CHAPTER 2

THE CURSE OF BIGNESS

America's Regulatory Capitalism

THE EX-TYCOON EXPIRED on a subway platform in Paris in 1938. Hardly any money was found on his person, and newspaper headlines back in the United States said that he had died a pauper. Although disgraced, he was in fact not poor, and his wallet had probably been pinched before the authorities appeared. But it was a better story to say that he had died in poverty. For more than any other American, Samuel Insull and his accession to prominence as a businessman and then his precipitous fall from grace provided the perfect morality tale for the giddiness of the stock market in the 1920s and its collapse in the 1930s. How better to demonstrate the bankruptcy of capitalism than with this fallen figure of Samuel Insull, the equivalent of eight cents in centimes in his pocket. The times, with their sorrow and pain, called out for such morality tales.

What a change from the boom years of the 1920s, when Insull embodied spunk and ambition and ability. Born in 1859, he had gone to work as a boy in London as a telephone switchboard operator and later as a shorthand secretary to the head of Thomas Edison's British operations. In due course, he became Edison's personal secretary, and from that point worked his way up in Edison's organization. When it was broken up, he became head of Chicago Edison and built it into a huge electric power company. He was the king, presiding over a far-flung enterprise that delivered electricity to a substantial part of the United States. Insull was known for his seriousness and his temper (Insult Insull, he was called), but most of all for his drive to create a great empire. He held out a grand vision of the future of electric power: "Every home, every factory, and every transportation line will obtain its energy from one common source, for the simple reason that that will be the cheapest way to produce and distribute it." The mechanism for implementing this vision was to be the kind of enterprise he had constructed—an endlessly complex and bewildering corporate pyramid. Insull's operating companies ran the power plants, dispatched the electricity, and read the meters. His holding companies, whose main assets were stock in other companies, were where the financial engineering was implemented, leaving plenty of room for financial manipulation. Who could make sense of it all? At one point, Insull held sixty-five chairmanships, eighty-five directorships, and eleven presidencies. For a time, "Insullism" was held up as the model for the future. But with the stock market crash and the Great Depression, Insull's empire collapsed, and the stock in his paramount holding company, Insull Utility Investments, plunged from over a hundred dollars a share in 1929 to little more than a dollar in 1932. In its aftermath, people said that Insull himself had never understood his own empire. He could not fail to observe, however, the fury of his investors; and in consequence, he prudently protected himself around the clock with thirty-six personal bodyguards.

As if the rage of his ruined shareholders were not enough, his troubles were compounded by a Cook County indictment for larceny and embezzlement; and Insull hurriedly decamped to Europe. With President-elect Roosevelt promising " 'to get' the Insulls," the U.S. government wanted him back. He moved through France; and Roosevelt asked dictator Benito Mussolini to help in case he turned up in Italy. By then, however, Insull was already in Greece. "Why am I not more popular in the United States?" he asked uncomprehendingly from his exile. "What have I done that every banker and business magnate has not done in the course of business?" The only response from the Greek government was his expulsion from the country, at the request of the United States. With nowhere else to go, Insull became a man without a country, sailing aimlessly around the Mediterranean in a chartered tramp freighter. When the ship docked in Turkey for provisions, he was arrested; and, although lacking an extradition treaty, the Turkish government packed him on a boat back to the United States. He was tried on fraud charges in Cook County. Yet despite the intensity of hatred against him, he won acquittal with surprising ease in 1934. The jury needed just five minutes to reach its verdict. But Insull had had enough of America, and he spent the last four years of his life outside the United States. Once worth hundreds of millions, he had lost much of his wealth; even the ownership of his shirt studs became the subject of a lawsuit. He habitually took the Paris subway in order to save money, although his wife had warned him, presciently as it turned out, that it might be bad for his heart.[1]

Well before his death, Insull had become the nation's symbol for the excesses of capitalism, for the chicanery and greed that had preceded the Great Depression, and, indeed, for all that could go wrong with unfettered markets. His name was invoked by President Roosevelt and the other New Dealers only to excoriate him. So much of the distress was attributed to the machinations of Insull and the other tycoons that Insullism was no longer held up as an expansive vision of the future but rather as one of the major causes of the Depression. In order to clean up the wreckage—and prevent future Insulls from creating future disasters—the New Deal embarked on a far-reaching program of experimentation and expansion of government authority over the economy. State ownership was not out of the question; the Tennessee Valley Authority was a great experiment in public ownership and development economics that electrified the dirt-poor region of the middle South. But for the most part, government would seek to control the key parts of the economy not through ownership but through a distinctly American approach—economic regulation. This thrust contrasted with that in Europe and the developing world. By comparison, the United States was more market-oriented. But government would still hold considerable sway over the market. Indeed, in the American context of the 1930s, the "regulatory idea" became the solution to the problems of the marketplace. This idea would maintain its grip for decades, until new economic disruptions and a growing intellectual critique undermined the consensus.

The Rise of Regulation

Regulation—rule making—has many purposes, of course. They range from health and safety and environmental protection to working conditions, equality, equity, and social policy. National regulation specifically for economic purposes originated in the nineteenth century, beginning during America's development era—with the establishment of the Interstate Commerce Commission (ICC) to regulate railroads, the great new industry of the era. Until then, the national government had been remarkably limited in its activities, as could be measured by the number of its civilian employees. In the early 1870s, the federal government employed a grand total of 51,020 civilians, of whom 36,696 were postal workers. The ICC marked the first major attempt by the government to oversee the national economy. Railways had become not only a critical industry but also a national force, erasing the boundaries of states as they tied the nation together. The ICC was created in order to ensure "just and reasonable" rates and equitable treatment of shippers and communities—and to limit manipulation by the robber barons. With five commissioners appointed to staggered six-year terms, it also became the model for future regulatory commissions. In its early years, its mandate was dramatically whittled back by the courts, only to be expanded again with the rise of progressivism after the turn of the century.

