EVOLUTION OF AMERICAN ECONOMIC SYSTEM

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DR. ALLEN: General Holman, Dr. Reichley, Gentlemen:

The subject of our discussion this morning, "The Evolution of the American Economic System," is, I am afraid, a rather depressing one, particularly since I am going to have to jerk you from the age of atomic warfare and the utilization of atomic energy back in time to the seventeenth century, to the days when wooden ships and mercantilist concepts, rather than the fission of atomic materials, ruled men's thoughts. In addition, the word "economic," in itself sums up, for most of us, a rather grim prospect, a prospect of laws, of hypothesis, and of theories, inevitably supported by tabulations, by graphs, by statistics, and by charts. Furthermore, the title suggests that the treatment will be essentially historical, a form of scholarship most aptly characterized by the mouse in "Alice in Wonderland" as "the driest thing I know." About the only encouragement I can offer you is that there will be no charts, no graphs, a minimum of economic gobbledegook, and that, considering the lateness of our start the lunch period will follow shortly after the completion of this discussion.

There will be no apology, however, for the material we are to consider this morning. The story of American success in World War I and World War II is, primarily, a story of the directing of immense economic resources from the support of a peacetime economy, unmatched in the world to the creation of literally floods of materials which became the supply bases for American victory in both wars. In fact, in the Second World War, there can be little doubt that the productive capacity of the United States--its ability to supply both its own forces and those of its allies--was the most essential single factor in the final triumph. Here in the Industrial College, we have the mission of studying and analyzing these factors which make possible the effective economic mobilization of this Nation for the support of our Armed Forces in the event of an emergency. Any analysis in the field of economic mobilization must, of necessity, be based solidly upon detailed--and I repeat "detailed"--knowledge of the economy of the United States. As a productive entity, the United States is unique among the great powers of the world, not only in its ability to maintain for its citizens the highest standard of living ever known, in its tremendous natural resources, and in its fortunate geographical position, but also in its specialized productive system, in its development of mass industrial techniques, and its application of the findings of science and technology to virtually all phases of its basic industries.

Other nations are well, and even abundantly, endowed with natural resources. Other nations have vast land areas and favorable geopraphic locations. Other nations have great numbers of intelligent and technically proficient workers and executives. The question then arises: How has the United States been able to achieve such unequaled results in the development of its national economy? The answer, to a considerable part, is to be found in the gradual, evolutionary development in the United States of an economy unique in the world.

While I think, it is generally recognized that the American economy is not the same as that of other great nations, few people are familiar with the process by which this situation arose. It is, perhaps, one of the most interesting facts of economic history that the United States, from its first beginnings as a series of small and isolated colonial enterprises down to its present condition, as a world power, presents an almost perfect case history of the evolutionary development of the human economic relationships, stabilized in space to the limits of a single nation, compressed in time to a scant four hundred years. Should an individual make a detailed analysis of the economic development of the United States, he would find, as a result of his study, that he had a fair picture of the whole story of man's development from the most primitive of economic relationships to the most advanced. Of course, gentlemen, this is not to say that the American economy has followed a rigid pattern in development, nor that it is devoid of special influences tending to set it apart from the economic development of other major world areas. However, as scientists have sometimes said that the development of the human being from embryo to mature individual tends to re-enact the evolution of the human species, so the development of American economic life presents an indicator of the over-all rise of mankind from primitive to advanced economic life.

In our attempt to compress the story of American economic evolution into the briefest possible space, it will be our effort to cover the subject in just two discussions. The present one will deal with the evolution of our national economy from its first beginnings down to the establishment of our status as a world power. The second lecture, which will be presented by Dr. Hunter tomorrow, will take up the extremely important story of the "American Economic System Today," of the America of our own experience, analyzing our present levels of economic achievement, our economic activities and our economic direction in terms of the problems confronting those charged with the preservation of national security.

