The Myth of the Robber Barons

The Role of Business in a Free Society

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> "By now most Americans are utterly convinced that all "big business" owes its existence to the original depredations of the "robber barons" - a myth which never really was plausible, which more recent scholarship by economic historians has thoroughly discredited, but which probably forever will have a secure hold on the American political imagination. Similarly, most Americans are now quick to believe that "big business" conspires secretly to manipulate the economic and political system - an enterprise which, in prosaic fact, corporate executives are too distracted and too unimaginative even to contemplate."
>
> Irving Kristol, *Corporate Capitalism in America*[1]

Introduction

What is the role of business in a free society? Is the "robber baron" figure accurate, or does business benefit more than just the shareholders and CEO's? In his book, The Myth of the Robber Barons, historian Burton W. Folsom goes through the individual histories of the famous businessmen of the mid-nineteenth and early twentieth centuries, those typically referred to as "robber barons": Cornelius Vanderbilt, James J. Hill, the Scranton Brothers, Charles Schwab and John D. Rockefeller. What is clearly evident from studying the lives of these men is that in the free market system, business can provide enormous benefits to society and its citizens. Furthermore, if the "robber baron" figure has any relevance, it is only with regards to those individuals who sought subsidies from the state in order to make their profits, not to the entrepeneurs who played by the rules of the market.

"Political entrepeneurs" vs. "market entrepeneurs"

When discussing entrepeneurs and their role in society, a key distinction must be made between those who operated within the free market and those who corrupted the market by seeking government assistance. Folsom differentiates between these two types of individuals by defining political entrepeneurs and market entrepeneurs. A "political entrepeneur" is someone who tries to succeed in business primarily through subsidies, creat-

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[1] Irving Kristol, *Corporate Capitalism in America*. Neoconservatism: The Autobiography of An Idea. 1995. 215.

ing pools, buying the votes of lawmakers, or stock speculation. Those that seek success by creating and marketing a better product at a low cost fit Folsom's definition of a "market entrepeneur." According to Folsom, it is the market entrepeneurs that have provided great benefits to the free society in which they lived.

Cornelius Vanderbilt: fighting monopolies through low fares

In the early 1800's, the only provider of steamship service in New York State was Robert Fulton. Fulton had been given the privilege of carrying all steamship traffic in New York for thirty years by the New York legislature. This state enforced monopoly made it very difficult for anyone else to compete against him. That changed in 1817 when Thomas Gibbons, a steamboat man from New Jersey, hired a young man named Cornelius Vanderbilt to run steamboats in New York State and crack the subsidized steamship monopoly of Robert Fulton. Vanderbilt succeeded, primarily for two reasons: he charged passengers low fares, and he was constantly introducing new technology on his steamships. Gibbons took Fulton to court because of his monopoly, and in 1824 the Supreme Court struck down the Fulton monopoly. As a result of that decision, the New York to Albany fare immediately dropped from seven dollars to three dollars.

Vanderbilt later went into business for himself in the 1830's and reduced the New York to Philadelphia fare from three dollars to one dollar. In addition, he charged six cents per trip and served free meals on the New Brunswick to New York route. After repeating his success against the Hudson River Steamboat Association, Vanderbilt was bought out for $100,000 plus $5,000 a year for the next ten years provided that he leave the Hudson River for the next ten years.

While Vanderbilt reaped great profits from his ventures, ultimately it was the steamship passengers who benefited the most. Vanderbilt's introduction of competition resulted in reduced fares wherever he went. The New York Evening Post went so far as to hail Vanderbilt as "the greatest anti-monopolist in the country." Vanderbilt would continue on in the steamship industry until his death in 1877, with a net worth of $100 million, making him the richest man in America. He had made his fortune providing something that his fellow citizens wanted: quality steamship travel at a low cost. He did it without subsidies, whereas his main competitors were dependent on help from the state.