By the late nineteenth century, America was well on its way to being an industrial nation. Its cities were becoming home to millions and millions of new immigrants, along with sprawling factories that spewed dark smoke out of their chimneys. The advent of industrialization and the transformation of living space brought a host of ills, which in turn became the target of a group of investigative journalists known as muckrakers. The term, borrowed from Bunyan's *Pilgrim's Progress,* was first used by President Theodore

Roosevelt, a writer of considerable accomplishment himself. Roosevelt did not mean the phrase as a compliment; he thought the writing of these journalists too negative, their work too focused on "the vile and debasing," and their impact too much a fan for the flames of revolution. Nevertheless, the muckrakers' exposés of the ailments of the new industrial society—dirty food, dirty working conditions, dirty cities, dirty business, dirty money, and dirty politics—set the agenda for turn-of-the-century America, and Roosevelt and other politicians embraced the cause. Regulation was the response to the catalog of abuses.

Much economic regulation focused on one problem—what to do about bigness and monopolies. Combinations to control prices and outputs were, of course, a perennial problem—indeed, one that had much exercised Adam Smith. "People of the same trade seldom meet together," he wrote in one of his most famous passages in *The Wealth of Nations,* published in 1776, "even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices." But those words were written at the very beginning of the Industrial Revolution. Smith could hardly have imagined the scale in America a century later resulting from technology, mergers, takeovers, economic concentration, and the emergence of huge (by the standards of the times) combines. In shorthand, they were known as trusts, often out-and-out monopolies that seemed determined to extinguish the atomistic world of small, family-owned enterprises. Trusts, said the editor of America's leading muckraking magazine in 1899, constituted "the red hot event." They were indeed the dominating national issue of the time.

Something had to be done. But what? Although he earned the sobriquet "trust buster," President Roosevelt was not against bigness per se. Combinations, he said, could be turned back no more easily than the spring floods on the Mississippi. But, he continued, "we can regulate and control them by levees"—that is, by regulation and public scrutiny. He distinguished between "good trusts" and "bad trusts." Only the latter should be destroyed.[2]

The People's Lawyer

Others saw size itself as the enemy and were determined to demolish the trusts. The foremost proponent of that position was "the people's lawyer of the Progressive Era," Louis Brandeis, whose eyes were fixed on one evil—what he called "the curse of bigness." Brandeis was a man of outstanding intellect. Entering Harvard Law School at age eighteen, he quickly amassed a phenomenal record, one of the best in the entire history of the school. He "is supposed to know everything and to have it always in mind," one of his fellow students wrote of him. "The Profs. listen to his opinions with the greatest deference, and it is generally correct. There are traditions of his omniscience floating through the School." Brandeis's subsequent career bore out his promise. He went on to become a formidable advocate, and on nothing was he was so powerful as in his advocacy of the destruction of bigness. He was a masterful attacker in the courtroom and no less masterly as a muckraker. The title of his most famous work—*Other People's Money and How the Bankers Use It*—told all. He was also a trenchant critic of Theodore Roosevelt. The president, he said dismissively, was in favor of "regulated monopoly," while he, in contrast, advocated "regulated competition." As for the public, he feared they "still admire the Captains of the trusts."

The issue of bigness and the trusts was thrashed out in both the political process and the courts. Although differentiating between "good" and "bad" trusts, the Roosevelt administration launched no fewer than forty-five antitrust suits, many of them long-running. None was more prominent than the prosecution that culminated in the Supreme Court's decision in 1911 to break up John D. Rockefeller's Standard Oil trust.

For his part Louis Brandeis became the chief economic adviser to Woodrow Wilson, who was elected president in 1912. Brandeis thereafter played a major role in designing both the new Federal Reserve System and the new regulatory agency, the Federal Trade Commission, which was intended to police bigness, restrict restraint of trade, and prevent "unfair" trade practices. Yet even Wilson did not fully satisfy the people's lawyer. "In my opinion," Brandeis explained, "the real curse was bigness rather than monopoly. Mr. Wilson (and others politically wise) made the attack on lines of monopoly—because Americans hated monopoly and loved bigness." In 1916, Wilson nominated Brandeis for the Supreme Court, and despite a fierce anti-Semitic campaign, he was confirmed. He served on the court for twenty-three years. He was an outstanding justice and, as it turned out, most committed to judicial restraint.[3]

Normalcy, "Not Nostrums"

And there regulation more or less stood for a number of years. Business seemed, in the worshipful fever of the 1920s, incapable of doing wrong, save for the occasional scandal such as that involving the naval oil reserve at Teapot Dome. Those captains of capitalism who had so exercised Brandeis were now heroes, and the less government did, the better. President Warren Harding opened the decade of the 1920s with a reassuring call for a return to "not heroism, but healing, not nostrums but normalcy." A Republican attorney general denounced the Federal Trade Commission as nothing more than "a publicity bureau to spread socialist propaganda." "Association" and "cooperation" among businesses were encouraged; it was part of rationalization, one of the high values of the day. Even the critics got on board. Lincoln Steffens, among the most famous of muckrakers, declared that "big business in America is producing what the Socialists held up as their goal: food, shelter, clothing for all."* Everything seemed to be working so well. "No Congress of the United States ever assembled," said President Calvin Coolidge in December 1928, "on surveying the state of the Union, has met with a more pleasing prospect than that which appears at the present time."

That prospect did not last long. Ten months later, on Black Thursday, October 24, 1929, the stock market crashed. Thereafter, the entire edifice of debt and credit both in the United States and around the world—banks, stock margin accounts, postwar reparations, loans to commodity-producing countries—came tumbling down. The nascent democracies in Germany and Japan succumbed to dictatorship. With unemployment at almost 25 percent in the United States and the GNP falling by half, it was not all that certain that democratic capitalism in the United States would survive.[4]

The New Deal: "I Never Felt Surer of Anything"

Franklin Roosevelt came to office in March 1933 with a mandate to do something, and to do it fast. Inauguration Day, his wife, Eleanor, observed, was "very, very solemn and a little terrifying." Roosevelt told the frightened country that the only thing it had to fear was fear itself; he immediately set about restoring confidence through words and spirit—and a great fury of vigorous economic improvisation. One line of effort was emergency response—a bank holiday, relief, welfare, and food programs. Another was "cooperation" and national planning. In his second Fireside Chat, in May 1933, Roosevelt called for "a partnership in planning between government and business, with government having the right to prevent, with the assistance of the overwhelming majority of that industry, unfair practices and to enforce this agreement by the authority of government."

