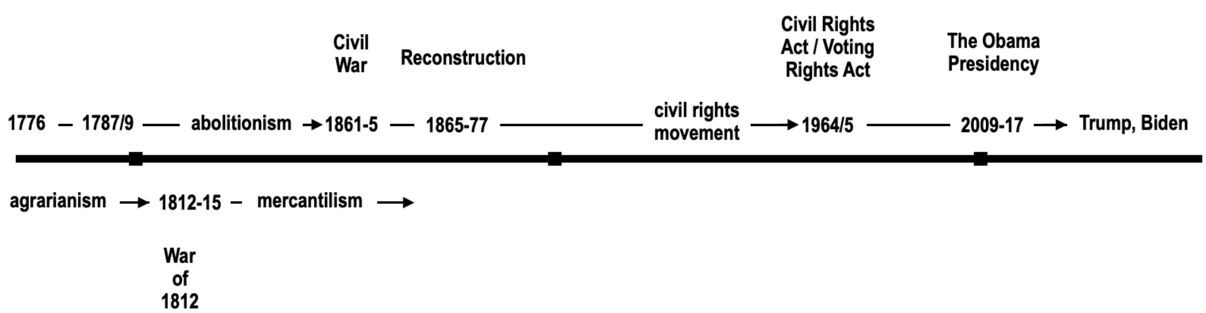
F. The Political Economy of Industrialization

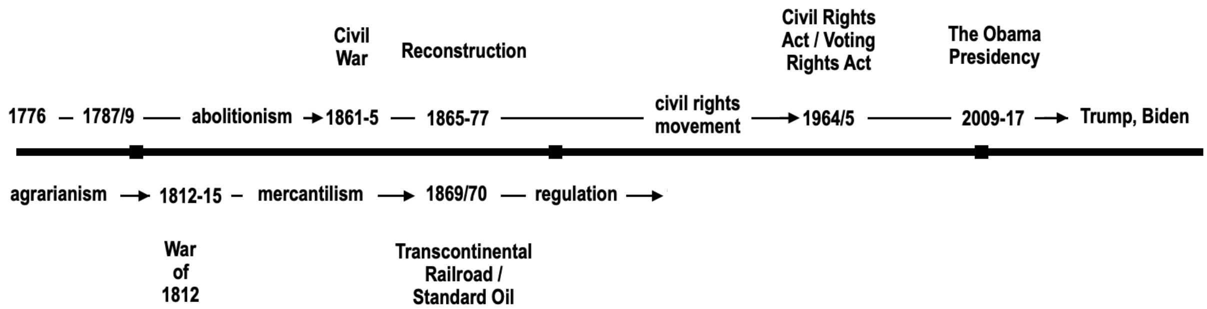
1. When the *Industrial* period of technological and commercial progress began following the Civil War, the idea that the government must continue to *encourage* its "merchants" became irrelevant.
2. Mercantilism had been adopted to help American industries to become big and successful; during the *Industrial* period, they became—at least in many people's minds—*too* big, and *too* successful. This led to a new incarnation of political economy, where the main emphasis of government intervention in the economy was to *regulate* the activities of modern industry. (To "regulate" simply means to impose rules, i.e. laws, on industry, because such rules are desired as part of the social contract.)
3. Here is a timeline showing the evolution of the social contract and political economy so far:



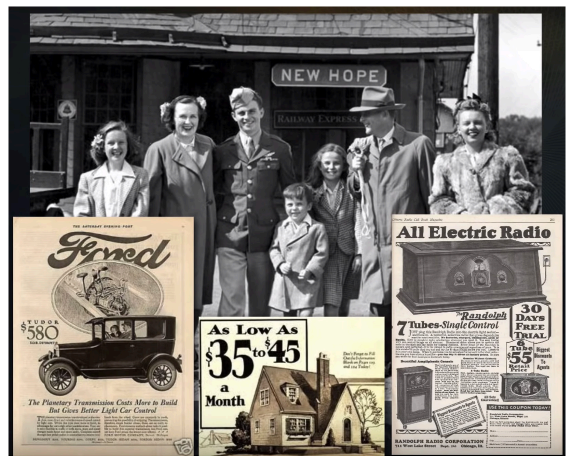
4. The first trigger for the era of regulation was completion of the *Transcontinental Railroad* in **1869**.
   a) The project, proposed by the federal government to link the new state of California to the east coast, was not financially viable. The industrial experts that the government recruited were clear in their response to the proposed project. They told the government that it could not be made profitable.
   b) The government decided to proceed anyways, and it was arranged that the builders of the railroad would be paid large sums in advance, so that they would not face any financial risk.
   c) When the operating railroad went bankrupt (as predicted), it was the taxpayers who footed the bill.
   d) The public reaction to this obviously corrupt scheme that wasted tax money was to demand new laws to control the railroads so that they served the "public interest."
   e) The **Interstate Commerce Act** of **1887** was the first of the laws passed to place the railroads under government control. (They would still be run by private companies, but they would have to follow strict government rules under government oversight.)
4. The second trigger for the rise of the political economy of regulation was the rise of massive corporations like *Standard Oil* in **1870**.

a) The Standard Oil company run by John D. Rockefeller was incredibly successful.
b) Rockefeller, like other titans of industry, understood how to integrate vast industrial undertakings on a scale never seen before.
c) Among the mechanisms he devised for doing so was an organization called a "trust," in which many different companies coordinated their activities to increase their efficiency and lower their costs.
d) The Standard Oil trust was so efficient that it drove almost all its competitors out of business.
e) This ruthless competition was resented by Rockefeller's rivals, and his vast wealth also triggered envy and hatred in people who struggled to adapt to industrialization while Rockefeller and men like him flourished and lived in a luxury never before imagined.
f) The **Sherman Anti-Trust Act** of **1890** was passed to prevent companies like Standard Oil from being *too* successful. (According to this law, the Standard Oil company was eventually broken up into 34 smaller companies.)

