14.4 REGULATION OF BIG BUSINESS

A central problem facing the business enterprise is maintaining the orderly governance of the markets in which they operate. The going concern wishes to form stable expectations over the viability of its business through time. An industrialized economics system means that firms are embedded in networks of interdependent financial flows, which suggests that firms must find mechanisms to coordinate their operations and establish norms governing how other participants in the markets will behave, especially via their pricing policy. Formal and informal cartel systems were frequently established in an attempt to bring harmony to markets. Earlier we have referred to these arrangements as **restrictive trade practices**, due to their objective of avoiding price competition between firms over market share. Recall, the business enterprise must ensure that it is capable of administering a price to the market that embodies a sufficient markup that recovers their costs over some defined period. Prices must be also provide a flow of income to its shareholders as profits, as well as a means of accumulating funds for investment purposes. If firms engage in a price war to capture a larger share of the market, they will undermine their revenue streams and have difficulty achieving their desired cash flows. The solution is to institute controls on individual firms so that they are properly incentivized to cooperate.

Market governance institutions are best viewed as efforts on the part of the business community to socialize the risks and rewards to individual firms. However, voluntary and privately organized market governance institutions were not terribly stable. There was always the risk that some participants would defect and undermine the cooperative agreement, resulting in a newfound round of ruinous competition.

A solution to the instability of private market governance structures was found in the federal government. The Interstate Commerce Commission (ICC) was established in 1887 in order to provide regulation over railroad rates, and emerged largely as a result of lobbying efforts by the railroads themselves. Government regulation over markets was not new to the American economic history. However, establishment of the ICC resulted in the federal government exercising its discretion over of the development of economic affairs, by instituting a new form of market governance by regulatory commission. With a standing commission now responsible for authorizing proposed rate schedules the problem of coordinating and enforcing voluntary rate design policies solved by outsourcing this function to the federal government.

The Interstate Commerce Commission emerged as a result of two political processes. On one hand, agricultural interests organized through the Grange, Patrons of Husbandry, and the like, viewed railroads as monopolies that extracted unfair monetary flows from them by charging exorbitant rates, and administering differential rate schedules that had the effect of advantaging some ratepayers at the expense of others, and undermining the ability for some farmers to bring their goods to market. These agricultural interests tended to view their monopoly power as the primary concern, and sought to compel railroads to act as if they were competitive and thereby undermine their ability to capture rents. Businessmen in the railroad and finance industry sought regulation as a means to ensure coordination between competitors, but held different views about how such regulation should be structured. Ultimately, the railway interests embraced the ICC for it helped to quell anti-monopolist agitated while preserving private control and ownership of the railway system.

THE SHERMAN ACT

The 1890s mark a turning point in American economic history. Historians generally mark 1890 as the close of the frontier, as the transcontinental railways had linked the Pacific with the Atlantic and allowed for rapid and low cost transportation and communication. In the 1890s cities in the United States began electrifying. By the 1890s, big business had become a powerful and central organizing institution in the American economy. Passage of the Sherman Act in 1890 serves as an important landmark in the history of big business and provides a useful bookend for delineating a new phase in the American economic development.

The Sherman Act of 1890 sought to prohibit behavior that may be construed as acting in restraint of trade. The anti-trust act makes illegal cartels and conspiracies to engage in price fixing. Consequently, some mechanisms that firms relied upon previously to govern markets were no longer legal, such as pooling arrangements and cartels. While the Sherman Act was seldom applied in earnest as a means to restrain corporate power, it did encourage the practice of firms attempting to consolidate control through mergers and acquisitions of their competitors.

The first great merger wave occurs between 1895 and 1904 and represents the effect of the Sherman Act on the methods by which firms attempted to control markets in the wake of the Panic of 1893. Efforts by firms to capture more market share in order to spread their fixed costs more widely, led to ruinous price wars. Since previous forms of market governance had been largely prohibited by law in the Sherman Act, firms responded by consolidating in order to eliminate the costs associated with redundant capacity in light of the depressed economic conditions of the early 1890s. Between 1895 and 1904 roughly 300 firms disappeared on an annual average basis. From 1898 to 1902 this wave of mergers was particularly acute, with 1028 firms lost to consolidation in 1899 alone. The 1890s merger movement produced some of the more notable monopolies in American history, such as U.S. Steel, American Tobacco, Du Pont, and International Harvester.

The Sherman Act, when measured by its efficacy in preventing the consolidation of corporate control, was a total failure. However, it is important to note its foundational importance to subsequent processes of coevolution between the going concern as big business and the legal framework. Extensive revision of the laws governing corporate behavior would occur in the 20th century. Nevertheless, the Sherman Act serves as a an excellent reference point for a turning point in the history of the corporation in American and closing our discussion of the history of big business.

