1. Introduction: the moral economy versus the market economy

For over a century in the US opponents of the market economy have attacked it for the excessively immoral behaviour its stress on individualism has allegedly generated. In this book we shall be concerned with the anti-market ideas of the Progressive movement that emerged in the US in the first three decades of the twentieth century and culminated with the New Deal of President Franklin Delano Roosevelt in the 1930s. The Progressive movement and the New Deal were composed of a diverse set of social interest groups, liberal and elitist and democratic or corporatist. The overarching ideology of the Progressive movement, the glue that held its diverse elements together, we shall argue in this book, was that its members aimed at replacing or at least supplementing the market economy with a moral economy of their own design. In that moral economy, government stewardship and planning became viewed as a necessary component of the economic system in order to ensure a better life for all.

The Progressive movement arose in response to a number of economic and political forces that came to the fore in the US at the beginning of the twentieth century, such as the growth of large corporations and labour unions, the development of new technology and the increase in the intensity and pervasiveness of business cycles. Our focus will be on business cycles and how they evoked calls for the government to protect its citizens from the market economy that caused them. Because they believed the market economy was immoral, Progressives argued that they followed a moral imperative of protecting society and its poorer members from the unemployment and lower income that took place during an economic downturn. Consequently, we shall examine the arguments in favour of government policies for the business cycle that developed during the Progressive Era and New Deal as a way of designing a moral economy that stressed fairness and a stable economy through planning. A moral economy is one whereby economic decisions are made through planning with an attitude of doing what is right and fair in order to achieve social justice. Planning is an essential feature of the moral economy, because its proponents believe that human wisdom as informed by mutual obligations can make collective
decisions about what society needs to have produced and do so in a way that avoids recessions.

This work explores the relationship between business cycles and planning as seen through the lenses of economists, pundits, politicians and business leaders during the Progressive Era and New Deal. This exploration centres on what they saw as the nature and causes of business cycles and use of government stewardship including collective decision-making and planning to avoid them. We want to make it clear, however, that our aim is not to establish the legitimacy of the moral economy over the market economy or the reverse. In using the distinction between the moral economy and the market economy we are adopting the rhetoric of moral economy advocates as a way of uncovering what motivated Progressives in the first four decades of the twentieth century, without involving ourselves in the correctness of their arguments that markets are immoral.

THE MARKET ECONOMY

The central assumption of modern economics is that scarcity is a fundamental human problem. To economists scarcity means that we do not have sufficient resources to produce everything human beings would like to have. Because of scarcity, goods and services must be rationed through a process where individuals, organizations and societies make choices as to how to use the resources that are available to them. Market advocates argue that the market economy is a superior way for making choices about what to produce with our limited resources, by letting each individual’s or organization’s willingness and ability to buy or sell at market prices allocate (ration) goods and services. Economic production, moreover, is enhanced through the division of labour, through which individuals and businesses cooperate to produce a good or service. The market economy relies on competition among individuals and firms to sell at the lowest possible price, but there must also be cooperation with consumers and other producers to make the sale take place. The market economy uses monetary incentives and competition to organize and order the social priorities of what to produce, how to produce it and who gets it. Prices in the market economy signal those priorities and government intervention that affects prices will disrupt these signals and alter the rationing process.

For the market to work effectively there needs to be the appropriate institutional setting. The primary requirement is the institution of private property, including the right of property-owners to use their property as they see fit. In this way they are free to determine how to put their wealth to its best use in terms of what signals the market economy sends them without
any hindrance. Advocates of the market economy, however, recognize that
government is also a necessary institution for the market economy, albeit a
limited one. Government must provide laws to protect property rights,
enforce those laws and contracts made under them and eliminate unscrupu-
lous behaviour among the elements of the market economy. Those advo-
cates also recognize that property rights may allow individuals who are
successful in meeting what the market economy favours to accumulate and
keep wealth. As long as the wealth is honestly gained from meeting the
social needs that the market economy has established it is acceptable.

As an underlying philosophy, market advocates hold that human beings
respond to economic incentives more reliably than they respond to moral
imperatives. This response to incentives is often viewed as following a path
of simple self-interest with the individual not caring about other persons.
But, as anyone who has ever tried to sell something, a product or their own
labour in the marketplace would know, to be successful in selling one must
always be thinking of others to determine what it is that they will want to
purchase. Self-interest is a complex mix of self-regard for making the most
money combined with catering to consumers or employers. The types of
incentives that will appeal to this complex mix of motivations are varied,
and markets are exceptional in creating this wide array of incentives. But
incentives will not work if individuals are immoral. Some may cheat.
Therefore, as long as there are legal and ethical codes to prevent cheating
the market economy functions acceptably. The role of the government
should be limited to maintaining and enforcing a legal system that promotes
free trade. As long as trade is voluntary, market exchanges allow everyone
to gain.

One important element of the market economy is that it contains very
high incentives for innovation. Once market conditions of supply and
demand in a particular market settle down into a routine, profits will reach a
relatively stable level. To earn higher profits, firms and their leaders must
innovate by either finding a way to produce the same goods or services more
cheaply or through the development of a new product that consumers will
want. Joseph Schumpeter (see Chapter 4) recognized this stress on tech-
nological change as a key function of entrepreneurs and labelled it the
process of creative destruction. Entrepreneurs are rarely the inventors of
new methods but they have the drive to implement them. In return, they earn
high profits by creating new industries in the market economy even as they
destroy older industries that cannot compete with them. The process of
creative destruction puts wealth in new areas where it will do the most good
for society. It also means that the wealth that an individual builds up through
market activities can be lost very quickly from the process of creative
destruction. One of the findings of this book is that advocates for the moral
economy based their argument for planning on the need to control the destructive phase of creative destruction, even though technological change had greatly revolutionized society and raised the standard of living for all of its members.

Another important point regarding the virtues of the market economy that its proponents make is the way it can handle the business cycle. The theory they rely on is Say’s Law of Markets. Say’s Law is captured by the familiar circular flow model covered in virtually every introductory economics textbook. In this model, all of the costs of production – labour, land, capital and entrepreneurial skill – become someone’s income: wages, rent, interest and profit. In turn, this income is spent on the items that have been produced and returned to businesses as revenues. The end result is that a full employment economy always generates the income necessary to cover the cost and purchase of everything produced. Overproduction or under-consumption cannot be a persistent problem. If some of the income generated by production is not spent but is saved, financial markets will adjust the price of saving, that is, interest rates, so that someone else will borrow the saved money and spend it. Prices of products may also have to fall to stimulate spending on consumption or investment goods. In the end, a prolonged period of insufficient demand cannot exist in a market economy as long as prices are flexible.

Up to the Great Depression of the 1930s, the consensus view among economists was that there could not be a sustained period of general overproduction of goods and services resulting in a sustained period of high unemployment. There could, of course, be overproduction of certain goods, Hula Hoops, for example, when consumer preferences were changing to skateboards. But through changes in the prices of Hula Hoops and skateboards, income earned in Hula Hoop production would be spent on skateboards. Unemployment would occur in the Hula Hoop industry but employment would increase in the skateboard industry. The long-run result is no prolonged period of unemployment.

We shall see later that Schumpeter tied the process of creative destruction to business cycles. When entrepreneurs are creating a new industry, they cause a boom in that industry that spreads to other parts of the economy. When the creation of the new industry is complete, production in that industry expands and prices fall. At the same time, firms and industries that compete with the new industry will have to reduce prices and some of them will go bankrupt. A recession may occur during this adjustment to a new structure in the economy. As long as prices are enabled to adjust in the manner predicted by Say’s Law, the recession caused by creative destruction will take care of itself. Many of the ills included in business cycles that
Progressives wanted to curb were simply the process of creative destruction working itself out through the market economy.

THE MORAL ECONOMY

For much of human history great thinkers have espoused the case for a moral economy. Plato, for example, clearly disliked the competition of the market economy and the persons who used it to make profits, because he believed that the pursuit of wealth was inimical to creating an effective society based on virtuous behaviour. Aristotle also placed a high priority on moral behaviour, but made a distinction between market activities that were acceptable because their goal was to meet the basic needs of life without which virtue was impossible and those that were not acceptable because their goal was profit and wealth (Stabile 2008, 12–15). For the next two millennia, the teachings of Christianity, which took a dour view of money making, paralleled the economic ideas of Aristotle and Plato, favouring a moral economy over the market economy by setting forth the idea of the just price and the just wage.

