HISTORY of the American Economy

Fifth Edition

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HBJ

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Preface

The appearance of the fifth edition of *History of the American Economy* merely five years after the publication of the fourth edition attests to the brisk continued advance of penetrating research in the fields of history, economics, and economic history. No era, indeed, almost no important issue on the economic past of the United States has missed the attention of the scholarly professions in recent times. New evidence and revised interpretations have been the compelling reason for this new edition. Each chapter has been revised and many are almost entirely new.

The book has also been restructured to better realize its primary purpose—the teaching of American economic history. This edition retains the presentation of material in chronological order, and the division of U.S. history into four periods: the Colonial Era; the Revolutionary, Early National, and Antebellum Eras, 1776–1860; the Reunification Era, 1861–1919; and the Modern Era, 1920 to the Present. However, a modest shift of emphasis has taken place with more attention given to events following the Civil War. In addition, the chapters have been rearranged to follow a pattern of topics or themes. Except for the section on the colonial period, where the chapter sequence is slightly different from those following, each section begins with a chapter on the impact of war and (or) its aftermath. Both short- and long-run analyses are given in these beginning chapters providing both a point of departure and a point of reference for the longer historical period. The second chapter in each section addresses the issues of money, banking, and business cycles. The third focuses on land, agriculture, and natural resource issues; the fourth on transportation; the fifth on product markets, market structure and concentration, and industrialization, and the sixth on conditions of labor. Each section ends with one or more chapters on issues of special importance to the period: the causes of the American Revolution; slavery; domestic and foreign trade; and post-World War II unemployment, inflation, and distribution of income, respectively.

To capture the readers' interest in economic history, substantial attention is given to lively policy issues in each chapter. Economic growth, institutional change, and the role of government in the economy remain important general themes, but special emphasis is given to the particular issues of government regulation and intervention—especially since the late nineteenth century—and to the distribution of income at various periods in the American past.

As before, included here are the findings of past and present-day scholars who are characterized by a tremendous heterogeneity of interest and by wide differences in method and point of view. In particular, the results of recent contributions in the vibrant field of American economic history are included. The reader will shortly discover what these results have been. It is fair to generalize that such recent studies have valiantly chipped away at the mythology of history and that many of the accepted "truths" of economic history have disappeared under the light of theoretical and statistical examination. Comforting as it was to think so, the distribution of income and wealth was greatly unequal well before the era of industrialization. Pre-Civil War business cycles did not result from "excessive speculation," "reckless over-banking," or "monetary overinvestment," but from sharp changes in the deficit or surplus position of the Treasury, swings in outlays for internal improvements, international forces, and factors affecting the public's confidence in banks and money. Slavery, as it turns out, was both as efficient and as profitable in the antebellum South as elementary economic analyses would suggest and was not about to "fall of its own weight" in the 1850s. The concentration of American industry, at least in the first great wave, was motivated not so much by the predatory hope of gaining monopolistic power as by the fearsome excess capacities that developed as firms first competed in a national market. To take a more recent example, the Federal Reserve did not meet the oncoming economic storm of the 1930s with easy money, but with money so tight that there were serious pressures on bank reserves until it was too late for monetary policy to save the day. Finally, a current example concerns the confusion and frustration of today's policymakers as they attempt to deal with the unique concurrence of high inflation, high unemployment, and record-setting federal deficits.

This and earlier editions have been sustained and supported by many individuals whose influence has surely filtered through to or directly benefited this one. I remain especially indebted to Hugh G. J. Aitken, Paul Uselding, and Stewart Lee, who offered critical comments and advice on the entire fourth edition, and similarly to George Green, Gavin Wright, and Richard Winkelman for their suggestions and criticism of drafts of this edition. I am grateful for the continued advice and encouragement of Lee Alston, Terry Anderson, Fred Bateman, Stuart Bruchey, Philip Coelho, Paul A. David, Lance Davis, Richard A. Easterlin, Stanley L. Engerman, Albert Fishlow, Robert W. Fogel, Robert Gallman, Claudia Goldin, Robert Higgs, J.R.T. Hughes, Gary Libecap, James Mak, Russell Menard, Lloyd Mercer, Donald N. McCloskey, Douglass C. North, Edwin Perkins, Jack Purdum, Joseph D. Reid, Jr., Mark Schmitz, Don Schaefer, R. L. Sexton, Austin Spencer, James Shepherd, Richard Sutch, Jeffery Williamson, and Mary Yeager.