5. The greatest symbol of the era of regulation arose in the field of banking.
   a) For centuries, beginning back in Renaissance Italy, banking had been a crucial industry for commercial progress. Banks had arisen as a key institution for providing money to the economy by offering a unique service: they kept people's money safe, which lending out a portion of it to productive enterprises, whose success produced more material goods and returned more money to the banks than had been loaned out.
   b) The greatest challenge of banking is to make sure that loans are productive, however. When money loaned to someone disappears, such as when a business fails or it is stolen, that is money its depositors may demand at any particular moment. Over the course of history, this happened periodically, resulting in "bankruptcy" (the "rupture" or "breaking" of a bank).
   c) As industrialization accelerated, so did the growth of banking. As the size of companies grew, however, so did the potential problems, if they failed. Banking "panics" would occur occasionally during the *Industrial* period, causing many depositors to lose their money, and—in keeping with the social contract of regulation—insist that the government "do something" to fix the problem.
   d) In **1939** the **Federal Reserve Bank of the United States** was created to regulate the American banking industry and prevent "panics."
   e) The Federal Reserve Bank performs many regulatory functions. One of them is perfectly visible when you look at American paper money: it says "Federal Reserve Note" on it. This is just one feature of a system in which the Federal Reserve Bank is designed to provide money to banks that need it, so that banks won't go bankrupt and the kinds of problems that occurred in the early *Industrial* period can be avoided. In effect, the Federal Reserve is a "bank for banks."
6. The chapter of *regulation* is the third of the chapters of political economy, after *agrarianism* and *mercantilism.* It is not the final chapter, however. Something happened to trigger another change…



G. The Roaring Twenties



The "Roaring Twenties" were a "boom time": a period of peace, prosperity, and optimism. Everything seemed to be going right.

1. Following **World War I (1914-19)**, and in light of all the industrial progress in America and the belief that everything "regulated" was well-organized, America entered into a period of unprecedented peace and prosperity. It is called the "Roaring Twenties."
2. It was the first time in history when the average person could afford a car, a home, and a wide array of consumer goods. Life was good!
3. One of the features of this sense of optimism was that people were eager to invest their money in the future, rather than saving it for some future setback.
4. One way to take advantage of how great things seemed to be was to invest in the stock market. (The stock market is a market when people can buy pieces of a company. When you own a piece of a company—when you own "stock" in a company—you get paid some money as a reward when it succeeds. You can also, if the value of the company is going up, sell your stock, and make a profit. Of course, if a company falters or fails, you can lose a lot of money too.)
5. Up until 1929, the stock market was booming. People believed that success in investing was guaranteed, and politicians kept saying that everything about the American economy is working perfectly. (Politicians love to take credit when the economy is strong. It helps them to get re-elected.) Then everything went wrong…

H. The Great Depression (1929-39)

1. The "Great Depression" is something that even expert economists cannot agree on. Exactly why and how it happened is an especially difficult problem.
2. One factor is the "boom" that came before. If people are *too* optimistic about the future, they can become irrational about it. In such cases a boom can become greatly exaggerated; it becomes what economists call a "bubble" economy. There was clearly a bubble in 1929.
3. In addition, even though other parts of the economy were carefully regulated, the stock market was not. Not surprisingly, some people took advantage of this free space to engage in schemes and conspiracies. For instance, there were "trusts" in the stock market called "pools" that would buy a lot of certain stock to make it seem especially valuable, and then when the price went up, sell it at a profit. Such pools were just taking advantage of people's enthusiasm and lack of professional knowledge. Unfortunately, one such pool operated in 1929 on the stock of a great company called "RCA" (now part of General Electric, and still one of the biggest companies in the world).
4. One of the biggest mistakes people made during the bubble was to borrow money to invest in stocks. This is possible, but very risky, of course. When you do it, you are buying stock with money that is not yours. If, and as happened in 1929, *when* stocks drop, you have to sell and pay back the bank no matter what. This can cause many people to sell at the same time, and the stock to "crash."
5. Following just such a crash in 1929, the Federal Reserve and the government were afraid to hand out big clumps of money to banks and investors. This caused many companies and banks to go out of business even though they were regulated.
6. Then the government created a bigger problem. It created a new tariff called the **Smoot-Hawley Tariff** of **1930**, which raised taxes on international trade. Other countries then raised their tariffs and many companies suffered because of the drop in international trade.
7. Finally, starting in 1934, a drought struck the American prairies lasting about five years. This "dust bowl" period meant that many American farmers were also in trouble at the same time as American industry was regrouping from the crash.
8. Many businesses failed. Many banks failed. Many farms failed. Many workers lost their jobs. The desperation of that moment triggered the desire for a new social contract: