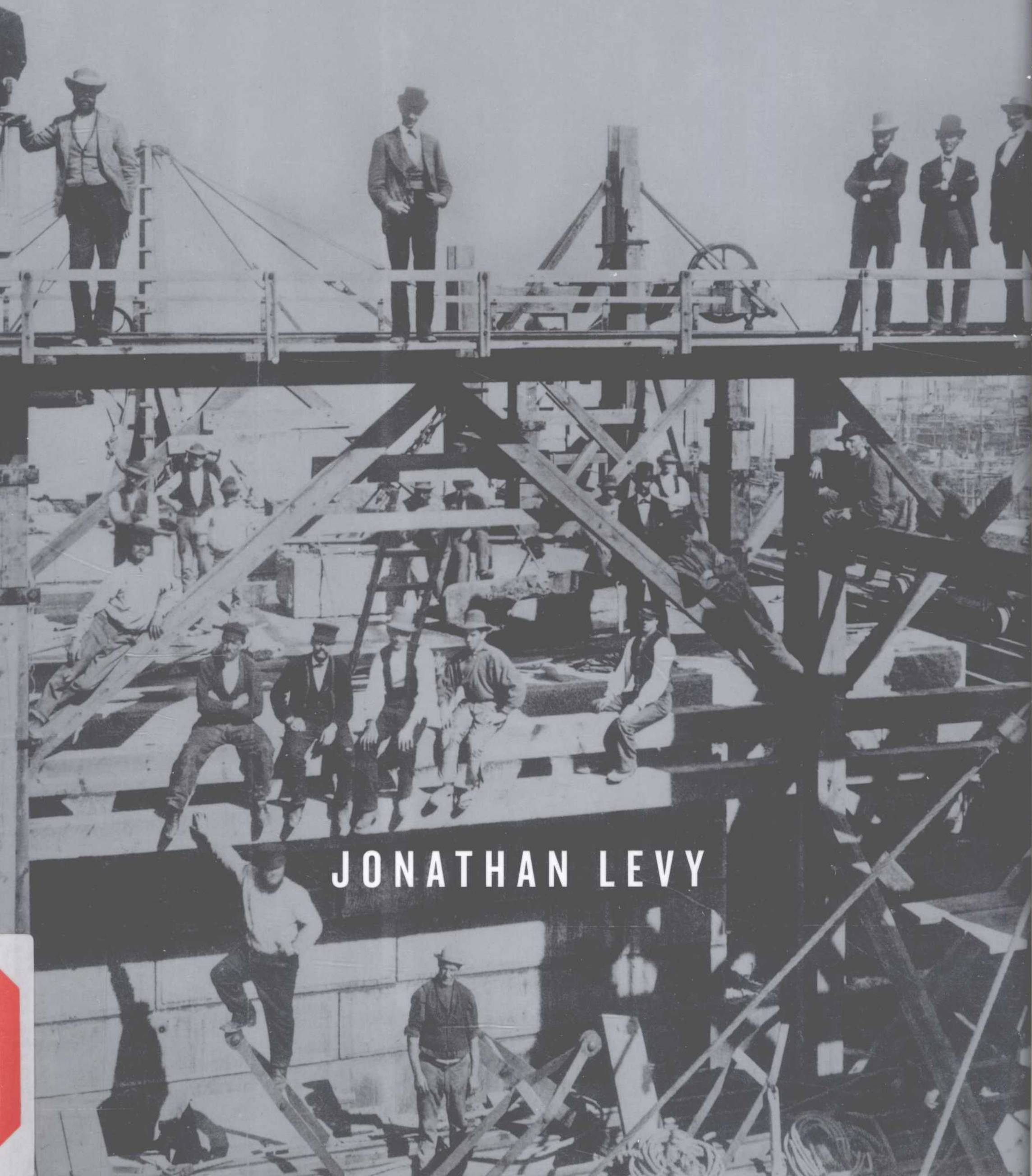
FREAKS OF FORTUNE

THE EMERGING WORLD OF CAPITALISM AND RISK IN AMERICA



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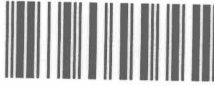
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Freaks of Fortune