Vanderbilt's story highlights the fundamental rule of the free market system. That is, if an individual seeks to succeed in business and make a profit, that person must provide some type of good or service that other individuals are willing to purchase voluntarily. Cornelius Vanderbilt understood this rule, and this resulted in the accumulation of enormous wealth in his lifetime.

James J. Hill: priming the pump

James J. Hill was a giant in the railroad industry and he made it on his own -- competing against the leaders of the Union Pacific (UP) and the Central Pacific (CP) Railroads who sought subsidies from the U.S. government.

The case of the UP and CP subsidies is a perfect example of the unintended consequences of federal help. Convinced that the railroad industry would not take hold in America unless the federal government offered assistance, Congress gave loans to the UP and CP: $16,000 per mile of flat prairie land, $32,000 per mile of hilly terrain, and $48,000 per mile in mountainous regions. With subsidies in hand, the two railroads set to work making their money. They built as quickly as possible, creating long winding tracks (in order to gain more miles) and often developing in unsettled land, provoking attacks from unfriendly Indian tribes. In addition, the UP and CP would build in the very difficult mountainous regions, gaining more money by doing so. When finally the two railroads went as far as sabotaging each others' tracks, Congress stepped in and ordered them to join together at Promontory Point, Utah.

Hill, on the other hand, used his own money and knowledge of the transportation business to create his Great Northern Railroad. Hill saw the Northwestern U.S. as a chance to develop America's last frontier. Hill's strategy was simple: as he made his way across the Northwest, he built slowly and developed the export of the region before moving further west. He helped develop farming technology in the region and offered to bring immigrants to the region for $10 each as long as they would farm there. Soon after, cities sprang up along the Great Northern Railroad, providing enormous economic benefit to Hill.

Here again, we have a case of an entrepeneur using the free market system to his advantage while at the same time providing benefits to others. Because of Hill's "priming the pump" along his railroad, many people were able to succeed themselves. The new immigrants that Hill transported to the region became successful farmers, and created communities with other successful farmers in the region. These communities then required the usual amenities: banks, a sheriff to enforce the laws, general stores, grain mills, local government, and so on.

Hill's innovative style illustrated another core principle of free-market economics, enunciated by Adam Smith. That is, in a free market, transactions between consenting parties motivated by self-interest are mutually advantageous. Hill offered new settlers the chance to succeed in the new frontier, and the settlers in turn offered Hill their future business to his railroad. When looked upon in that light, it is no wonder why Hill prospered so tremendously.

The Scrantons: creating something out of nothing

The story of the Scranton Brothers and their experiences in the iron industry are illustrative of the old adage, "if at first you don't succeed, try, try again." It was in the 1840's in the Lackawanna Valley of Pennsylvania that Joseph, Selden and George Scranton became the first Americans to mass produce iron rails for the burgeoning railroad industry. Up until that time, the market had been controlled by the English, and American railroad entrepeneurs had to pay exorbitant prices for their iron rails. The Scrantons changed that, but it was not easy. Their story is one of enormous success, but it is of success that followed several failures. The story illustrates another key element of the free market system: not everyone succeeds on their first try. It took the Scrantons several tries and a tremendous amount of risk before they reaped the benefits of their struggles.

Starting in 1840, William Henry, the father-in-law of Selden Scranton, searched the Lackawanna Valley in order to find a site for his iron works. After being rejected by the neighboring city of Wilkes-Barre, Henry settled twenty miles east into the Lackawanna wilderness. Needing $20,000 for his venture, Henry found believers in his own family: Selden and his brothers, Joseph and George. Along with four others, these men would spend the next two years building a blast furnace and digging the ore and coal in order to produce iron.

The Scrantons soon realized that their daring experiment would not be easy. Unfortunately, they discovered that the area chosen for their iron works contained poor qualities of ore and limestone, which forced the Scrantons to find a second location from which to transport their lime and ore (it was too late to sell out and find a new site entirely). Hoping to recover some of their resulting transportation costs, the Scrantons raised $86,000 more for the purpose of building a factory to build nails. Again, they experienced problems: the nail factory failed, pushing them even closer to bankruptcy.

