversial opinion handed down in 1895 in the *E.C. Knight* case, the Supreme Court seemed to indicate that the federal government could not act against holding companies [31, pp. 304-23].

When the 1890s depression ended in 1897, a vast merger wave began. Between 1897 and 1904, 1,800 companies were absorbed into new consolidations [23, pp. 1-5; 6, pp. 75-77; 12, pp. 59-77]. The merger movement, it should be emphasized, was not a phenomenon occurring soley in response to Supreme Court opinions. Some investment bankers and corporate attorneys induced mergers for no other reason than to garner large promotion and underwriting fees, and in some cases to profit from speculation in new securities. The mergers also included holding companies that had been planned early in the 1890s but deferred because of depressed conditions between 1893 and 1897. Moreover, not every merger was organized as a means to control unruly markets and as a substitute for a horizontally-organized cartel. About 12 percent of the mergers were put together to create vertically integrated firms, following the strategies of some of the most innovative firms of the 1870s and 1880s [12, pp. 71-72].

Despite these other reasons for mergers, however, it is difficult to escape the conclusion that the merger movement was in important respects a result of the Sherman Act and how it was interpreted by the Supreme Court in the 1890s. Clearly, corporate attorneys, investment bankers, and senior managers saw the mergers as a legal way to gain the potential advantages of market control that had resulted from cartels.

It is also clear that the government and the courts between 1902 and 1904 had a lot to do with putting an end to the merger phenomenon. To appease supporters of antitrust who were outraged by the turn-of-the-century frenzy to create giant enterprises, Theodore Roosevelt mounted a highly politicized, publicized, and ultimately successful prosecution of the Northern Securities Company, a holding company created to control the Great Northern and Northern Pacific Railroads. In the 1904 Supreme Court decision on *Northern Securities* brought on appeal, the justices reaffirmed the lower courts' narrow definition of restraint of trade. The majority of justices, however, went even further. They raised the question of intent, that is, did the creators of the Northern Securities company intend to restrain trade by creating a holding company. The majority believed they had [37, pp. 134-42; 23, pp. 166-69; 12, pp. 95-97; 25, pp. 218-19].

Corporate managers and their attorneys were distressed at a decision that raised questions about the legality of many of the recent mergers [12, pp. 97-112; 37, pp. 134-42, 253-85; 23, pp. 166-73; 41, pp. 61-88]. Providing greater guidance to management were Supreme Court decisions in the celebrated *American Tobacco* and *Standard Oil* cases decided in 1911. In each case the Court made a distinction between reasonable and unreasonable restraints of trade. Both companies had created near monopolies, and in doing so had acted deliberately and adversely against competitors. An *intent* to create monopoly and to harm competitors, therefore, became a critical factor in the Court's future determination of whether restraints were reasonable or not [12, pp. 94-98; 37, pp. 372-82].

It took several years for corporate leaders to fully adjust to the implications of these decisions. A large legal commentary developed to interpret the decisions for lawyers advising corporate management. The suit against United States Steel took on particular importance because the company's president, Elbert Gary, had publicized the corporation's effort to act as a leader in stabilizing prices in the steel industry, a policy also instituted by leading firms in other industries such as agricultural equipment, paper, and meatpacking. The company won the case in the federal courts in 1915. On appeal by the government, the Supreme Court finally decided in favor of the corporation in 1920 [30, pp. 593-620; 10, pp. 12-17].

In large part, the 1920 decision hinged on two facts. One, USS was not a monopoly. Indeed, it had lost market share since its formation in 1901. And, second, it had not set out to harm its competitors. In the proceedings, as a matter of fact, competitors testified that they had done well under the price leadership exercised by United States Steel [30, pp. 593-620].

In effect, then, by 1920 antitrust policy provided rules of behavior toward competitors that created incentives for managers to sustain oligopolistic market arrangements. Public policy in a few cases had created oligopolies, as in the tobacco, oil, and black powder industries. But in other industries where an oligopolistic structure evolved on its own--meatpacking, electrical products, pharmaceuticals, and automobiles--the government and the courts sent a distinct message to corporate strategists about the need to have competitors.