THE EMERGING WORLD OF CAPITALISM AND RISK IN AMERICA

Jonathan Levy

Harvard University Press
Cambridge, Massachusetts,
and London, England
2012

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Printed in the United States of America

Library of Congress Cataloging-in-Publication Data

Levy, Jonathan, 1978-
Freaks of fortune : the emerging world of capitalism and risk in America / Jonathan Levy.
p. cm.
Includes bibliographical references and index.
ISBN 978-0-674-04748-8 (alk. paper)
1. Capitalism—United States—History—19th century. 2. Risk-Sociological aspects—History—19th century. 3. Risk-taking (Psychology)—United States—History—19th century. 4. United States—Economic conditions—19th century. 5. United States—Social conditions—19th century. I. Title.
HC105.L48 2012
330.12'2097309034—dc23 2012014805

For my parents,

Joanne and Martin Levy

. . . this savage's sword, thought I, which thus finally shapes and fashions both warp and woof; this easy, indifferent sword must be chance—aye, chance, free will, and necessity—no wise incompatible—all interweavingly working together. The straight warp of necessity, not to be swerved from its ultimate course—its every alternating vibration, indeed, only tending to that; free will still free to ply her shuttle between given threads; and chance, though restrained in its play within the right lines of necessity, and sideways in its motions directed by free will, though thus prescribed to by both, chance by turns rules either, and has the last featuring blow at events.

—Herman Melville, *Moby-Dick*

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Contents

Prologue: Voyage 1

1. The Assumption of Risk 7
2. The Perils of the Seas 21
3. The Actuarial Science of Freedom 60
4. The Failure of the Freedman's Bank 104
5. Betting the Farm 150
6. Fraternity in the Age of Capital 191
7. Trading the Future 231
8. The Trust Question 264

Epilogue: Freaks of Fortune 308

Appendix 319
Notes 325
Acknowledgments 395
Index 399

Prologue

Voyage

Sail forth! Steer for the deep waters only!
Reckless, O soul, exploring, I with thee, and thou with me;
For we are bound where mariner has not yet dared to go,
And we will risk the ship, ourselves and all.
—Walt Whitman, "Passage to India" (1871)

IN THE NINETEENTH-CENTURY UNITED STATES, voyage was an image that Americans invoked time and again to capture what it was like to live on the stormy seas of capitalism. In 1871 Walt Whitman offered a maritime allegory of the experience of individual freedom. To do so he evoked risk. Long a technical concept in the financial arena of marine insurance, at the end of the eighteenth century "risk" still simply referred to the commodity bought and sold in an insurance contract. Outside the world of long-distance maritime trade risk had very little meaning or use.

Sometime during the nineteenth century it became all but impossible to imagine the modern condition without the word "risk." By 1871 Whitman was able to invest risk with great lyrical power. Capitalism—an economic system that thrives off radical uncertainty—was asserting control.[1] Meanwhile, men had begun to insure their own lives, brokers had begun to sell mortgage-backed securities, and farmers were beginning to buy commodities futures contracts. Uncertainties and anxieties—some old, some new—had to be managed and coped with, perhaps even capitalized upon. Risk management was born.

The spread of capitalism had brought the insecurity of the sea to the land. Human beings had long associated the power of chance with the capricious tides of the high seas. Now the image of the ship on stormy waters became a powerful metaphor for the perils and possibilities of life under capitalism. Nineteenth-century Americans spoke of howling winds, thunder claps, unknown breakers, and tempests and storms and cyclones that swept over the deep—for which they were not responsible. But they had to learn to cope with them, and even to profit from them. As daunting as the task of managing risk could be, there was also the existential thrill of taking a risk. That tension was at the very operational and moral heart of both capitalism and a rising liberal order.

In the nineteenth-century Americans had their own term for this tension, for all of the sudden economic twists and turns, booms and busts, and ups and downs that were newly and inexplicably in their midst. They called them "freaks of fortune."