Rather than throw in the towel, the Scrantons turned to iron rails and finally achieved success. Promising to deliver rails faster and cheaper than their British counterparts, the Scrantons secured several railroad contracts and were on their way. In order to get their product to its desired destination, the Scrantons built a city and a railroad around their iron works. This city, named Scranton, became a hub of activity and brought wealth and prosperity to the Scrantons as well as the citizens of their town. The ability to produce rails faster and cheaper yielded great returns for Joseph, George and Selden Scranton.

The Scrantons' contribution to society was twofold. First, they built a successful iron industry, which allowed Americans to mass produce rails and use them to cut transportation costs, open markets in the west, and speed new products to cities throughout the nation. Second, the development of a city resulted in enormous rewards for nearly everyone. The people living in northeastern Pennsylvania found new and better opportunities available, as Scranton became a magnet for entrepeneurs in nearby towns. Immigrants came to Scranton to work in the factories. The Scrantons donated land and labor to build a church for the old settlers, and their company store traded goods with nearby farmers. Many landowners in the area became wealthy merely by holding on to their land. Land that was valued at $15 an acre in 1840 had gone to $800 an acre by 1857. A little five and ten cent store called Woolworth's grew into a chain of stores and later into a major American corporation. One could say that the success of the Scrantons "trickled down" to others in the community. The Scrantons bore all the risks, but everyone was able to reap the benefits.

Charles Schwab: rewarding productivity

The story of Charles Schwab is an interesting one. Schwab experienced tremendous success in his business and personal life, but he also suffered incredible hardship. Despite the ups and downs of his life, what Charles Schwab will be remembered for was his system of rewarding productive and innovative behavior from his workers. This system of rewards, consisting of cash bonuses and promotions, resulted in higher productivity and lower costs of production.

Charles Schwab made it to the top through hard work and determination. While working at Carnegie Steel, the innovative Schwab impressed Andrew Carnegie, who eventually made him president of Carnegie Steel. Carnegie had instituted a system of rewards for workers who helped the company produce cheaper and better steel. Workers producing the fewest "seconds" (an industry term for substandard rails) were given $20 cash bonuses. Those workers who showed exceptional abilities were promoted to higher positions and given large salaries (Carnegie paid one mill supervisor a larger salary than the President of the United States at the time).

When Carnegie made the thirty five year-old Schwab the president of Carnegie Steel in 1897, the two men set off making the company one of the industry's giants. After sales of $40 million in 1900, Carnegie retired and sold his steel company to J.P Morgan, who combined Carnegie with other companies to create U.S. Steel. Morgan then installed Schwab as president of U.S. Steel.

At U.S. Steel, however, Schwab was not able to use the Carnegie system. He had little or no authority in the operation of the company, and those that did have the authority were not interested in innovating or cutting prices. Schwab now allowed his destructive impulses to come to the surface, engaging in gambling, adultery and living beyond his income. Thoroughly depressed, he resigned from U.S. Steel in 1904.

Charles Schwab's comeback was quite spectacular. Taking over the much smaller Bethlehem Steel, Schwab was able to implement the Carnegie system and achieved similar results as before. He offered bonuses to reward productive workers, and he encouraged innovation and creativity. This system led to the creation of the "Bethlehem Beam", a steel beam made directly from an ingot as a single section as opposed to riveting smaller beams together. Illustrative of the success of the Bethlehem Beam was the fact that U.S. Steel, the company that frowned upon Charles Schwab's innovative management style, secretly began producing the beams until Schwab found out and forced U.S. Steel to pay royalties.