There is a variety of possible methods of dealing with the evolutionary development of the American economy. Each has its individual merits and each its faults. One can use a strictly chronological treatment, a treatment based on geographical areas, a treatment devoted to the development of specific industries and activities or a sociological approach. As in the case of the blind men and the elephant, in each of these approaches the person discussing the subject is almost certain to consider it in terms of his own background and inclinations. Since I am one of those rather unfortunate individuals known as an economic historian, I shall predicate my discussion largely on the major historical periods of American national development, modified only to the extent necessary to provide greater simplicity, and to lay emphasis on the periodic character of our economic evolution. When I say "the periodic character" perhaps I should warn you that any periodic treatment of an evolutionary process tends inevitably toward oversimplification and toward the impression that the various periods cited are sharply distinct from one another, representing clear-cut steps from basic to ultimate situations. Of course, nothing could be further from the truth. The economic evolution of the United States, like any evolutionary process, was not a precise advance through successive stages. In our growth as a nation, economically as well as politically, we went forward at times, we remained stationary at times, and at times we receded. In addition, the development was by no means uniform over the entire Nation. In some areas rapid strides were made, in others the pace was more leisurely, and in still others, as we know, progress was extremely halting. However, the general level of development was progressive and did move through clearly recognizable stages.

For the sake of convenience, the economic evolution of the United States for the period which I am considering, might be divided into three major sectors: These may be called, (1) the Colonial Economy; (2) the Federal Economy, (3) the Industrial Economy. Naturally, these major economic periods may be subdivided, and some of the subdivisions will become apparent as we continue our discussion.

First, and longest in point of time, of the basic phases of American economic development was the Colonial Economy. This period, extending from the earliest settlements down to the close of the American Revolution, represents the beginning of a definitely American pattern of economic life. At the outset, when the first settlements appeared along the eastern coasts of the North American continent, the economic situation that resulted was unusual. The settlers represented relatively advanced economies in the various European states of their origins. Accordingly, they had definite individual and group economic relations which they naturally carried with them to the New World. However, the primitive conditions in the new World made the attempt to introduce European economic patterns impossible of attainment. For the first few years, nearly every colony struggled to re-create in America the economy of its mother country. That economy might be British, Dutch, Swedish, or French. Then, after failure and disillusionment, there followed a period of sharp adjustment to the new conditions--we might say to the realities of American pioneer life. The result of this adjustment was a very primitive economic life, composed, in most cases, of a combination of aboriginal American and contemporary European practices. At this time, the European settlers were frequently reduced to the hunting and collective economies which had disappeared from the European scene thousands of years before the first settlements in America. Fortunately for the settlers, the Indians of the eastern American continent were relatively advanced economically and had developed surprisingly effective primitive agricultural forms. After futile efforts to clear the forests and prepare the fields in the European manner, the colonists learned from their Indian neighbors that the rich soil of the New World would support effective agriculture with only the simplest of preparation, generally nothing more than girdling or burning the trees and removing the underbrush. This fact--the ability of the rich American coastal soil to support agriculture with only the most primitive hand preparation--became one of the most important factors in the colonial economy and continued to influence American economic development down well into our national history.

After the settlements had attained a certain degree of stability, the first primitive economic existence, paralleling closely that of the Indians, gave way to what might be termed the "early Colonial period." It is not possible to set any definite date for this period, since it varied with each colony, and, in the case of the western frontier areas of the United States, persisted down well into the present century. However, this economy was characterized by the employment of nearly all of the available labor force in subsistence-type agriculture. The extremely primitive methods of cultivation, the lack of equipment and of an adequate supply of draft animals, the almost complete nonexistence of practical means of transportation--all of these factors forced each family or small community group to rely upon its own efforts for the necessities of life, and discouraged any attempt to produce a marketable surplus of staple materials. In general, the material needs of the population, aside from food, were extremely few, and every effort was made by the colonists to utilize the products of the forest and field, shaped by the skill of the individual husbandman, to supply the requirements for goods of all types. As the colonies grew in size, a certain degree of specialization appeared on the economic scene. Thus, local craftsmen who possessed unusual skill in the making of tools and implements, furniture and wooden ware, in the making and repairing of shoes and in other basic crafts began to devote most of their time to their trade. However, the work was almost invariably performed in the home, and the hiring of craftsmen in an entrepreneur system was quite unknown. It was during this period that some of the more fortunately situated colonies began to realize exportable surpluses of various commodities. In New England, for example, the seemingly limitless supplies of good timber provided by the forests encouraged the production of lumber, wooden ware, and particularly the staves and hoops for casks, which became absolutely essential to the foreign trade of the British Empire. Farther south, in the middle colonies, wheat was produced in quantities which made its export to the West Indies possible. Most fortunate of all of the earlier colonial areas was the South. In the South it was soon discovered that the Indian crop, tobacco, had a high commercial value, and there rapidly developed a substantial export trade in this staple.