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I am also grateful to my colleagues Alan Olmstead, Vic Goldberg, and Peter Lindert for their prodding and support; to Melissa Cadet for her valuable research assistance; to Norma Tassler for her administrative assistance; to Katherine Bostock and Irene Elrod for compiling the excellent index; and finally to my wife, Linda, who typed the entire manuscript and suggested many improvements in the revisions.

I hope old friends of earlier editions of the book will enjoy this new edition and find it improved, and that new acquaintances will also benefit from it. I welcome and encourage you to send me your comments and advice.

Gary M. Walton

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1 Introduction: The Emerging Roles of Economic History

Young people, to whom this book is primarily addressed, are not easily convinced of the benefits of historical study. For the most part, the history we were exposed to in elementary and high school probably seemed irrelevant to everyday life. Too often kings and nobles, generals and wars, presidents and legislators have been arrayed into long, tiresome lists, thus giving a preoccupation with explaining what happened to whom, and when, rather than how and why events happened. With such a presentation of history, the past often becomes crystallized into a kind of mythology to be taken on faith and not seriously questioned.

Yet even the unenthusiastic beginner cannot escape the impression that knowledge of the past is useful, indeed vital. We draw on history for a sense of the heritage that underlies both our rights and duties. Without history, we are separated from information that is essential to decision making, and we are deprived of the clues that help us to untangle the complexities of the world around us. In a sense, history is the source of our very identity, as the enthusiasm a few years ago for *Roots* so clearly illustrated.[1] "In an eternal present, which is a specious present, the past is all we know. And as the past is forever slipping back, it reminds us that we too shall in time belong wholly to the past."[2]

But it is as a tool in problem solving that history is particularly useful—not just to professors and government officials, but to businesspeople, scientists, and decision makers of every kind. For example, on national television several years ago, two renowned scientists debated an emotionally charged question of immense importance: How much

[1]Alex Haley, *Roots* (New York: Doubleday, 1976).

[2]Herbert J. Muller, *The Uses of the Past* (New York: Oxford University Press, 1957), p. 31.

should be spent for civilian defense against the ravages of nuclear war? Harrison Brown of the California Institute of Technology took the position that any large-scale construction of fallout shelters would be worthless and that the hope of mankind depended on agreement between the United States and the Soviet Union on questions of disarmament. Dr. Herman Kahn of the Hudson Institute in New York City took the opposite view—that shelters would be effective against fallout and, to some extent, nuclear blast and fire. After the opening minutes of the program, it became clear that the discussion would not revolve around scientific opinion. Both Brown and Kahn had been intimately connected with developments in nuclear energy and did not differ on questions of scientific theory. Indeed, for almost an hour, the discussion was based solely on historical facts and past experience. In previous wars, they asked, how did the strategies of belligerents affect civilian populations? What was the psychological reaction of both troops and civilians to the cruel and unnecessary destruction of cities and towns? Specifically, how had Confederate soldiers reacted to Sherman's march through Georgia? What were the reactions of Londoners to the blitzkrieg and of the defenders of Stalingrad to German brutality? How, in general, have civilian populations behaved under the stresses of war? Is there historical evidence of degrees of civilian fear? Would nuclear blast result in panic or in sullen, resolute resistance?

So the discussion continued for nearly an hour. As soon as the two scientists left their laboratories and began to discuss public policy, they had to resort to experience. Moreover, each scientist could assume that the other was familiar with certain recorded and more or less formal accounts of experience—in short, with history. As is often the case in literate, intelligent conversation, the search for truth ended in an appeal to history.

History, then, does more than sharpen the wits; it is a vast body of information essential to a wide spectrum of public-policy decisions. This is especially true of economic history because of its quantitative features and its theoretical basis to the organization of historical facts. In combination, these enhance our ability to test (refute or support) particular propositions on policy recommendations. Consider, for instance, the recommendation for mandatory wage and price controls as a means to combat recent inflation. Figure 1-1 traces a decade of inflation and reveals our experience with wage and price controls during the Nixon years.

As shown in Figure 1-1, Nixon's controls were imposed in August 1971, when the inflation rate was 4.5 percent. The precontrol rate of inflation was 6 percent in early 1970 and was actually falling at the time controls were imposed. The rate of inflation continued to drift down and remained around 3 percent throughout 1972, started to rise in 1973, and by the time the controls were completely lifted in early 1974 the rate was 10 percent and rising.

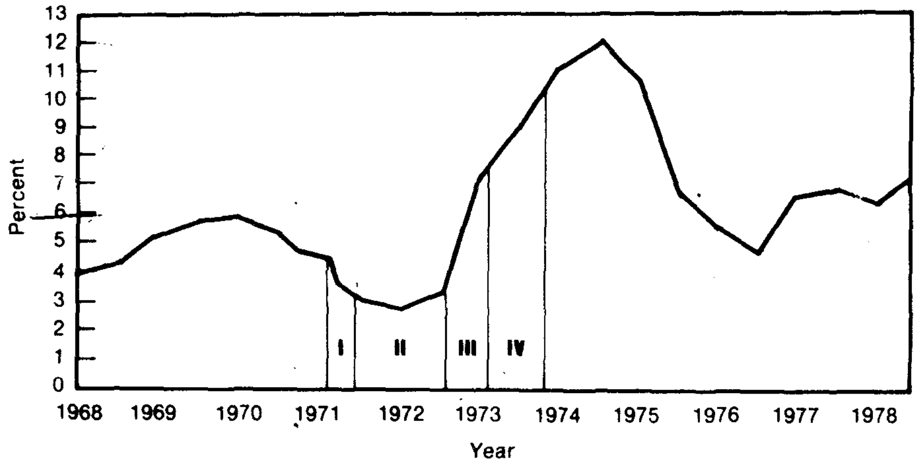

FIGURE 1-1
Inflation During Nixon's Price Controls.
Source: U.S. Department of Commerce Statistical Abstract, 1978, p. 483.

Rather than curb inflation, price controls actually contributed to the problem. For example, to circumvent the Nixon controls, the lumber industry regularly exported lumber from the United States to Canada, then reimported it for sale at higher, more profitable prices. Although poultry feed was not subject to controls, chickens were, and as feed became more expensive, it ultimately became unprofitable and uneconomic to feed chickens. As a result, millions of baby chickens were slaughtered instead of taken to market, and shortages of chicken became pervasive. As it became more profitable to sell fertilizers and chemical pesticides abroad rather than at home, agricultural production suffered for want of these essential inputs. These and many other similar disruptions to production made the growth rate of goods and services less and therefore the inflationary situation worse than it would have been without controls.

Although ultimately futile, controls worked somewhat more effectively during World War II, at least temporarily, because of patriotic appeal. When pressures on prices began to mount, Congress passed the Price Control Act of 1942 and established the Office of Price Administration. Further controls and efforts at surveillance were realized through the Office of Economic Stabilization, and at the peak of the surveillance and control effort these offices were supported with almost 400,000 volunteer "price-watchers" scattered around the country. Although prices were temporarily contained, rising only 14 percent between November 1941 and August 1945, the main influence of controls was to change the timing of inflation. Once controls were lifted in 1945, prices soared by almost 50 percent in three years.