Within the context created by the freaks—by the economic chance-world of capitalism—the history of risk comes into view. The notion that risk has a history might come as a surprise. Or, it may seem that an obsession with risk is recent, dating to some time after the 1970s and the onset of crisis for industrial capitalism in the West. An era of pervasive insecurity ensued, one in which risk had to be "embraced."[2] Newly emboldened entrepreneurs began to take "risks." Sociologists began to speak of "risk society." Engineers began to practice "risk assessment." Financiers began to promise "risk management." As the contemporary sociologist François Ewald explains, risk was now "in human beings, in their conduct, in their liberty, in the relations between them, in the fact of their association, in society."[3] Since risk is now so ubiquitous, it might seem impossible to write its history.

Yet, risk does have a history. As a human invention, as a historical protagonist, risk has a biography. In the United States, the most decisive chapters in risk's history were written in the nineteenth century. For by the end of that century, much like throughout the world today, risk was in fact everywhere. Before that century of capitalist transformation,

however, it was not. But risk did not appear out of nowhere. It was born on the deep, in the act of maritime voyaging.

Risk was first synonymous with marine insurance—a financial instrument for coping with the uncertainty of transporting commercial goods across maritime space. Buying and selling "risks," long-distance trading merchants purchased from each other financial compensation in the contingent event that a "peril of the seas" or an "act of God" struck their long-distance voyages and destroyed their property. Risk did not then mean extreme peril, hazard, or danger.[4] It did not refer to the immaterial fear of an undesirable event. Rather, it originally referred to something material: a financial instrument for coping with the mere *possibility* of peril, hazard, or danger.

The etymology of the word reflects this historical origin. It can be traced back to the sixteenth-century French *risqué,* and even further to the thirteenth-century Italian *rischio.* Beyond that, all possible roots, including the likely Arabic candidate, appear in maritime "commercial contexts." It is possible that mariners invented the term to refer to uncharted waters upon which they would not voyage. The *Oxford English Dictionary* emphasizes that risk connoted the possibility of "damage to merchandise when transported by sea."[5] Risk made its appearance in the English language in the sixteenth century, but in the United States even as late as the 1820s it had yet to be fully anglicized from "risque"—the commodity exchanged in a marine insurance contract. Then, rather suddenly, risk exploded in everyday language. So would financial risk management.

Risk management was one way to cope with an uncertain future. But at the opening of the nineteenth century there were other ways to do the same. Commerce was ever-present, but America was still very much a rural and hierarchical society. The large majority of persons were legal dependents: wives, children, servants, and slaves. Households and communities achieved social security by coping with the burden of peril together. For

men who were masters of households, the ownership of physical forms of capital and wealth—slaves and above all land—anchored economic security. Risk management was for offshore hazards, inapplicable to dangers onshore, where men might tremble before "acts of God" instead of commodifying them. Many onshore dangers—fire, disease, a bad harvest, a premature death—were after all still biblical in nature. Religious authorities counseled that in the end divine providence ruled over the future. And if the future was certain because God determined it, then risk management might be unnecessary, if not all together wrong. After migrating inland risk management competed with other ways to cope—socially, economically, culturally—with the perils of an uncertain future. It would always remain in competition.

Nevertheless, across the nineteenth century Americans began to react to the insecurities of capitalism and its "perennial gale of creative destruction" in a new way.[6] As slavery was abolished and the United States became more urban and industrial, increasingly men began to hedge the perils of life under capitalism by using financial instruments born of capitalism itself. Finance transformed perils, hazards, and dangers—some perennial, some new because of capitalism—into risks. An insurance policy offset the risk of losing the ability to earn income in a market economy; a derivatives contract hedged against the risk of future market price volatility. Nonfinancial collective strategies did not completely die off. Families still shouldered burdens together. Many individuals still believed in an otherworldly fate. But this transformation was ultimately momentous, marking the emergence of risk as we know it today.