During the early Colonial period, the interchange of goods between the colonists was primarily on a barter basis, the value of any particular goods being expressed not in their monetary equivalent but in terms of any item that the vendor might desire at that time. In fact, so strong and persistent was this concept of value in terms of staple commodities, that expression persisted long after species were relatively common in the Colonies; and we find well down to the eighteenth century values in Virginia and in Maryland expressed in hundredweight of tobacco or in other commodities.

The emergence of exportable surpluses of goods led to the development of the last phase of the American Colonial economy. This may be termed for convenience, the "late Colonial period." This period is most significant in that it saw the development of a substantial export trade based upon the large export surpluses of a variety of staple commodities, together--and this is most important--with specific production by the colonists of specialized items for export purposes. This appearance of the American colonies on the inter-national commercial scene had tremendous economic importance which, however, was generally forgotten in the political difficulties it created. The story of British mercantilist theory, and the attempt to apply it to the North American colonies, is too well-known to need more than passing mention. Briefly, as the colonies became large-scale producers of highly desirable goods, the British Government and commercial interests united in their desire to preserve this trade for themselves. Mercantilist theories as to the importance of national self-sufficiency in raw materials and commercial desires for the profits of the lucrative colonial trade were in complete harmony; they found their expression in the creation of an imperial system, dedicated to the preservation of a closed-trade relationship between mother country and colonies. As we all know, this closed-trade theory did not coincide with the desires of the colonists, who soon found that the ports of other European states and colonies offered better trading possibilities for their products than did those of England. However, for more than a century, an uneasy relationship was maintained between colonies and mother country, and, it must be said, that the colonies in general prospered. In the South, particularly, the operations of British mercantilism brought superficial prosperity and the highest standard of living known up to that time in the American colonies. However, southern participation in mercantilist trade was basically unsound, being predicated on a continuing credit relationship between the planter-producers of the staple Colonial items and the British agents who handled the trade between mother nation and colony. In consequence, when values of tobacco, rice, indigo, and cotton fluctuated sharply in British and European markets, the American planters were unable to determine their financial standing, since items desired by them were invariably purchased on a long-term credit basis. The southern discontent that grew out of the credit relationship between agent and planter undoubtedly had much to do with the aligning of southern opinion in support of the northern colonies in their opposition to the British trade regulations.

As a rough summary, it might be said that the mercantilist economy was simply not suited to the needs of a growing and energetic population, and, under the circumstances, an economic if not a political, break with the mother country was inevitable.