Another fascinating wartime attempt, this time with partial controls, came during the American Revolution, a period noted for its hyperinflation. The well-intentioned legislature of Pennsylvania decided to impose price controls on various items needed by the army. The idea was to reduce the expense of supplying Washington's Army, then quartered in Pennsylvania. As prices on uncontrolled goods rose to record heights, farmers and suppliers withheld their goods viewing the controlled prices as arbitrarily and unfairly low. Thanks in part to the misdirected law, Washington's Army nearly starved to death at Valley Forge, thereby pressing the Continental Congress to adopt the following resolution on June 4, 1778:

> Where as . . . it hath been found by experience that limitations upon the prices of commodities are not only ineffectual for the purposes proposed, but likewise productive of very evil consequences to the great detriment of the public service and grievous oppression of individuals . . . resolved, that it be recommended to the several states to repeal or suspend all laws or resolutions within the said states respectively limiting, regulating or restraining the Price of any Article, Manufacture or Commodity.[3]

In all three instances, the effects of controls are revealed, and perhaps more importantly, these lessons of history show that the laws of people, no matter how well intentioned, cannot counter or nullify the laws of economics.

Besides the importance of historical study for its vital role in deliberating private and public policy recommendations, knowledge of history has other merits. For one thing, history can be fun—especially as we get older and try to recapture parts of our lives in nostalgic reminiscence. For another, good history, especially in an appealing literary form, both entertains as well as enriches our self-consciousness. A sense of history is really a sense of participation in high drama—a sense of having a part in the great flow of events that link us with those of earlier times and with those yet to be born.

THE MERGING OF ECONOMICS AND HISTORY

In this book, we will be concerned with a specialized historical narrative—"a longitudinal cut through the whole fabric of history," to use Edwin Gay's expression.[4] It is often convenient to trace historical devel-

[3] Journal of the Continental Congress (New York, 1908), vol. 21, p. 569.

[4] Edwin F. Gay, "The Tasks of Economic History," *Journal of Economic History*, I (December 1941), p. 15.

opments within a certain field of learning, such as music, science, or law. But as we have already emphasized and will continue to show, an understanding of the economic history of the United States is more than just a convenience; it is a prerequisite to solving many of the policy problems that presently demand solution. For a moment, however, let's leave the justification of our study to look more closely at the two disciplines of history and economics and to consider how they merge.

Like any organized body of knowledge, both economics and history abstract from reality. Without such aid, the human mind cannot comprehend the complexity of our economic system. We cannot simply look at the interrelationships among economic variables and make sense out of them. It is equally apparent that history must be selective—that any attempt to record the whole of the past would be an exercise in futility. Consider, then, how economists and historians make their respective subjects manageable.

Economics

The wealth of a country consists of its resources—its people (especially their knowledge and skills), its natural endowments, and its stock of produced goods. The management of these resources is a perplexing and difficult problem, because resources are *scarce* in relation to unlimited human wants. Put a little differently, there is a discrepancy between the amount of goods and services that the people in any society would *like* to have and the amount that they *can* have. Just as the members of a family must choose among alternatives when spending income, so the people in a society must make choices about the use of resources.

We know from observation that the American economy operates without much apparent guidance to determine what will be produced from its resources and how output will be distributed. For example, anyone who works with young people observes their endless wrestling with the problem of choosing a career—that is, the problem of what kind of resource they want to become. Their choices, to be sure, are not determined entirely by prospects of monetary gain; a gifted college senior may aspire to be a minister rather than a business executive. Nevertheless, choices of this kind are strongly influenced by market forces and by ultimate financial reward.

Similarly, we are all familiar with the problem of deciding how to spend our personal incomes. What amount should we allocate to food and to clothing? Should we spend more on a house or on entertainment and recreation? How much should we spend on present satisfaction and how much should we set aside for an uncertain future? Each family or individual who manages personal income must continuously make choices of this kind. Whether we like it or not, the act we perform almost continuously is that of *economizing*.

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