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* business 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. 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, while lending out a portion of it to productive enterprises. The success of those enterprises produced more material goods and returned more money to the banks than had been loaned out. This was how they profited.
   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 **1913** 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…