Those firms that survived and flourished over the long term in this environment were the enterprises, as Alfred D. Chandler has argued, that made three-pronged investments in manufacturing, marketing, and management. To be sure, some managers had concluded on their own--and even before the court decisions-- that more stable returns were possible when a company steadily controlled a significant proportion of a market instead of trying to control the entire market, which in the normal course of events would fluctuate [6, p. 67; 39]. Even so, antitrust should not be discounted in understandting oligopolistic competition, because the government and the courts by the 1920s had made clear how even the largest industrial firms should behave toward competitors, a point reinforced by the growing fraternity of corporate lawyers specializing in antitrust law. Because of antitrust, corporate strategists had solid reasons to avoid the futile efforts still common at the turn of the century to gain total control of an industry by acquiring competitors or forcing them out of business.

During the 1920s a semblance of stability appeared as the government significantly reduced its antitrust activity. Some of the largest firms took advantage of the calmer atmosphere to enhance their organizational structures to speed internal communications, build efficient accounting systems, and concentrate on completing their vertical structures, which contributed to another merger movement. Consumer goods producers focused on improving marketing and advertising, and many of the great industrial research operations matured in these years too, as managers spent some of their growing corporate earnings on laboratories, scientists, and engineers [16; 36, pp. 150-52; 17; 27, pp. 51-67]. The strengthening of the largest industrial

corporations in the 1920s positioned them well to cope with the decade-long impact of the financial collapse that occured in 1929. The largest firms operating in oligopolistic markets eventually scaled down operations in the 1930s to take advantage of what markets there were for their goods in a severely depressed economy [3, pp. 48-102]. Antitrust nevertheless remained an issue. Even so, important advisers to President Roosevelt and leading members of Congress believed that the concentration of American industry contributed to the intractable nature of the depression by hindering the government's attempts to increase production.

By 1937, the President seized on this interpretation of the persistence of economic problems [16, pp. 116-137]. He supported the creation of a Temporary National Economic Commission, made up of members of the Senate and including commissioners of the Federal Trade Commission, to study the intractability of the depression. A year later Roosevelt gave his blessing to Thurmond Arnold, head of the Justice Department's antitrust division, to mount an antitrust campaign. The war intervened, and government and large business forged an alliance of necessity to ensure the production of war materials. After the war, the new Truman administration took up where Arnold had left off and initiated a large number of antitrust suits. Indeed, by the beginning of 1949, almost 50 of the 100 largest industrial corporations were facing some kind of antitrust prosecution, including major suits against Alcoa, DuPont, and US Rubber [12, p. 170].

While many of these suits were pending, members of Congress turned to strengthening the antitrust laws. The result of the heightened interest in antitrust was the passage in 1950 of the Cellar Kefauver Act, which is also known as the Antimerger Act of 1950. Ostensibly, the legislation was to repair a "loophole" in the Clayton Act of 1914, which prohibited the purchase of a competitor's stock, but not the purchase of a competitor's assets. The message the legislation sent was that firms could not enhance their market power by strengthening their horizontal and perhaps their vertical structure in an industry where they already had an important market position. What the law did was to encourage non-product-related diversification. Product-related diversification had been one of the strategies the largest corporations had already adopted to cope with the depression in the 1930s. To take advantage of economies of scope, large corporations continued after the war to move into new but related lines of products. But Cellar Kefauver induced a variation on the strategy, leading to what has been called diversified or conglomerate mergers. To avoid antitrust prosecution, mergers had to be in lines of business not too closely related to a corporation's main product base [12, pp. 177-90; 35, pp. 223-26]. To be sure, not every major firm adopted such a strategy. Indeed, one reasonable alternative to diversification was to focus even more closely on traditional lines of business, using growing returns from the post-war boom to improve production processes and to develop (in-house) new, related products. Another alternative for some firms was to increase foreign sales by building factories and distribution networks abroad, although this was not always easy in the first decade after the war [42]. Even so, there can be little doubt that Cellar Kefauver, and the courts and Justice Department, limited one line of development: diversification by purchasing

related kinds of business and enhancing by vertical integration product lines already produced. Between 1954 and 1969, the overwhelming majority of antitrust suits brought under Cellar Kefauver were against horizontal and vertical of mergers, even though such mergers declined as a percentage of the total number. During the period of strictest enforcement of Cellar Kefauver (1964-1972) the number of diversified mergers was higher than in the period before or after [12, pp. 203-12, 222-25].

Thus, antitrust in the post-war period contributed to another major change in managerial capitalism. If the original 1890 law ultimately played out in the courts to sanction oligopolistic markets, the legislation of 1950 encouraged a form of diversification for some firms in the 1950s and 1960s that, in retrospect, did not make the best use of the economic advantages of oligopoly.

The Wagner-Connery National Labor Relations Act of 1935 was as important as antitrust to the development of America managerial capitalism. As antitrust initially contributed to bringing stability to oligopolistic markets, this labor legislation ultimately helped stabilize the labor markets of key industries like autos, chemicals, communications, and steel. In traditional political and labor history, the Wagner Act is portrayed as a culmination of a long struggle for the power of workers to organize. There is no question that union members' wages and benefits improved in the three decades after the passage of the NLRA. There also is little question that the managers of the largest industrial corporations were initially hostile to the Wagner Act and the movement to organize workers that followed its passage. While opponents of the Wagner Act ultimately succeeded in weakening its provisions through Taft-Hartley in 1947, most managers by then accepted the fact of organized labor's authority to bargain in the interests of its members.

All of these results are well known, and documented in the historical literature on the history of unionization [2, 26]. What, until recently, received much less attention was the impact of the Wagner Act on labor-management relations, especially on the factory floor in the negotiations between managers and union representatives over work rules, job classifications, and the scheduling of work. Traditional historical accounts saw the Wagner Act in terms of what the worker gained. The more recent work sees the consequences of the Wagner Act more ambiguously, in terms of losses in managerial effectiveness, industrial productivity, and ultimately worker satisfaction [34, 5, 4, 19, 14, 20, 38, 24].

The sense that government-guaranteed union organization might have been detrimental hinges on what recent scholarship suggests management was attempting to accomplish in building worker cooperation, motivation, and morale before the depression of the 1930s. As entrepreneurs and, later, professional managers built giant enterprises at the end of the nineteenth century, they turned over the "management of the men" to foremen. In the first two decades of the century foremen employed the "drive system," a regime based on the assumption that workers needed to be coerced into producing. The system flourished because of abundant supplies of willing workers drawn from immigrants, young Americans leaving the farm, and--during World War I--blacks moving out of the South [34, pp. 43-44; 19, pp.

115-26]. Even before war in Europe in 1914 reduced the supply of immigrant labor, a small number of thoughtful managers began to question the foreman's use of the drive system. High worker turnover increased operating costs because new workers had to be trained. And dissatisfied workers were a cost too, as they resisted the regimen of the drive system.[19, pp. 163-65]

By the 1920s, the most progressive corporations abandoned the drive system and replaced it with campaigns to build worker morale. The goal was to create a sense of dual commitment. In return for high levels of effort and loyalty to the company, management attempted to guarantee workers not only good wages and some benefits, but also the prospect of long-term employment. Programs varied among the largest corporations, as a growing body of professionals--personnel managers--looked after systematizing and improving the lot of employees, in what has been called "welfare capitalism" [19, pp. 163-65].

On the face of it, the system was paternalistic, and in less than subtle hands--such as Henry Ford's--manipulative and intrusive. At its best, however, the system improved working conditions, provided some health and pension benefits, and offered opportunities for training and the upgrading of skills. And workers, in some places, could make their views known to management through grievance systems and company unions. The latter, anathema to organized labor, nevertheless provided a channel of communication--narrow as it may have been--between managers and workers [4, pp. 88-89; 33, pp. 335-57].

Nevertheless, whatever efforts managers made toward building morale, loyalty, and commitment could not withstand the economic collapse of the 1930s. At first, companies tried to avoid layoffs by sharing work. Line workers were shifted to maintenance and repair jobs. When workers had to be let go, management provided severance packages, the cashing in of pensions, and the like. Companies long identified with a particular community contributed to local agencies helping the unemployed [5, pp. 68-78]. Despite these efforts, even the largest, most powerful firms eventually succumbed to the reality of significant loss of demand. They cut production and their work forces. Between 1929 and 1933 industry output had declined almost 60 percent in iron and steel, and 65 percent in automobiles. By 1933, GM alone had reduced production by 75 per cent [7, pp. 23-36].

