

Background Essay: The Rise of Big Business

Directions:

Read the essay and answer the review questions at the end.

After the Civil War, the American economy was characterized by the rise of big business. Technological innovations made mass production in manufacturing possible. Transportation and communication revolutions developed national markets for goods. Large-scale companies grew as the scale and scope of modern business increased dramatically. While the rise of big business was controversial and led to increasing government regulation, the American economy grew rapidly and became the world's largest industrial economy with widespread benefits.

The American constitutional system greatly contributed to the growth of the post-war economy. While the federal government had often encouraged economic growth of the private market by providing land grants, a banking system, and various subsidies, the American economy was generally a system of free enterprise largely unfettered by government restraints and characterized by self-regulating markets. A constitutional rule of law protected private property and patents, allowed entrepreneurs to fail and start over again with bankruptcy law, and enforced contracts. Therefore, entrepreneurs with talent, motivation, and good fortune had the freedom to innovate and opportunity to succeed.

The late nineteenth century experienced rapid expansion of railroad mileage across the country, linking farmers, raw materials, factories, and consumers in a market economy. Railroads

provided faster, cheaper, and more reliable transportation. In addition, railroads became the first corporations that provided a model for the rise of big business. They raised huge amounts of capital through the sale of stock, built new bureaucratic management to organize increasingly complex operations across wide geographical areas, and stimulated demand for other heavy industries such as coal, iron, and steel.

Big business grew in the late nineteenth century when new sources of power such as the steam engine, coal, and electricity drove the machines in larger factories that organized production under one roof. Companies could now mass produce standardized goods faster and more efficiently. Companies employed thousands of workers in factories often in urban areas. These large companies followed the railroad model and incorporated as public companies which then sold shares of ownership as stock. Therefore, ownership became increasingly divorced from management. A large bureaucracy of managers sought rational, efficient operations, while central offices analyzed operations and made strategic decisions for the firm.

The rise of big business caused great controversy. The late nineteenth century experienced a long-term decline of prices known as deflation. Companies struggled to make profits in this fiercely competitive environment. As a result, they formed “pools” or “trade associations” that were informal agreements to

cooperate in the fixing of prices and allocating business so that members were all profitable. Since these agreements were voluntary, they were not legally binding and were often broken by members. Eventually, big business formed “trusts,” a type of business consolidation that would more formally create a single holding company for the stocks of several leading businesses in an industry. This new, powerful company would be able to exercise a great deal of control over price and output decisions for the entire industry. The size of these businesses gave them an advantage over smaller competitors because they closed less efficient plants and cut costs with new technologies. Businesses grew in size and dominated entire industries as monopolies or oligarchies. Many American reformers, consumers, and businessmen feared the trusts would destroy competition in the American economy and exercise disproportionate political influence.

Whereas reformers worried about the threat to the American free-enterprise and democratic political system, industrialists argued that they were saving the system from ruinous competition through economies of scale. For example, Andrew Carnegie, who worked in a mill as a young man, mastered telegraph technology, and then worked for the Pennsylvania railroad. With money from investments, he became an entrepreneur in iron and steel for railroad bridges and rails. He founded Carnegie Steel and relentlessly introduced any new process or technological innovation that would cut even minute wasteful costs in order to lower the price of his steel. Carnegie also frequently invested millions of dollars in profits back into the latest technology instead of distributing them as dividends to investors. In addition, Carnegie Steel vertically integrated, which

was the process of acquiring sources of raw materials and the railroads that transported the raw materials to the factories to eliminate the costs of middlemen. As a result, Carnegie helped contribute to the lowering of the price of a ton of steel rails from over \$100 in the 1860s down to \$11 by 1900. He sold Carnegie Steel to banker J.P. Morgan in 1901 for \$480 million and became a philanthropist.

Another highly successful entrepreneur of the late nineteenth century was John D. Rockefeller who built Standard Oil. When large amounts of crude oil were discovered in northwest Pennsylvania in 1859, the young bookkeeper decided to enter the refining industry to manufacture kerosene and other byproducts such as lubricating oil and gasoline. Like Carnegie, Rockefeller invested in new technology and modified any process such as making his own oil barrels and reducing the number of solder drops on tin can seals to lower costs. Besides vertical integration, Rockefeller engaged in horizontal integration, which meant buying out competitors to control a greater share of the industry. Standard Oil was a remarkably efficient firm with strong economies of scale that led to reducing the price of oil for consumers and other industries while preserving large profits for the company.

Standard Oil controlled approximately 90% of the oil industry by 1900 through fair and unfair business practices, and drew criticism of big business. Rockefeller entered into voluntary agreements with competitors and set their production quotas to his liking. He induced competitors to sell their businesses by threatening to put them out of business, though he usually offered a generous price in cash or valuable company stock. Standard Oil also forced rebates from railroads that lowered

shipping costs for its oil while guaranteeing a large, fixed amount of traffic for the railroads in a mutually beneficial arrangement. In addition, Standard Oil routinely engaged in bribes to local politicians or state legislators to win favorable treatment and block government regulation. As a result, the company became a symbol of the danger of trusts in the popular imagination, and competitors warned of its monopolistic practices. The investigative journalist Ida Tarbell wrote a scathing exposé of the company entitled the *History of the Standard Oil Company*. Although trusts often engaged in fair and beneficial practices to consumers and the economy as a whole, the industrialists were often seen as “robber barons,” who became immensely wealthy through corruption and mistreating workers, competitors, and the public.

The rise of big business was highly controversial especially among smaller competitors. Many small and local businesses could not compete with the lower prices of large corporations that resulted from greater efficiency or railroad rebates. These small businesses often either went bankrupt or were bought out. Representatives of small business, politicians, and ordinary Americans feared that corporations threatened free markets, and therefore the American Dream, with monopolistic control. On the other hand, many small businesses thrived when they decided to either produce a niche product or target a local market rather than directly competing with those companies that dominated the industry. For example, several Pittsburgh steel mills specialized in making nails, nuts and bolts, and barbed wire that Carnegie Steel had no interest in producing.

The success of mass production in the late nineteenth century led to the rise of mass

marketing to sell goods. Companies began to market their goods with name brands to differentiate them on shelves. Indeed, stores themselves changed dramatically from practical dry-goods stores to attractive urban department stores and chain stores. Department stores offered a shopping experience with wondrous and dazzling displays for consumers, and chain stores such as the A&P offered reliable, standardized products. Advertisements flooded newspapers and influenced buying decisions by glamorizing goods. In rural areas, farmers became consumers of goods by shopping in Sears, Roebuck, and Montgomery Ward mail-order catalogs. The wealthy in the Gilded Age demonstrated their social status with gaudy displays of wealth known as “conspicuous consumption.” Culture for the middle class began to reflect consumerism rather than the virtues of Victorian character.

Although many were tempted to display their great wealth to impress others, entrepreneurs also dedicated much of their wealth to philanthropy. Some like Carnegie and Rockefeller had hundreds of millions of dollars when most Americans struggled to make a few hundred dollars per year. Concerned about American civic culture and the condition of the masses, they gave millions of dollars away to universities, libraries, museums, medical research, and urban beautification projects to educate and uplift the condition of their fellow Americans. They also endowed large foundations that would continue to donate millions of dollars to causes ranging from world peace to eradicating disease. Many of the entrepreneurs felt the imperatives of the “Gospel of Wealth” that great wealth brought a social responsibility to create a better society. However, critics then and now argued that the industrialists’ philanthropy was a just a ploy to

forestall government regulation, maintain social control over the masses through the public spaces, and preserve inequalities of wealth by keeping the system in place rather than reforming it.

The convulsions in the American economy and problem of the trusts led to many calls for reform. Farmers, small business, and Progressive reformers sought government regulation of railroads and industry, though some with a more radical view wanted socialist government ownership. Surprisingly, businessmen were often at the forefront of reforms including government regulation. Ruinous competitive pressures in the market made them seek relief in the form of government regulation that might preserve profitability. The regulations led to the rise of the national regulatory state with executive agencies that acted as a broker among different social interests.

Government regulation began with the Interstate Commerce Act (1887) and the Sherman Antitrust Act (1890). The Interstate Commerce Act targeted railroad rebates by prohibiting rate discrimination and was generally supported by the railroads. Railroads sought relief from competitive pressures that forced prices downward, and the businesses that demanded that they give rebates. They thought the law would help to rationalize the industry. Railroads also supported measures in the Progressive Era including the Elkins Act (1903) that prohibited rebates and the Hepburn Act (1906) that created a commission that set “reasonable” rates rather than the market. During World War I, the federal government took over the railroads to ensure efficient mobilization for war. These regulatory measures had the support of an angry American populace, but none solved the problems of the railroad industry including

competitive pressures that drove prices and profitability down.

The Commerce Clause in Article I, section 8 of the Constitution granted Congress authority to regulate interstate trade. Congress used this authority to pass the regulations of the Sherman Anti-Trust Act (1890), which banned “every ... combination ... in restraint of trade or commerce among the several states.” However, the legislation was written vaguely and satisfied neither its supporters nor its opponents. In *U.S. v E.C. Knight* (1895), the Supreme Court decided that the “sugar trust” that controlled 90 percent of the industry did not violate the Sherman Act because there was no evidence that the trust controlled prices. The Court also decided the trust’s activity was rooted in manufacturing, and therefore did not restrain interstate commerce and could not be regulated.

Presidents Theodore Roosevelt, William Howard Taft, and Woodrow Wilson sought various regulatory agencies to control the trusts and often prosecuted the trusts in federal court. President Theodore Roosevelt became known as a “trust-buster.” This nickname proved especially true for the dissolution of the 1904 Northern Securities Company by the Court for violating the Sherman Act. However, his successor William Howard Taft prosecuted more trusts, including Rockefeller’s Standard Oil. In 1911, the Court articulated the “rule of reason” in breaking up the Standard Oil Company when it decided that immense size was not always a problem and that not all restraints of trade were unreasonable or illegal. In other words, it distinguished between “good” and “bad” trusts based upon behavior. President Woodrow Wilson signed the Clayton Act (1914) into law enumerating illegal antitrust activities and empowering another executive agency, the Federal Trade Commission,

to enforce its provisions. Neither railroad nor business regulation solved the problems of big business nor were they wholly satisfactory to nearly any interest group with a stake in regulation. Ironically, World War I saw the close cooperation of government and business in order to achieve greater efficiency in industrial production for war. This established a precedent of a very close government-business relationship that would influence later New Deal reforms during the Great Depression.

The rise of big business during the industrial age dramatically reshaped the American economy and society. Although many of the changes benefitted Americans and resulted in greater prosperity, the debate over regulating business would endure throughout the twentieth century particularly during the convulsions of the Great Depression.

REVIEW QUESTIONS

1. How did railroads contribute to the rise of the modern corporation?
2. What were the characteristics of the modern corporation?
3. Why were trusts formed? Why did many Americans oppose them?
4. How was small business affected by the rise of big business?
5. How were goods mass-marketed?
6. Why did the wealthy industrialists engage in philanthropy?
7. What was the response of Congress, the Supreme Court, and presidents to the rise of big business?