The successful conclusion of the American Revolution left the United States free to pursue its own economic affairs. However, the first few years of independence indicated that economic freedom in a mercantilist world was not an unmixed blessing. Freed from the restrictions of the British closed-trade system, the former colonists found that they were also excluded from its benefits. In addition, the nations of Europe were not overanxious to establish favorable trade relations with the new Republic. With this unfortunate beginning, the economy of the United States entered into its second major phase. This may be termed the "Federal Economy," and extended in time from the Revolution down to approximately 1860. Faced by the repercussions of the disintegration of the old Colonial economy, the United States was obliged to make major economic and political adjustments. The deterioration in the economic life of the country continued steadily until it was checked by two closely spaced, although very dissimiliar, events. The first of these, the establishment of the Federal Government under the Constitution, we all know. The second was the opening of the long period of European wars rising out of the French Revolution in 1793. Constitutional government for the United States provided for the elimination of the interstate tariff barriers which had grown up in the period after the Revolutionary War and also provided a strong and effective central power, capable of conducting effective negotiations with foreign powers and of protecting American economic interests throughout the world. The European cycle of wars, on the other hand, provided a virtually insatiable market for anything and everything that America could produce and, overnight, changed our economic situation from depression to relative prosperity. While the restrictive measures of the major combatant nations (England and France) interfered with American foreign trade, the general trend of commerce, with the exception of the period 1812-15 when we were actually at war with Great Britian was steadily upward. With the conclusion of the European wars, the so-called Napoleonic Wars, in 1815, the re-establishment of stable political and economic conditions in Europe increased the market for American agricultural products and, at the same time, provided us with sources of imports outside the British Empire. The great merchant fleet, which the United States had developed during the war years when European commerce was hampered by the various trade restrictions, continued to expand, and the United States steadily rose to a prominent position in world shipping. It is rather difficult, in some ways, for us to remember that in 1840 the American Merchant Marine was second only to that of Great Britian, and by some computations, was actually larger. Thus, during the years from about 1825 to 1860, we saw the United States develop an economy based upon tremendous exports of agricultural products, carried to a considerable extent in American flag vessels. The profits of this commerce, fortunately, were widely distributed--the New England States providing a large proportion of the shipping, while the Central and Southern States produced constantly increasing volumes of wheat, corn, wool, tobacco, rice, and cotton, which were in great demand all over the world. American traders competed for business in the Orient, in the Mediterranean, in Western Europe, and even in the Islands of the Pacific. In addition to its economy of commerce and the production of export agricultural commodities, the period prior to the war between the States saw the sure development of the economic trend which was, for many years, to characterize American life, that is, the movement to the West. The possession of virtually limitless land in its western areas gave the United States a unique economic safety valve and the basis for a steady productive increase in its markets, which set a special character upon the national economic life. From the beginning of our national existence until the twentieth century, the frontier offered an opportunity for individual enterprise which served as a constant magnet to the increasing populations of the seaboard areas in addition to the crowded peoples of the European states. Consequently, throughout virtually all of our national life down to 1900, the steady drain of people from the East to the West maintained the characteristic state of labor scarcity which, perhaps more than any other single factor, has led to the development of specialized economic ways in this country. I would like to emphasize that: The economy of industry and agriculture of the United States, which has led to our dominant position in the world, is an economy predicated upon labor scarcity. In the countries of Europe, the pressures of increasing population had always reacted to depress the labor markets, decreasing the value of labor in proportion to that of materials and facilities. Thus, European agriculture and industry were based upon the presence of more than ample supplies of low-cost labor and tended to develop economic principles which reduced the expenditure in capital goods and materials by increasing the expenditure of manpower. This situation led to the so-called "scientific" farming and "shop-type" industry in which the skilled farmer and the skilled craftsman made the maximum utilization of limited land or facilities, the product representing a very great investment in human energy in proportion to its total value. In the United States, on the contrary, land in limitless quantities was to be had virtually for the asking, and the vast resources of forests, fields, and mines provided cheap materials. However, manpower remained a scarce commodity.

Attracted by the possibilities of an independent life on the frontier, the labor force of the older states was steadily siphoned westward, and the manpower shortage remained an essential factor in American life. During the phase which we have designated as the "Federal Economy," the lack of effective machine devices for the production of goods tended largely to bar the United States from manufacturing other than for local consumption. Therefore, the national economy turned with more and more emphasis into the production of agricultural staple products for the export trade, a trade which still was, to a considerable extent, carried by American shipping. This type of agriculture led, in turn, to a very specialized system, particularly in the Southern States, in which the large farming units concentrated on the production of single staple crops, "mining" the land, since land was by far the cheapest factor in the productive cycle. The shortage of labor led also to the use of slaves in the areas where this type of labor was economically favorable, and thus economic specialization gave rise to social and political differences which, in the War Between the States, were destined to nearly destroy the Nation.

While the agricultural-export economy of this period was essentially a prosperous one, it did not lead to the accumulation of large capital reserves. The needs of the new nation for capital investments were, of course, very great, and as time went on, the amount of foreign investments in the United States rose steadily. This position, as a debtor nation, also became characteristic of the American economy, continuing down to the conclusion of World War I. Authorities differ as to the impact of the indebtedness factor on our economic development, but it is probable that the desire of European export capital to find profitable investments in the American market led to the development of efficient railroad communications many years before the time that would have been normal under an internal investment system, and unquestionably did much to foster the industrialization of the northeastern part of the United States.

As the Nation increased in size and population, the Federal Government began to support the economy by definite legislative policy. Most significant, perhaps, of these national policies were the public lands policy and the tariff policy. From 1787, with the passage of the Northwest Ordinance, the central government followed a consistent policy of encouraging the development and population of the public lands. Undoubtedly, the rapid westward expansion of the United States reflects, to a considerable extent, this encouragement by the Government. At the same time, the steadily rising national importance of the manufacturing interests of the Nation became evident in the development of a policy of increasingly greater tariff protection. This protectionist policy, in turn, came to be one of the great political goals of the northern and eastern sections of the country and strongly influenced the industrial development of the Nation down approximately to the period between World War I and World War II.