Management, in short, had not been able to live up to the implicit promises of the corporate welfarism of the 1920s. Of most significance, managerial capitalism had failed utterly in its implied commitment to stable employment for the loyal and hardworking employee. Managers did not break these implied promises lightly, but they ultimately had to let people go, and in record numbers. Of all of the promises that organized labor made to industrial workers later in the 1930s, perhaps the most potent was the one promising job security and the rights of seniority. Ultimately, it was organized labor that was to provide more than good wages and benefits; they were virtually to guarantee a long-term stake in a job.

Managers at the largest corporations at first resisted unionization promoted by the 1935 National Labor Relations Act. It was a confrontational, and at times bloody, process that finally led to NLRB-supported union

creation. By 1937 managers at a number of large firms concluded that resistance, and the strikes, sit-ins, and sabotage that often followed, were counterproductive. With General Motors in the lead, and United States Steel not far behind, managers in early 1937 concluded that they had to deal with the new unions, even though many managers continued to lobby for a weakening of the original National Labor Relations Act [14, pp. 23-41].

By the early post-World War II years, managers and unions had created a new labor-management relations system for the largest industrial corporations. The system that evolved was one based on the concept of managers' "right to manage." This was the key issue to managers at the largest industrial firms. Production planning was a complex task requiring a work force willing to follow orders. Disruptions and slowdowns were extremely costly. Management wanted to control the design, scheduling, and pace of production, but was willing to turn over to the unions specific job descriptions, work rules, layoff procedures, and seniority rules. Oligopolistic firms could pass on to consumers increased labor costs because managements at other large firms in the same industry were negotiating with the same unions [14; 24, pp. 270-80]. By the 1950s, the United States' labor policy helped create the kind of stable work force that management had failed to provide for itself in the 1920s. Workers received good wages, generous benefits, and with the growth of seniority reasonable assurances about the safety of their jobs.

But there were costs to this government-inspired, NLRB-protected system of labor-management relations. It was a legalistic, essentially adversarial, system that spawned large management and union bureaucracies. Of greater long-term consequence was the trading away by both management and the unions of genuine concern about worker morale and satisfaction. While management essentially got the control of the shop floor it wanted, there were unhappy consequences to this "victory." In the mass-production, mass-processing industries, line workers continued to be, in the trite phrase, mere cogs in a complex machine. Both managers and union leaders acquiesced in a system that kept line workers passive. Workers were not expected by either side, as a routine matter, to make suggestions about how to improve a process that they knew first-hand, sometimes better than the managers and engineers who had originally designed the shop-floor production system [24]. Managers lost the kind of intense worker involvement in the work process that we now know has proved to be so important to the post-war success of Japanese and German industry. Elaborate and rigid job descriptions pegged to a hierarchy of pay scales has reduced the flexibility of management when it wanted to redesign the production process and adopt new technologies. The full costs of the system remained hidden until the advent of serious foreign competition in the 1970s. Ultimately, however, managers could not conceive of a system that might require them to involve workers in changing the shop floor.

In conclusion, over time public policy has had a significant impact on the development and behavior of the largest industrial firms. While this might seem an obvious point, it has not been taken into account sufficiently in most of our studies of big business. The growing recent literature on antitrust and

labor policy make clear the obvious but sometimes forgotten point that markets are more than a simple matter of exchange. Public policy and the law establish rules that encourage certain kinds of behaviors and discourage others, that point economic actors in particular directions. The impact of public policy is most easily understood in directly regulated industries, but it also can be seen in nominally "unregulated" industries too. In regulated industries, government often set limits on prices and acted to limit entry or exit from the market. In the comparatively unregulated setting of the largest industrial corporation, government also had a profound impact by framing the rules of behavior in the markets in which firms sold their goods and acquired labor. That is, government antitrust and labor policy placed limits on and created opportunities for the large managerial firm in both the sale of its products and in the utilization and treatment of its workers. Public policy, to put it another way, helped shape the relationships among the large industrial corporation and its competitors, and between the enterprise and its unionized workers

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