While the president was working on the speech, one of his assistants, Raymond Moley, warned him, "You realize, then, that you're taking an enormous step away from the philosophy of equalitarianism and laissez-faire?"

The president was silent for a moment, and then replied with great earnestness, "If that philosophy hadn't proved to be bankrupt, Herbert Hoover would be sitting here right now. I never felt surer of anything in my life than I do of the soundness of this passage."

That thinking was embodied nowhere more clearly than in the National Recovery Administration. The NRA was premised on the belief that the es-

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* A few years earlier, in 1919, Steffens had encapsulated the utopian embrace by some Western intellectuals of the new Soviet Union with the immortal phrase "I have seen the future and it works." Actually, Steffens had been playing with the phrase on the train to the Soviet Union before he even laid eyes on the country, trying out variations such as "I have been over into the future and it works."

sential problems were overproduction and too much supply—of virtually everything. In response, the NRA sought to get labor, business, and government to cooperate in a grand partnership—a corporatist combine to reduce output, set prices, and thus push up incomes. Such coordination was essential, it was thought, because America had reached a phase of "economic maturity." The Depression had proved that America could no longer depend on an ever-expanding economy for its well-being. It seemed the country was ready to accept the NRA and its unprecedented intervention—and, in the process, to put aside traditional antitrust considerations. And indeed, the NRA began with an initial burst of enthusiasm, emblazoning its blue-eagle emblem in windows across the nation and filling New York's Fifth Avenue with ticker tape and throngs of well-wishers in a promotional parade in September 1933. But it did not work. America was not so eager to toss aside its deeply rooted suspicion of concentration and cartels, or to put its confidence in the forthrightness of businessmen and government officials to harness these dangerous forces for the public good. In attempting to establish such a system, the NRA violated the tenets of traditional progressivism. The American conscience would not brook such a transgression. In trying to perform his impossible task, the NRA's director, General Hugh Johnson, was reduced from a reformist hellcat to a sobbing alcoholic, and within two years the NRA and its mandate were tossed out by the courts.

Instead, the New Deal pursued another approach—regulation instead of ownership or nationalization, antitrust rather than concentration and rationalization, decentralized control instead of planning. In so doing, the New Deal put in place a system to regulate markets and ensure that they worked better—and, by-the-by, to save capitalism from itself. Despite the wide variety in the purposes of the various regulatory agencies, there were two unifying themes—the failure of markets and the problem of monopoly.

The Securities and Exchange Commission (SEC) was a highly visible and critically important part of this effort. It was meant to make the battered financial markets work better, and to restore confidence in them through increased disclosure requirements and the establishment of a level playing field that did not give insiders an unfair advantage. How better to do it than by putting a financier, Joseph P. Kennedy (father of a future president), in charge? When opponents of Kennedy's nomination pointed out that he had in fact been a master speculator, Roosevelt replied that it was all to the good, because Kennedy knew the tricks of the trade.

The SEC got a great boost when it turned out that Richard Whitney, the distinguished president of the New York Stock Exchange and a leading opponent of the SEC, had himself embezzled $30 million—a truly dizzying number in the 1930s—to cover bad debts. Like Roosevelt, Whitney had attended Groton and Harvard; and when Roosevelt was told of this particular villainy, he was heard to gasp, "Not Dick Whitney!" But, yes, even Dick Whitney. In order to enjoin such behavior in the future, the SEC created a whole series of reporting requirements that were intended to help investors understand in what they were investing. Disclosure and a level playing field were the basic principles. Not only buyers, said Roosevelt, but also sellers should beware. Among other things, they should beware to tell the truth. Echoing Brandeis's book *Other People's Money,* Roosevelt laid out the principle that those "handling or using other people's money are trustees acting for others."[5]

"The Prophet of Regulation"

The guiding hand in the creation of the SEC was James Landis, raised in Tokyo by his American missionary parents and, like Brandeis, a brilliant lawyer. He was tenured at Harvard Law School before age thirty and was its dean before age forty. In between, he joined the New Deal, where he was among the brightest of its young stars. He also became, in the historian Thomas McCraw's phrase, one of the "prophets of regulation"—along with Louis Brandeis, for whom he worked as a Supreme Court clerk. Indeed, Landis looked to be Brandeis's likely heir at the intersection of intellectual work and policy, defining the relationship between state and marketplace for the next generation. He seemed destined for the same sort of grand national career that Brandeis had achieved.

An urgent summons from his mentor Felix Frankfurter, Harvard professor and Roosevelt confidant, took Landis down to Washington on a Friday train in April 1933. Landis expected to stay the weekend, help out, and then head back to Cambridge by Monday. As it turned out, he stayed four years. He was the quintessential New Dealer, working day after day until midnight, often sleeping for a few hours on a cot in his office, drafting legislation almost around the clock through the economic emergency, and rushing back and forth to the White House to confer directly with the president. "You can't drive your mind as though it were a brewery horse," Frankfurter warned him. But he did not give up the pace. Details of daily living eluded him, a sloppiness that would come back to haunt him. His personal life took second place to the national emergency. His wife, invited to bring her husband to a party, responded, "What husband?"

Landis served first as a federal trade commissioner and then as a commissioner on the new Securities and Exchange Commission, which he had done much to create. And in so doing he set out to give all the interested parties a stake in the new system. Among his shrewdest decisions in creating the SEC was to enroll the business community as a partner in the process. For instance, one of the requirements instituted for public companies was the disinterested audit. By instituting this requirement, Landis did much to establish the profession of the independent accountant.

Another of Landis's monuments was the Public Utility Holding Company Act of 1935, which created the structure for the electric power industry in the United States that lasted until the middle 1990s. Electric power was among the issues that most viscerally engaged President Roosevelt personally. Viewing electricity as a great tool for economic development and conservation, he promoted, against enormous opposition, both rural electrification and the Tennessee Valley Authority. The latter was unprecedented—a far-reaching public corporation that built dams, generated huge amounts of power, manufactured fertilizers, controlled floods, restored forests, and replenished the soil—all of it in the cause of economic development. Roosevelt was very proud of it.

But there was also the private side of electric power. Roosevelt regarded holding companies, particularly in electric power, as one of the nation's scourges and a principal cause of the financial collapse. He was intent on banishing "the Insulls" forever. These holding companies, with their "concentrated economic power," constituted a form of private socialism, he said, adding, "I am against private socialism as thoroughly as I am against governmental socialism. The one is equally as dangerous as the other; and destruction of private socialism is utterly essential to avoid governmental socialism."

The result was the Public Utility Holding Company Act. The legislation dismantled much of the holding-company structure and severely restricted what remained, in order to prevent holding companies from "exploiting" operating companies. It also gave the SEC power to promote physical integration of electric utilities to achieve greater engineering efficiencies. The act was bitterly opposed by industry, which enlisted in its cause such legal luminaries as John Foster Dulles, Dean Acheson, and John W. Davis, the 1924 Democratic presidential candidate. It took a full decade of legal challenges before the law was finally accepted.

Landis was not only an activist. He was a theorist, and did more than anybody else to set out the doctrine for economic regulation. As a young law professor he had pioneered the study of the legislative process and the implementation of law. In 1938, having left the SEC, he put down his thinking in what became a classic work on regulation, *The Administrative Process.* Markets themselves, he said, had big problems, problems too large and sprawling for traditional government, which was simply too weak, too incoherent, and too lacking in expertise. "In terms of political theory, the administrative process springs from the inadequacy of a simple tripartite form of government to deal with modern problems." Legislation was the beginning, not the end. There was a need for, in effect, a fourth branch of government—the "administrative branch"—embodied in independent regulatory agencies that would be "quasi-legislative, quasi-executive, quasi-judicial" and that would ensure the implementation of the legislation. And he admonished policy makers not to be cowed by the growth of government activity this task would entail. "A consequence of an expanding interest of government in various phases of the industrial scene must be the creation of more administrative agencies if the demand for expertness is to be met. . . . Efficiency in the processes of governmental regulation is best served by the creation of more rather than less agencies. And it is efficiency that is the desperate need." This branch would be staffed not by politicians or amateurs but by experts who devoted themselves to the issues "52 weeks a year, year after year." How much that sounded like the job description for James Landis himself during the hectic New Deal years.[6]

Landis's words were written in the heyday of regulation, as the New Deal entrenched his strategy through unprecedented extension of administrative regulatory powers. In addition to the preexisting Interstate Commerce Commission and the Federal Trade Commission, both of which were strengthened, the New Deal also bolstered the Federal Power Commission with new responsibilities for electricity and natural gas prices. The Roosevelt administration created not only the Securities and Exchange Commission but also the Federal Communications Commission, the Civil Aeronautics Board, and the National Labor Relations Board. The attack on business took on an added fervor in the late 1930s, when liberals blamed business for a steep recession because of what was its alleged failure to invest (the "capital strike"). Roosevelt denounced "economic royalists" for deliberately fostering the recession in order to undermine the New Deal. Thus, as the 1930s came to a close, the Roosevelt administration had finally completed the blueprint of the New Deal strategy, after its early fits and starts. The cozy partner relationship with business envisioned in the early New Deal had given way to James Landis's more prickly and vigilant vision.

Keynes' American Beachhead

But the true test of the regulatory system was stayed by fresh economic exigencies. The recession in the late 1930s distracted the country from its regulatory fervor. And the government's response reflected the emergence of a new economic strategy—Keynesianism. During the early years of the New Deal, Keynes had written a couple of "public letters" to Roosevelt and, indeed, through the good offices of the ever-busy Felix Frankfurter, had called on the president in the White House in 1934. Roosevelt reported back to Frankfurter that he had had a "grand talk with Keynes and liked him immensely," although comments to others suggested that he had been somewhat irritated by Keynes' patronizing manner. For his part, Keynes said that he had found the talk "fascinating and illuminating." He did, however, complain about Roosevelt's hands—"Rather disappointing. Firm and fairly strong, but not clever or with finesse." There is no evidence that Keynes at this point, although much engaged in writing *The General Theory,* did anything to convert the president—or the New Deal—to his thinking. In fact, Roosevelt was suspicious of deficit spending; in the margin of a book that prefigured Keynes' arguments, he had written, "Too good to be true—you can't get something for nothing."

The General Theory was published in 1936, and Keynes' ideas thereupon crossed the Atlantic with remarkable rapidity. The most powerful beachhead proved to be the Harvard economics department, led by Professor Alvin Hansen and supported by a host of other converts and recruits—from full professors right down to undergraduates. They absorbed, refined, and transmitted the Keynesian message in record time. Their propagatory influence in turn was enormous. The intellectual work was centered in Hansen's Fiscal Policy Seminar, which brought the latest academic research and Washington policy makers together on a regular basis. Keynesianism quickly gained adherents in Washington, in large part because it seemed to provide a way to address basic economic questions "without the dangerously statist features of other, more intrusive methods." In the judgment of Nobel laureate Paul Samuelson, a Harvard graduate student in the late 1930s, "The Hansen influence can be said to have transformed the New Deal of Franklin Roosevelt from its first-term populist melange . . . to a mixed economy pursuing coherent and informed macroeconomic policies." Between 1938 and 1940, Keynesian fiscal policies began to be applied in the United States. And with the arrival of Keynesianism—combined with the focus on recession and the growing specter of international conflict—regulatory innovation passed into the background.[7]

Toward Full Employment

World War II did not help the cause of regulatory intervention. The War Industries Board's management of the economy during the First World War had been considered a great success and was much praised. The leader of the effort, Bernard Baruch, was virtually beatified. World War II would be an altogether different story. The scale of both the economy and this war effort dwarfed the previous world war's. Roosevelt and his wartime administration confronted a much more complex challenge than that which had faced Woodrow Wilson and Bernard Baruch. And the government's record reflected that complexity. The difficulties encountered by the two main coordination agencies during World War II, the Office of Price Administration and the War Production Board, undercut plans for increased government intervention in the economy after the war. The Office of Price Administration, observed historian Alan Brinkley, "may have been the most intrusive bureaucracy ever created in America." Its example was "a jarring reversal of the Second New Deal . . . it reminded much of the public that state power could be used not only to assist but to deny." The War Production Board was the target of similar criticism. Thus the management of the wartime economy stood alongside the National Recovery Administration as a warning to America against highly interventionist policies. "In 1945, the war agencies emerged from four years of effort and achievement with nothing even remotely comparable to the standing and authority the war boards of World War I had enjoyed at the end of 1918. If they served as models at all, they were models of the perils of state management of the economy, not of its promise." Even liberals wanted, in the aftermath of the war, "to find a role for government that would allow it to manage the economy without managing the institutions of the economy."[8]

Moreover, after World War II, capitalism was not in the doghouse in America as it was in Europe. Mobilization by industry had worked; the businessmen attacked as the "economic royalists" by Roosevelt in the late 1930s had rallied to the cause and contributed mightily to the war effort in the 1940s. Now they were heroes, patriotic, get-it-done "dollar-a-year men." And after the war, the American economy, instead of slipping back into a new depression as feared, took off on a great boom.

Yet in the aftermath of the war, all of the major Western nations were engaging in experiments with various flavors of the mixed economy. And despite the negative experience of government intervention during the war and the sharply improved status of capitalists and capitalism, America was no exception. The debate over which direction the American economy would take after 1945 manifested itself in the congressional battle over the Full Employment Act. In its early drafts, the bill contained language that would have guaranteed a "useful and remunerative job" as a *right* to "all Americans able to work and seeking work." The support for such statements came, at least in part, from arguments consciously paralleling the birth of the British welfare state. In 1943 the National Resources Planning Board had published a tract entitled *Security, Work, and Relief Policies.* It was dubbed the American Beveridge Plan owing to the similarity of its content and conclusions to Beveridge's phenomenally influential 1942 report, which had launched the welfare state in Britain. There was, indeed, considerable momentum for America to follow the lead of its allies in constructing a mixed economy.

But ultimately, American political traditions and the unique American war experience limited the expansion of direct government control that would be implied in underwriting employment for all citizens. In the end, the Full Employment Act was transformed into merely the Employment Act and was passed in 1946, loaded down with the very conditional and convoluted promise only that government would "use all practicable means consistent with its needs and obligations and other considerations of national policy . . . to foster and promote . . . conditions under which there will be afforded useful employment, for those able, willing, and seeking to work."

Yet even as America deferred to the forces of the market more than its allies, the regulatory framework of the New Deal remained. Throughout the Truman and Eisenhower years, there was little regulatory conflict. America was in the midst of its own thirty glorious years, and increasing prosperity diluted New Deal–type regulatory zeal. Economic expansion was the spirit of the era, and thoughts of dampening the progress of the market seemed far from the public's mind. Harvard economist John Kenneth Galbraith noted at the time that "everything happens as if Saint Peter, when receiving souls in heaven to send the ones to Paradise and the others to Hell, asked them only one question: 'What have you done on earth to increase the gross national product?' "[9]

Regulation and Reform

Thus, the postwar years were a time of a regulatory equilibrium. The activism and zeal promised by James Landis in 1938 were once again stayed by a changing economic focus. But not everyone was quite so sanguine about the state of regulation. As early as 1946, an investigation concluded that new rules—in the form of the Administrative Procedures Act—were needed to ensure equal treatment and due process. But more troubling was the lack of understanding about exactly how the government would oversee the decentralized and growing hydra of the "administrative branch." In 1949 Truman appointed former president Herbert Hoover to examine the issue. The Hoover Commission recommended that the executive branch be reorganized along functional lines, but it had no idea how to deal with the regulatory agencies.

Dwight Eisenhower was similarly baffled. His team entered office in 1952 as "determined, even jaunty reformers, 'modern' Republicans at last in charge of government which for twenty years has been misused by liberals." But Eisenhower slowly came to realize that he did not even have control over the executive branch. The New Deal had irreversibly extended government obligations with its rhetoric and its creation of a new administrative branch through the process of "delegation" of authority. Regulation during the Eisenhower administration was not particularly vivid or distinguished. It was a stable business, rather clubby in nature.

John Kennedy sought to revivify the regulatory idea. He appointed strong chairmen—such as Newton Minow, at the Federal Communications Commission, who captured national headlines by declaring that television had become a "vast wasteland." But real scrutiny of the regulatory system, which had become entrenched, inefficient, and overloaded with cases that it moved through with none of the vigor envisioned by its New Deal framers, would come from the man who had been so instrumental in creating it—James Landis.

Landis had not fared well after the New Deal. Unlike Brandeis, he had not fulfilled his early brilliant promise. After an unhappy tenure, he resigned as dean of the Harvard Law School, served as head of the Civil Aeronautics Board during the Truman administration until Truman fired him, and then went to work in the private sector for his old boss at the SEC, Joseph Kennedy. He did a variety of odd jobs, including helping with the research for John Kennedy's Pulitzer Prize–winning book, *Profiles in Courage.* When Kennedy was elected president in 1960, he asked Landis to prepare a detailed diagnosis of the regulatory apparatus. And with all his old fire renewed, Landis delivered a devastating critique of the system that had developed unsatisfactorily since his optimistic 1938 work. Whereas in the 1930s he had celebrated the idea of regulation as the means to efficiency, he now denounced the practice for its rigidity and incapacity. The report found that "delay had become the hallmark of federal regulation," and cited as two main causes the absence of an overall regulatory policy and the deterioration of the quality of regulatory personnel. He identified the Federal Power Commission as "the outstanding example" of "the breakdown of the administrative process." It would take thirteen years, he said, to clear up the natural-gas-price cases already pending. And the number of cases likely to be filed over those thirteen years would not be cleared up until 2043—even with a tripling of staff.[10]

Kennedy made Landis a special assistant, with the charge to reform regulation and upgrade the quality of the regulators and their output. Despite his initial impact, Landis never really had a chance to get back into the fray. The reason was personal. It turned out that Landis had failed, for inexplicable reasons, to pay his taxes over several years. He resigned, stood trial, spent thirty days in jail plus a year on probation, and was suspended from the practice of law for a year. His brilliant reputation as the leading thinker about the regulatory idea was spent. A few years later, he was found floating in his swimming pool, dead. His house was seized by the government, to pay off his remaining tax penalties.

While regulation still mattered very much to those who were regulated, it continued to remain well in the background of public concern, partly because things were working. But there was a shift of focus from regulation of the market to regulation of the economy through Keynesian fiscal policies. Keynesianism was about managing the overall economy, not the specific workings of the marketplace. These were years of great economic growth, and tens of millions of Americans migrated from cramped urban life to the green grass of suburban housing. The lawn mower in the garage was as much a symbol of prosperity as the automobile. Keynesianism seemed to be fulfilling its promises of growth and full employment. The good economic performance and long expansion of the Kennedy–Johnson years (until disrupted by the Vietnam War) marked the high point of Keynesianism, offering proof that the economy could be fine-tuned through macroeconomic management and the fiscal tools of taxation and spending. The attitude was summed up by John Kennedy when he received an honorary degree from Yale University. He began by saying that he had obtained the best of all worlds—"a Harvard education and a Yale degree." He concluded, "What is at stake is not some grand warfare of rival ideologies which will sweep the country with passion but the practical management of the modern economy."

These years were the apogee in the United States of the belief in government knowledge. It had taken three decades for Keynes' "scribblings" to move from rooms in King's College, Cambridge, into standard-issue government policy. To underline the point, Keynes made the cover of *Time* magazine in 1965—nineteen years after his death. He was only the second deceased person to be so honored (Sigmund Freud was the first).

The Last Liberal Administration

The most massive effort to actually manage the marketplace came in a subsequent administration, which sought to put in place thoroughgoing government control of wages. What was particularly odd was that this initiative was not the handiwork of left-wing liberals but of the administration of Richard Nixon, a moderately conservative Republican who was a critic of government intervention in the economy. As a young man during World War II, prior to joining the navy, Nixon had worked as a junior attorney in the tire-rationing division of the Office of Price Administration, an experience that left him with a lasting distaste for price controls.

What, then, were the forces that led Nixon to try to impose government management on the most basic elements of the market? Certainly, economic matters were hardly his passion. That was reserved for foreign policy. Even foreign economic policy did not much interest him. There was a memorable time during some moment of international monetary perturbation when he rudely suggested exactly what should be done with the lira. As for domestic economics, he liked to give his radio talks on economics at noon on Saturdays, because he was convinced that the only listeners would be farmers riding their tractors, and they were likely, in any event, to be his supporters.

For one thing, whatever the effects of the Vietnam War on the national consensus in the 1960s, confidence had risen in the ability of government to manage the economy and to reach out to solve big social problems through such programs as the War on Poverty. Nixon shared in these beliefs, at least in part. "Now, I am a Keynesian," he declared in January 1971—leaving his aides to draft replies to the angry letters that flowed into the White House from conservative supporters. He introduced a Keynesian "full employment" budget, which provided for deficit spending to reduce unemployment. A Republican congressman from Illinois told Nixon that he would reluctantly support the president's budget, "but I'm going to have to burn up a lot of old speeches denouncing deficit spending." To this Nixon replied, "I'm in the same boat."

While Nixon may have philosophically opposed intervention in the economy, philosophy took a rear seat to politics. He had lost very narrowly to John Kennedy in 1960—49.7 to 49.5 percent of the popular vote. He sometimes blamed the state of Illinois, whose electoral votes had made all the difference and where the Chicago Democratic machine was known for its effectiveness in getting out all possible voters, dead as well as living. Kennedy won Illinois by just 8,858 votes. But Nixon certainly believed that mismanagement of the economy had also cost him the election. "He attributed his defeat in the 1960 election largely to the recession of that year," wrote economist and Nixon adviser Herbert Stein, "and he attributed the recession, or at least its depth and duration, to economic officials, 'financial types,' who put curbing inflation ahead of cutting unemployment." Looking toward his 1972 reelection campaign, Nixon was not going to let that happen again. And he had to pay attention to economics. Despite the optimism about government's ability to manage the economy, economic conditions had begun to deteriorate. The inflation rate, which had been 1.5 percent at the beginning of the 1960s, had risen to 5 percent. Unemployment was also up from the 3.5 percent level of the late 1960s to 5 percent.

So the central economic issue became how to manage the inflation-unemployment trade-offs in a way that was not politically self-destructive; in other words, how to bring down inflation without slowing the economy and raising unemployment. One approach increasingly seemed to provide the answer—an income policy, whereby the government intervened to set and control wages, whether in hortatory words or legal requirements. Such policies had become common in Western European countries. In the 1970s, the Democratic Congress provided the tools by passing legislation that delegated authority to the president to impose a mandatory policy.

The administration remained overtly dedicated to markets. But there were those in it who believed that the "market" was more an idyll of the past than an accurate description of how the current economy functioned. To them, the economy was like the question that Lenin had expressed—*Kto kvo?*—Who could do what to whom? That is, they saw the economy "as organized by relations of power, status, rivalry and emulation." Government intervention was required to bring some greater balance to the struggles for power between strong corporations and strong unions that would drive the wage-price spiral upward.

A critical push toward an income policy came from Arthur Burns, whom Nixon had appointed to be chairman of the Federal Reserve. Burns was a well-known conservative economist; Nixon paid special attention to Burns because he had warned Nixon in 1960 that the Federal Reserve's tight monetary policy would accentuate the economic downturn and thus threaten Nixon's chances in the race against Kennedy—which is exactly what had happened. Now, a decade later, in May 1970, Burns stood up and declared that he had changed his mind about economic policy. The economy was no longer operating as it used to, owing to the now much more powerful position of corporations and labor unions, which together were driving up both wages and prices. The now-traditional fiscal and monetary policies were seen as inadequate. His solution: a wage-price review board, composed of distinguished citizens, who would pass judgment on major wage and price increases. Their power, in Burns's new lexicon, would be limited to persuasion, friendly and otherwise.

Further reinforcement of the pressures toward control came with the recruitment of former Texas Democratic governor John Connally to fill the critical slot of Treasury secretary. The forceful Connally had no philosophical aversion to controls. Indeed, he did not seem to have strong feelings one way or the other on economic policy. "I can play it round or I can play it flat," he would say. "Just tell me how to play it." What Connally did like was the dramatic gesture, the big play; and grabbing inflation by the neck and shaking it out of the system would be such a move.

A second issue was also now at the fore—the dollar. The price of gold had been fixed at thirty-five dollars an ounce since the Roosevelt administration. But the growing U.S. balance-of-payments deficit meant that foreign governments were accumulating large amounts of dollars—in aggregate volume far exceeding the U.S. government's stock of gold. These governments, or their central banks, could show up at any time at the "gold window" of the U.S. Treasury and insist on trading in their dollars for gold, which would precipitate a run. The issue was not theoretical. In the second week of August 1971, the British ambassador turned up at the Treasury Department to request that $3 billion be converted into gold.[11]

With inflation rising, the clamor to do something was mounting in both political circles and the press. At the end of June 1971, Nixon had told his economic advisers, "We will not have a wage price board. We will have jawboning." But resistance to an income policy weakened with each passing month. The climax came on August 13–15, 1971, when Nixon and fifteen advisers repaired to the presidential mountain retreat at Camp David. Out of this conclave came the New Economic Policy, which would temporarily—for a ninety-day period—freeze wages and prices to check inflation. That would, it was thought, solve the inflation-employment dilemma, for such controls would allow the administration to pursue a more expansive fiscal policy—stimulating employment in time for the 1972 presidential election without stoking inflation. The gold window was to be closed. Arthur Burns argued vociferously against it, warning, "*Pravda* would write that this was a sign of the collapse of capitalism." Burns was overruled. The gold window would be closed. But this would accentuate the need to fight inflation; for shutting the gold window would weaken the dollar against other currencies, thus adding to inflation by driving up the price of imported goods. Going off the gold standard and giving up fixed exchange rates constituted a momentous step in the history of international economics.

Most of the participants at the Camp David meeting were exhilarated by all the great decisions they had made. During their discussions, much attention was given to the presentation of the new policy, particularly to television. President Nixon expressed grave concern that if he gave his speech during prime time on Sunday, he would preempt the tremendously popular television series *Bonanza,* thus potentially alienating those addicted to the adventures of the Cartwright family on the Ponderosa ranch. But his advisers convinced him that the speech had to be given before the markets opened on Monday morning, and that meant prime time. A few of the advisers would recollect that more time was spent discussing the timing of the speech than how the economic program would work. Indeed, there was virtually no discussion of what would happen after the initial ninety-day freeze or how the new system would be terminated.

Nixon's chief of staff, H. R. Haldeman, went in to see the president privately at Camp David the evening before his speech. "The P. was down in his study with the lights off and the fire going in the fireplace, even though it was a hot night out," Haldeman wrote in his diary. "He was in one of his sort of mystic moods." Nixon told Haldeman "that this is where he made all his big cogitations. . . . He said what really matters here is the same thing as did with [Franklin] Roosevelt, we need to raise the spirit of the country, that will be the thrust of the rhetoric of the speech. . . . We've got to change the spirit, and then the economy could take off like hell." As he worked on the speech, Nixon tormented himself, worrying whether the headlines would read NIXON ACTS BOLDLY or NIXON CHANGES MIND. "Having talked until recently about the evils of wage and price controls," Nixon later wrote, "I knew I had opened myself to the charge that I had either betrayed my own principles or concealed my real intentions." But Nixon was nothing if not a practical politician, as he made clear in his masterful explanation of his shift. "Philosophically, however, I was still against wage-price controls, even though I was convinced that the objective reality of the economic situation forced me to impose them."

Nixon's speech—despite the preemption of *Bonanza*—was a great hit. The public felt that the government was coming to its defense against the price gougers. The international speculators had been dealt a deadly blow. During the next evening's newscasts, 90 percent of the coverage was devoted to Nixon's new policy. The coverage was favorable. And the Dow Jones Industrial Average registered a 32.9-point gain—the largest one-day increase up to then.

The Cost of Living Council took up the job of running the controls. After the initial ninety days, the controls were gradually relaxed and the system seemed to be working. But unemployment was not declining, and the administration launched a more expansionary policy. Nixon won reelection in 1972. In the months that followed, inflation began to pick up again in response to a variety of forces—domestic wage-and-price pressures, a synchronized international economic boom, crop failures in the Soviet Union, and increases in the price of oil, even prior to the Arab oil embargo. Nixon, under increasing political pressure from the investigations of the Watergate break-in, reluctantly reimposed a freeze in June 1973. Government officials were now in the business of setting prices and wages. This time, however, it was apparent that the control system was not working. Ranchers stopped shipping their cattle to the market, farmers drowned their chickens, and consumers emptied the shelves of supermarkets. Nixon took some comfort from a side benefit that George Shultz, at the time head of the Office of Management and Budget, identified. "At least," Shultz told the president, "we have now convinced everyone else of the rightness of our original position that wage-price controls are not the answer." Most of the system was finally abolished in April 1974, seventeen months after Nixon's triumphant reelection victory over George McGovern—and four months before Nixon resigned as president.

In retrospect, some would call the Nixon presidency the "last liberal administration." This was not only because of the imposition of economic controls. It also carried out a great expansion of regulation into new areas, launching affirmative action and establishing the Environmental Protection Agency, the Occupational Safety and Health Administration, and the Equal Employment Opportunity Commission. "Probably more new regulation was imposed on the economy during the Nixon Administration than in any other Presidency since the New Deal," Herbert Stein ruefully observed.[12]

Only one segment of the wage-and-price control system was not abolished—price controls over oil and natural gas. Owing in part to the deep and dark suspicions about conspiracy and monopoly in the energy sector, they were maintained for another several years. But Washington's effort to run the energy market was a lasting lesson in the perversities that can ensue when government takes over the marketplace. There were at least thirty-two different prices of natural gas, a rather standard commodity, each of whose molecules is based on one atom of carbon and four atoms of hydrogen. The oil-price-control system established several tiers of oil prices. The prices for domestic production were also held down, in effect forcing domestic producers to subsidize imported oil and providing additional incentives to import oil into the United States. The whole enterprise was an elaborate and confusing system of price controls, entitlements, and allocations. It was estimated that just the standard reporting requirements for what became the Federal Energy Administration involved some two hundred thousand respondents from industry, committing an estimated 5 million man-hours annually.

Malaise and Inflation

Overall, the 1970s were characterized by chronically poor economic performance. The oil embargo, which accompanied the 1973 Yom Kippur War between Arabs and Israelis, delivered a terrific shock to the economy. In 1974, inflation reached the highest level since the end of World War I. Within months, unemployment stood at 9.2 percent, two points higher than at any time in the postwar years. And there was a growing fear that inflation and inflationary expectations were becoming so embedded as to threaten every household, as well as the social order and stability of the nation. As part of their campaign to conquer inflation, members of Gerald Ford's administration took to wearing buttons that said WIN—"Whip Inflation Now." After some ridicule, they were withdrawn. In the 1976 presidential election, Jimmy Carter, running against economic distress and campaigning as an outsider, defeated Ford. Not long after, in an effort to cheer up the nation, Carter's chief inflation fighter renamed inflation "bananas." After protests from banana interests, he switched the code word to "kumquats." That did not do any good either.

At the end of the 1970s, the shah of Iran was toppled from power, setting off a second severe oil shock. The price of oil went from thirteen to thirty-four dollars a barrel, lines at gas stations snarled across the country again, and the nation's ire rose dramatically. So did inflation, rising as high as 13.2 percent. The Carter administration felt itself under siege. "In many respects, this would appear to be the worst of times," the White House chief of staff wrote to Carter. The president retreated to Camp David to meditate on the country's problems. He embraced a new book that identified "narcissism" as the heart of America's difficulties. He also forced five members of his cabinet to quit or resign, and followed up with a speech diagnosing America's crisis of confidence—quickly redubbed "malaise"—as the ailment that was afflicting America's soul. Whatever self-confidence remained was turned into humiliation a few months later, when Iranian students took American officials hostage in Tehran.

There were many reasons for America's affliction in the late 1970s—ranging from Middle East politics and Islamic fundamentalism to the rigidity of labor markets. The two oil crises stunned the global economy with their powerful shocks. The legacy of the Vietnam War included a pervasive national bitterness and a suspicion of and alienation from government. Yet it also came to be seen that a good part of America's ills resulted from the balance between government and marketplace that had been struck over the preceding decades—although it was a balance that had been shifting increasingly toward the side of government. After all, the coexistence of high inflation and high unemployment was new, and that in itself demanded a reassessment. Some wanted to respond with more planning, more controls. But the tide of opinion had turned. "We were at the end of two decades in which government spending, government taxes, government deficits, government regulation and government expansion of the money supply had all increased rapidly," wrote Herbert Stein. "And at the end of those two decades the inflation rate was high, real economic growth was slow and our 'normal' unemployment rate . . . was higher than ever. Nothing was more natural than the conclusion that the problems were caused by all these government increases and would be cured by reversing, or at least stopping, them."

What had been confidence in government knowledge was now turning to cynicism. The Keynesian paradigm was not what it seemed to be. It was not all that easy to manage the economy by wielding the levers of fiscal policy. In fact, it was not clear, with all the lags and uncertainties, that it could be done at all. Indeed, critics argued that the effort to apply Keynesianism was in itself inherently inflationary. Instead of picking up the slack of inadequate private-sector investment as Keynes had proposed in the 1930s, public spending, it now seemed, was crowding it out. Confidence was also ebbing in the ability of government to solve major social problems through big, interventionist programs. However altruistic and idealistic the purposes of these programs, the application of new methods of cost-benefit analysis, combined with everyday observation, led people to question whether the public was getting value for the tax dollars it spent on them. In a low-inflation, growing economy, the public had accepted the tax burden. But with recession and slow growth—and with inflation pushing people into higher brackets—taxes stoked the anger of the public. Conservatives had traditionally argued that high taxes on working people and high transfer payments to nonworkers held back the economy. That had, no less traditionally, been dismissed as the "fanciful ideology" of the right. But now this contention could no longer be dismissed; indeed, a new wave of academic research supported the assertion.[13]

All of this was accompanied by the appearance of a fundamental questioning about the system of regulatory capitalism that had emerged out of the New Deal. Although the discussion had been simmering in the intellectual community since the 1950s, it took the economic travails of the 1970s to bring it to the fore. The system seemed to have bogged down. It was too rigid, too slow, too distorting. It could make things worse. It hobbled technological and commercial innovation. Most important, by replacing the decisions of the market with its own decisions, it denied markets the salutary effects of competition. It froze relationships, shored up cost levels, and, of critical significance, institutionalized inflation.

Conditions warranted change, and America was ready to go in a new direction. The ideas were there. The specter of market failure had shaped four decades of government economic policies. But the message of the 1970s was that government could fail, too. Perhaps markets were not so dumb after all.