After the middle point of the nineteenth century was passed, the pattern of the "Federal Economy" may be seen at its full development. Under it, the United States was divided roughly into three economic areas: the North and Northeast, based upon commerce, commercial banking to a limited degree, and food production for a largely local market; the South, devoted almost exclusively to the production of a few staple crops, of which cotton was by far the most important, and depending upon the export of these crops for the maintenance of its over-all economy; and the Frontier, an area primarily devoted to subsistence farming, in which grazing and local manufacturing were just beginning to appear. This economic cleavage, accentuated, in effect, by the fact that the economic areas coincided almost precisely with the major geographic divisions of the country, led inevitably to a struggle for control of the Federal Government; a struggle which was finally resolved in war from 1860 to 1865.

The last economic phase to be considered in this discussion may be termed loosely the "Industrial Economy." This phase may be said to have had its origins during the dislocations of the War Between the States. In the tremendous demands for military items of all types required by the northern armies, the manufacturers of the Northern States found a perfect market. In the huge profits obtainable from government contracts--and we sometimes hear of such contracts even today--lay the source of the capital accumulations necessary for the conducting of large-scale industry. Finally, in the heavy drain on the already limited manpower resources of that section was the strongest possible inducement to produce goods with a minimum of human effort. New machines appeared on the scene. The advances in technology kept pace with the requirements of the economy, and mechanical devices for the production of textiles, for the manufacturing of metal goods of all types, and for the carrying on of agriculture were ready for use. The northern manufacturers and farmers were quick to seize upon these new machines, and in the space of a very few years, this section of the United States made the economic leap from an agricultural and commercial area to an industrial area. At the conclusion of the war, the great market afforded by the rapidly growing nation the abundant investment capital available from both domestic and foreign sources and the increasing flow of mineral wealth from the mines which were being opened constantly--all accelerated what would have been in any event an astonishingly rapid industrialization. The South, severely damaged in its economic and political institutions by the War, remained a producer of agricultural commodities, and the New West was far too busy with the problems of social and political growth to do more than supply food to the eastern areas and for export. Thus, the story of the years from 1860 to the turn of the twentieth century is a story of the evolution of a national economy, based on the integration of large-scale industry and large-scale agriculture. The commercial importance of the American Merchant Marine declined steadily as the introduction of steam-propelled, iron ships destroyed the price advantage which had favored American ship owners in the days of sailing vessels, and as the steadily mounting wage scale of American seamen made the recruitment of hands increasingly difficult.

In industry, the years beginning in the 1870's saw a period of fierce competition. This led to the elimination of the less sturdy industrial enterprises. From 1870 to about 190., the over-all level of prices tended to drop steadily, and this, in turn, reduced industrial profits and emphasized the importance of efficient operation. Under these economic pressures, there was a very strong tendency for industrial organizations to increase in size and strength through processes of combination. At first, producers resorted to simple price-fixing agreements, but gradually the advantages of the so-called "thrust" type of organization, under which a board of trustees held controlling interest in a number of organizations, became the characteristic type. However, the public reactions to the trust form of enterprise were unfavorable, and by the end of the nineteenth century, the holding company, or the large single combination had replaced the trust as the major industrial producer. Under this system of combined corporate enterprise, industrial units became progressively larger in size and, as a result, secured operating economies not open to smaller producers.

Combinations on the part of industry had their counterpart in the ranks of labor, and there appeared powerful trade unions which, in many cases, during this era were able to meet the employers successfully in the struggle for economic advantage.

The opening of the present century saw an economy in which the basic characteristics of the American material and human equation had been developed to a high degree. The Nation had enormous resources of the majority of needed industrial raw materials, its agricultural assets were unequaled, and the tariff system provided a unique protected market. These factors gave rise to a very special economy. Every emphasis was laid on the efficient production of goods by the minimum expenditure of manpower. This trend, which, as I have indicated, had its origins in the early colonies, continued to dominate our economy as the United States emerged as a world power. Mass production in industry and mechanized agriculture were the American answer to the economic situation of labor shortage. The economy of labor scarcity had its advantages in high levels of mechanization, in advanced industrial and agricultural technology, in low unit production costs, and in highly standardized products. As a result, in spite of high labor costs, American products were generally able to compete successfully on the world market, and in the protected market of the United States they enjoyed a virtual monopoly.