Schwab's success at Bethlehem had great consequences. Bethlehem Steel's labor force doubled every five years between 1905 and 1920, while U.S. Steel's growth stagnated. Additionally, the government turned to Schwab to supply the iron ships during World War I. Unfortunately, Schwab's destructive lifestyle resurfaced in later life, and Schwab died a debtor. His troubled personal life, however, cannot overshadow his accomplishments in the steel industry. Charles Schwab's practice of rewarding workers who increase productivity and innovation resulted in great profits, for Carnegie Steel, for Bethlehem Steel, and for the employees of both companies.

John D. Rockefeller: living a charitable life

Few individuals in American history are as misunderstood as John D. Rockefeller. Much is made of his extraordinary wealth, and rightly so. Due to his success in the oil industry, Rockefeller earned an estimated $900 million in his lifetime, making him the wealthiest man in U.S. history. What is not as well known is that Rockefeller's goal was not to amass such a large fortune. He gave $550 million of that money to charitable causes, primarily schools, churches, evangelists and missionaries. In addition, he was instrumental in the early fights against deadly diseases, paying teams of scientists to find cures for yellow fever, meningitis and hookworm.

Along with his charitable giving, Rockefeller provided an even greater benefit. He provided the finest quality fuel at the lowest possible price. His Standard Oil Company and its low priced, quality fuel allowed millions of families to light their homes with kerosene at very little cost. Rockefeller was often accused of having a monopoly in the oil market. If he did, it was a consumer created monopoly, because no other oil refiner offered fuel at a lower price.

While Rockefeller's business record is impressive, it is his spiritual record and personal humility that is most interesting (primarily because it receives little or no coverage in history texts). John D. Rockefeller was a devout Christian, as he believed that a strong spiritual life was crucial for an effective business life. He tithed, and he rested on Sundays. Rockefeller gave more as he earned more, and he earned more as he gave more. He believed that God had blessed him with his good fortune, and it was necessary that he share that fortune with others. Additionally, Rockefeller was not one to relax as others did the work that made his fortune; he would often be found at 6:30 AM, rolling barrels, piling hoops and so forth. He paid his workers higher than market wages, and was rarely if at all visited by labor unrest.

Perhaps no figure in American business history has been as maligned or mistreated more than John D. Rockefeller. Far from being a "robber baron", Rockefeller used his enormous wealth to do enormous good, sharing his earnings with others.

Conclusion

What do these stories hold for today's society? It is quite clear that the power of the free market system is not mere myth. On the contrary, when freed of government intervention, business can contribute substantially to the society which supports it. All of these examples were taken from a time when government intervention in the economy was minimal. While each of these men faced competition that was subsidized by the State, they all eventually triumphed, and the providers of the subsidies upon realizing that there were entrepeneurs willing to conduct their business without federal help, eliminated the subsidies.

The fundamental principles of the free market system are clear, as illustrated by these five stories. First, in order for an individual to obtain profits, that individual must provide goods or services that other individuals are willing to purchase in a voluntary exchange. Cornelius Vanderbilt demonstrated this when he offered low fares to steamship passengers.

Second, it is possible for a society to benefit from various self-interested individuals participating in mutually advantageous exchange. James J. Hill was acting in his own interest when he sought to develop the region surrounding his railroad, as were the immigrants who paid the low fares to travel to and settle in the region.

Third, in order to succeed in the free market system, it is sometimes necessary for an entrepeneur to take risks. The Scrantons were faced with bankruptcy several times before they secured their fortune. It was through their perseverance that their dream of owning a successful iron works and building a city around it became a reality.

And fourth, and perhaps most importantly, when businesses prosper that prosperity does not stop with the business owner or the shareholders. In a free society, it is possible for many people to ultimately benefit from the success of one business owner. Charles Schwab rewarded his employees for their efforts at increasing his profits. The citizens of the Lackawanna Valley benefited from the Scranton's successful iron works, and John D. Rockefeller's Christian beliefs led him to share much of his substantial fortune with others.

These four principles are the underpinnings of a free society, and the examples of the aforementioned individuals demonstrate that these principles work in practice, and not just in theory. We should heed these principles and these examples as we approach a new century of opportunities and innovations.