The world of capitalism and risk thus formed as nineteenth-century Americans became ever-more dependent upon new financial institutions, markets, and forms of wealth for their security. These included insurance policies, savings accounts, government debt markets, mortgage-backed securities markets, bond markets, futures markets, and stock markets. With this, the corporation became risk management's institutional home ground. Corporate risk communities offered a new form of social security. To provide economic security, corporate actors accumulated financial forms of capital and wealth. Doing so corporations also brought about a cultural transformation. They became the reserves of new probabilistic, statistical explanations of future change that secularized old

providential beliefs. In sum, by the opening of the twentieth century the modern American corporate financial system had come to life.

Risk thus recasts the history of American capitalism from the standpoint of powerful new financial corporations. Finance is an expansive terrain. But analyzing the nitty-gritty details of new financial practices demonstrates how risk burrowed into popular consciousness. Moreover, following risk across many registers of thought, action, and experience captures much of the human drama of capitalist transformation. The spread of commerce; the rise and fall of American slavery; the Industrial Revolution; the economic development of the West; the ascendance of the corporation—all were at stake in the rise of corporate risk management. But so was how Americans thought about the future, felt about the future, acted upon it, managed it, and sometimes simply resigned themselves to it.

The thread that runs most consistently through risk's history is a moral one. For risk triumphed in the nineteenth-century United States in the context of the nation's moral struggle over freedom and slavery. A generation—financiers, abolitionists, actuaries, jurists, preachers, legislators, corporate executives, philosophers, social scientists—developed a vision of freedom that linked the liberal ideal of self-ownership to the personal assumption of "risk." In a democratic society, according to the new gospel, free and equal men must take, run, own, assume, bear, carry, and manage personal risks. That involved actively attempting to become the master of one's own personal destiny, adopting a moral duty to attend to the future. Which meant taking risks. But it also meant offloading one's risk onto new financial corporations—like when a wage worker insured his productive labor against workplace accident, an ex-slave opened a savings account, or a Wall Street financier hatched a corporate profit-sharing and employee benefit plan. A new vision of what it meant to be a free and secure actor thus took shape in the new material and psychological reality created by the modern American corporate financial system.

Liberal notions of selfhood had long emphasized the need for self-mastery, even in the face of uncertainty. But only in the nineteenth century did self-ownership come to mean mastery over a personal financial

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"risk." The moral conundrum that posed, and still poses, is that individual freedom required a new form of dependence. A dependence, that is, upon a new corporate financial system, the central nervous system of a rising capitalism that fed off radical uncertainty and ceaseless change.

Therefore corporate risk management time and again manufactured new forms of uncertainty and insecurity.[7] That was the essential truth taught by the freaks—economic events that eluded the grasp of corporate risk management. As free men began to assume their own personal risks, old forms of security and dependence perished. Not assuming risk, that is, no longer became an option. Whitman was right. Once at risk the only thing certain on life's voyage would be uncertainty itself. Within the economic chance-world of capitalism, desire for risk management and longing for the freaks of fortune constitute one and the same history.

CHAPTER 1

The Assumption of Risk

Safety from an evil which may lurk in the future is as real as any other commodity.

—Elizur Wright, "Life Insurance for the Poor" (1876)

IN 1836, NICHOLAS FARWELL WAS AN ENGINE-MAN on the one-year-old Boston and Worcester Railroad when a train ran off the tracks because a fellow employee mislaid a switch. Farwell and his car were thrown from the rail, and the railcar crushed and permanently destroyed his right hand. His career as an engine-man over, Farwell asked the Railroad for compensation but it refused. Farwell hired a lawyer and took his case eventually all the way to the Massachusetts Supreme Court. He valued his right hand at $10,000.

Chief Justice Lemuel Shaw's 1842 decision in *Farwell v. Boston and Worcester R.R. Corp.* ruled that Farwell himself was responsible for the "peril" that had destroyed his right hand.[1] Farwell therefore also personally assumed a "risk." By invoking risk Shaw's decision rested upon precedents in the international law of marine insurance.[2] In 1842 railroad wage work was new. Maritime commerce was old. Shaw granted "that the maritime law has its own rules and analogies" not always applicable to other "branches of law." Applying the moral logic of risk to a dispute concerning an industrial workplace accident followed no direct legal precedent. But Shaw still held it a "good authority" for the case at hand. To grapple with a novel aspect of American economic life, Shaw invited risk inland.