Although the economy of the United States was still very definitely a debtor economy, in practical fact, the financial resources of American business and banking were such as to make the balance of payments a convenient device for the adjustment of our uniformly favorable foreign trade picture, rather than a drain on the producing economy.

The tendency toward the creation of successively larger industrial units, which was to become so characteristic of the period after World War I, had already been established, and the "billion dollar corporation" became a reality. Thus, in 1914, as the United States observed the threatening clouds of war in Europe, it had emerged as one of the strongest industrial powers of the world. While contemporary Europeans regarded our economic institutions as anarchistic and felt that the Government played a very weak role indeed in the regulation of enterprise for the national well-being, the average American of the day was convinced that his national economy was by far the best achieved by man in his struggle for a better life.

While the economic evolution of the United States is not a story which can be summarized in a few words or reduced to a neat set of rules or laws, it is possible to see a general pattern running through our economic life from its beginnings down to the end of the period under discussion. The United States represents, in the first place, a condensed case history of a people wonderfully well-endowed by nature in their progress from a primitive hunting and collective economy to an elaborate industrial and agricultural economy. It gives us the opportunity to study, almost at first hand, the economic history of mankind, under conditions which are recorded in the pages of our own history.

As I have said, perhaps the dominant theme of the American economic development is the theme of labor scarcity. From the colonial settler, who resorted to Indian methods of agriculture to save labor, down to the mass production industrialist who was willing to pour millions into facilities and tools for the same purpose, America has learned to use its materials and its ingenuity to save human effort. This has led to an economy of very special character. Our agriculture has tended towards the large farm dedicated to the production of a very limited range of staple crops and livestock. In industry, under the same pressures, America has become characterized by the mass production of a limited variety of standardized items and the use of specialized machinery in place of skilled artisans. These economic facts which remain constant down to the present day, must occupy a major position in all economic mobilization planning. They are a source of strength and at the same time they are a source of weakness. American industry can surpass the world in its volume of production per man-hour. It can also excel in the production of standard items at low cost and in securing the complete interchangeability of subassemblies and parts. On the other side of the coin, however, there are definite disadvantages. The American industrial pattern produces relatively few highly skilled workmen. The facilities developed by our mass industries are highly specialized and, in general, can produce only the items for which they were originally designed. The experience of World War II, in which the great motor factories provided merely "shed space," as it has been termed, for the new machines of war production, illustrates that point. Mass production techniques in themselves emphasize lack of design changes and long runs of indentical items, a situation which may be most unfortunate in the production of military materiel. Finally, American industry has tended to concentrate on technological advances in production rather than in research and development, thus making us perhaps less well-suited for industrial pioneering than for routine production. The demands of modern military technology, as you know, are such that this industrial factor might become a very serious weakness.

The present discussion has attempted to trace the development of our national economy from its conception to the emergence of what we now regard as the American free-enterprise system. Dr. Hunter will discuss the last and most important phase of our economic progress. In leaving this discussion, I should like to re-emphasize that the American economy of today is the evolutionary descendent of the American economy of a whole series of yesterdays. Economic mobilization planning and organization, if it is to be successful, must take into account the entire fabric of relationships, techniques, customs, and laws which have become an essential part of the American productive system. Any plans not based on sound and complete knowledge of the substructure of our economic life will be as definitely predestined for failure as strategic plans made in ignorance of the human, geographic and economic factors of a potential enemy. The American people will always be ready to make any possible effort demanded of them by the defense of their Government and their way of life. However, that effort must be made in the manner and along the lines which the people themselves have come to accept as truly and properly American. As a nation, we can be led to almost any achievement--but we do not like to be pushed. It is the absolute duty of all officers and civilians in policy-making positions and positions of leadership to predicate their actions on the known facts of American political, social and economic life as it is. Any other course can lead only to disaster.

Thank you, gentlemen

DR. REICHLEY: Thank you.

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