14.5 CONCLUSION

This chapter has sought to provide a broad outline for understanding some of the more important themes that contextualize the big business in American history. The history is expansive, and so we have held a fairly narrow view of the going concern in a limited period of American history. The value in this approach, however, has been to focus on a foundational period in American economic history, the 19th century, and explore how the interaction between corporations under the control of members of the business community and legal frameworks established a course of development in which big business becomes a normal feature of capitalism in the United States. By tracing the corporation from its roots in colonial Virginia to the landmark Sherman Act in 1890, we have taken care to view the firm as a vehicle for institutional change and the locus of cumulative causation. Therefore, we walk away from this reading of American economic history with the understanding that thinking about the firm as a site of institutional capacity facilitates a more dynamic understanding of economic development. We see that power, control and influence matter in formulating a rich understanding of why the United States economy developed as it did, rather than following some other technical possibility.

CHAPTER 15. COSTS AND PRICES: THE EVIDENCE

INTRODUCTION TO COSTS AND PRICES

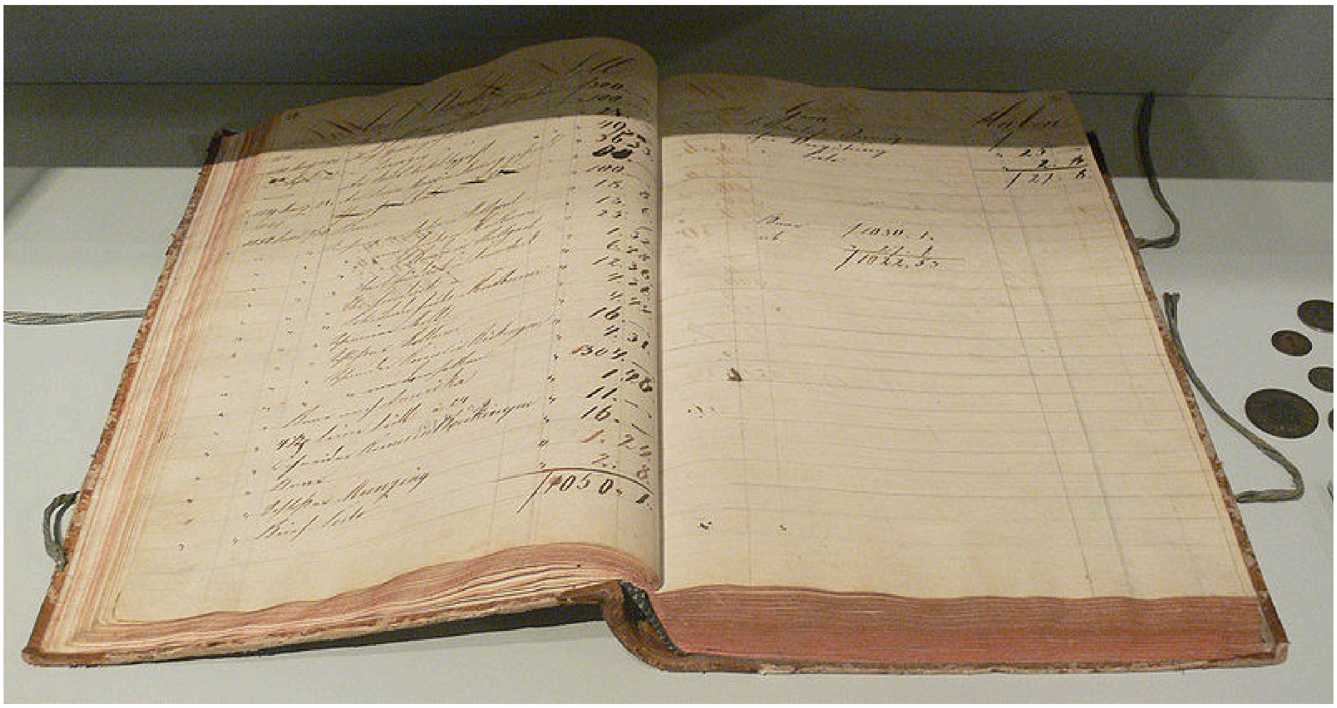

Figure 1. Ledger from a German general store, 1828. (Praefcke, Public Domain).

CHAPTER OBJECTIVES

Introduction to Prices and Costs
In this chapter, you will learn about:

- Testing the Neoclassical Theory of the Firm
- Costing and Pricing: A Heterodox Alternative