In ruling Farwell personally responsible for the "risk," Shaw also led the wage worker, almost by the nose, to a fledgling corporate financial system. There the wage worker might offload, commercially, that same personal "risk"—just like merchants offloaded the risks of long-distance trade. *Farwell* was thus an early and emblematic agent of the larger dynamic that launched risk's national history in the United States, which eventually drew almost all Americans within its orbit. Shaw attached "risk" to the very meaning and substance of Farwell's personal freedom, empowering both his individual autonomy and what would become, by the end of the nineteenth century, modern American corporate risk management. Therefore *Farwell* provides the opportunity to concretely establish the historical problem of risk.

The Massachusetts Court ruled against the crippled workingman. According to Shaw, Farwell, in contracting out his productive labor, had taken "upon himself the risks and perils incident to his situation" as an engine-man. The two words "risk" and "peril" did not then have the same meaning, and Shaw was not being loose with language. The peril of the accident, Shaw reasoned, was already priced into Farwell's wage, which was higher than the wages paid to workers who were engaged in less hazardous tasks. Within his two-dollar-per-day wage was a "premium for the risk which he thus assumes." Therefore, the railroad corporation was responsible to Farwell for no further compensation.[3]

Farwell stated that as a free man the plaintiff was a proprietor of a personal "risk." The risk he assumed was an element of his self-ownership—the same as the productive labor embodied in his now mangled and disabled right hand. No different than his own body, Farwell's "risk" was part of his selfhood. Like his productive labor, it was his private property, a thing over which he held absolute dominion. The peril was not conceived along propertied terms.

Shaw arrived to this ruling in a series of related moves. For one, Farwell became the owner of what might be termed a downside risk. He became responsible for the possibility of an abnormal future peril, hazard, or danger. The cost of this industrial accident was his own, and the Boston and Worcester Railroad owed him no compensation for his injury. It was a "pure accident," Shaw declared, as the freak event was

neither the fault of Farwell nor of the railroad corporation.[4] But Farwell was ruled responsible for its consequences.

Yet, as a free man, Farwell also owned an upside risk—an equally abnormal and corresponding future pecuniary reward. In this case, it was represented monetarily in his higher wage. Both Farwell and the Boston and Worcester Railroad were ruled free and equal contracting parties in like pursuit of commercial gain. In contracting out his productive labor for the new, hazardous employment of railroad work, Farwell—Shaw held—had bargained for extra money compensation for "the risk which he thus assumes." This was a moral idea, the notion that more "risk" assumed justified more reward. As a free man, Farwell was entitled to an upside. But, for the same reason, he assumed a downside. Linking together freedom, self-ownership, and the personal assumption of risk, it was as if Shaw had enclosed a new "risk" within the sphere of Farwell's individual autonomy.

"Enclosure" is a term than can only be historically associated with one specific kind of commodity: land. In England, from the fifteenth to the nineteenth centuries, parliamentary magistrates, lawyers, landowners, mortgage lenders, and enterprising farmers conducted the slow process of "enclosing" a common-fields system that dated back to early medieval times. Land previously held in commons became the exclusive property of private individuals. The word "enclosure" referred to the techniques of demarcating newly private property—the building of hedges, fences, and drainage canals, or the filings and petitions of lawyers and magistrates—along the way to the creation of early modern English agrarian capitalism. By the nineteenth century, the crazy quilt of mutualist obligations that was early modern landed property was all but gone. An old set of hedges that had allocated some land to individual households and some to broader collectivities was replaced by a new set demarcating absolute, and therefore alienable, individual property rights.[5]

In the seventeenth century, when English colonists arrived on American shores, one of the first things they did was to begin to enclose the land, and to claim it as their own. Some New England villages had a full-blown common-field system, and all colonies to some degree maintained collective use-rights in land. They did so through a blend of customary

practices that treated the land as a social good as much as an individual commodity. But in America as well, by the nineteenth century a not too dissimilar set of actors had enclosed the land.[6]

Farwell provided a legal technique for an analogous, later enclosure. "Risk," the commodity long exchanged in a marine insurance contract, was something that a person could in fact "assume" and own, alienate, or contract out to another to "carry." And yet, in the early modern period, outside the world of long-distance trade the notion that the cost of a contingent event could be priced and enclosed into a commodity that could then be offloaded through a financial instrument called "insurance" would have baffled most people. At least a fence, a hedge, or a drainage canal could demarcate an enclosed piece of land for the naked eye to see. But a future peril was much more abstract and ephemeral.

A legal precedent, however, could do something like the boundary work of a physical hedge. Enclosed "marine risks" had existed for centuries. In 1842, Shaw enclosed the new personal "accident risk" of the modern industrial workplace. Just as Farwell could sell his productive labor to a boss, so could he sell his accident risk to an insurance corporation. Farwell's employment implicated two commodities which existed in tandem—his productive labor and now the "risk" attendant to its hire. *Farwell* perfectly captured the capitalist approach to peril: commodify it.

To do so Shaw first had to dispense with a legal principle in which the burden of hazard was held in common, much like the land had once been. If the early modern enclosure of land had commodified the commons, then Shaw's enclosure of an "accident risk" commodified a contingency. The common-fields system was after all a form of safety-first agriculture, a communal hedge against the danger of a bad harvest or a bad market.[7] Farwell had sued under the English common law rule *respondeat superior,* which rendered "masters" responsible for accidents caused by their "servants." The paternalist legal rule was premised upon a status-based hierarchy, and was typical of the many highly personal, if asymmetrical, social bonds that persisted into nineteenth-century America. Such bonds achieved social security but were not predicated upon the demand for individual autonomy—and certainly not the individualist moral logic of risk. To understand just how remarkable a deci-

sion *Farwell* was, consider that according to the international law of marine insurance—at the time Shaw handed *Farwell* down—a seaman's wages were not legally insurable. As Shaw's contemporary Theophilus Parsons wrote in 1859, masters were legally responsible to directly care for and compensate a seaman who became "sick, or wounded, or maimed in the discharge of his duty" provided it was "not by his own fault."[8]

Shaw departed with *respondeat superior*. Speaking of the "pure accident" that had befallen Farwell, he snapped one chord in the dependent bond between "masters" and "servants," enshrining the Nicholas Farwells of the world as masters and proprietors of their own personal risks. Having personally assumed a risk, Farwell appeared to have no social recourse whatsoever.

For this reason, through the years *Farwell* has struck many as a callous decision—an early blow to the incipient American working class, an implicit subsidy for nascent railroad corporations. That it was, although for what it is worth in the end the Boston and Worcester Railroad, seemingly from charitable impulses, provided Farwell some compensation, even if it was far less than the $10,000 he thought he was owed. And, over time, American courts would begin to recognize employer negligence and liability for some categories of workplace accident. Further down the road, railroad brotherhoods, a new collective strategy, would cope with the individual cost of workplace accident. In time, in the early twentieth century, states would pass workmen's compensation laws.[9]

All of these paths run through *Farwell* and have been illuminated by historians with great care. The reason to linger over *Farwell*—besides, at the outset, to emphasize the crucial role of the law in setting the working rules of risk—is to pin down the maritime source of its individualist logic. But it is also to underscore the practical endpoint it implied: the potential offloading of Farwell's freshly minted personal risk onto a financial corporation.

An "assumption of risk" occurred because Farwell was a free man. But that very same freedom suggested a financial solution for the peril at hand. Departing with the domestic law of master-servant relations, Shaw sure enough turned to the international law of marine insurance. Marine insurance had for centuries offered long-distance trading merchants financial compensation in the contingent event their cargoes were

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