Those ideas did not put money making to an end. For most of those two millennia, the market economy developed until it became too powerful to ignore. We give Adam Smith credit for providing the first intellectual defence of the market economy. We must remember, however, that he was a moral philosopher and that his first book, *The Theory of Moral Sentiments*, was a highly regarded treatise on how humans developed moral behaviour. In it, he offered a succinct definition of a moral economy:

> All the members of human society stand in need of each others assistance, and are likewise exposed to mutual injuries. Where the necessary assistance is reciprocally afforded from love, from gratitude, from friendship, and esteem, the society flourishes and is happy. All the different members of it are bound together by the agreeable bands of love and affection, and are, as it were, drawn to one common centre of mutual good offices. (Smith 1759 [1976], pp. 85–6)

The moral economy must be based on morals and the bonds of love and mutual assistance with each person caring about every other person. This moral economy, however, was not the type of economy Smith found in the cities of Glasgow and Edinburgh. That world used buying and selling in the marketplace to exist and it was the world that preoccupied Smith in *The Wealth of Nations*. He anticipated this world in the second part of the above quotation:
But though the necessary assistance should not be afforded from such generous and disinterested motives, though among the different members of the society there should be no mutual love and affection, the society, though less happy and agreeable, will not necessarily be dissolved. Society may subsist among different men, as among different merchants, from a sense of its utility, without any mutual love or affection; and though no man in it should owe any obligation, or be bound in gratitude to any other, it may still be upheld by a mercenary exchange of good offices according to an agreed valuation. (Smith 1759 [1976], pp. 85–6)

In the urbanized, industrial economy that was emerging while he was writing, the bonds of family and friendship were breaking apart through the development of social distance and Smith’s genius was in showing how the market economy replaced them with exchange transactions and provided an increased standard of living for all members of society. When society did not have a moral sense of mutual assistance, the market economy would suffice by using the incentives of self-interest to provide its members with what they needed to live. Put differently, the division of labour and specialization were necessary for economic growth. But at the same time, specialization increased the social distance between people. Donald Frey describes this process as follows: ‘As social distance increased, self-interest was needed to replace the weakened bonds of human sympathy’ (Frey 2009, p. 36).

The economy and economics changed substantially in the century after Smith wrote The Wealth of Nations, moving further away from the idea of a moral economy. In the market economy, through the process of creative destruction, technological innovations in transportation, communication and production transformed the economy from one with a few small factories of Smith’s day to an industrial society where capitalists combined large quantities of labour and capital in a mass production economy with many large firms. In addition, this economy did not grow smoothly but showed the boom and bust of the business cycle. Economists began writing about these elements of what was then a new economy. Their ideas expanded on Smith’s theory of markets, including the development of Say’s Law.

Still, the moral economy did not disappear. Instead, it was transformed into the socialism and communism championed by individuals such as Robert Owen, Pierre Saint-Simon and Karl Marx, with their call for communal or national economic planning. They wanted to replicate a moral economy that took over the economic gains of the market economy and used planning to offset the human deprivation they saw in the market economy. Although advocates of small villages of cooperation such as Owen experimented with planning, those arguing for national planning...
were less transparent on how they would organize a system of planning. Marx, for example, insisted that the pattern of the market economy at the time of a transformation to socialism would determine how planning would take place. In this context we see the Progressive Era as the designing phase for the reforms that were needed for US society to regain the moral economy that thinkers from Plato to Marx had envisioned. Could the modern economy, these latter-day visionaries asked, be run under moral rules and in a way that avoided business cycles?

MORAL ECONOMY OR MORAL HAZARD

The moral economy, however, has not been without its own excesses. For over two millennia, the moral economy held sway and immoral behaviour in the form of intolerance of intellectual achievement and exploitation of peasants and slaves took place under its social order. During the twentieth century the followers of Marx caused the death of millions of persons in their efforts to build the moral economy of communism in Russia and China. In considering whether the moral economy is feasible, we can look to its origins among the Greek philosophers. To Plato and Aristotle, the term economics referred to household management, an economy of small-scale production on estates that was organized by family relations, where a benevolent male parent made all of the plans for the family. At heart all schemes of the moral economy ask why the entire economy cannot be run like a family, without market relations of buying and selling.

Consider the case of a family planning a holiday dinner. If the dinner takes place at a family member’s home, he will usually take care of the dinner or at least the main courses. Typically a benevolent parent would host the meal and plan it. Other members of the family may bring servings of food, dessert or wine. Because of close family ties, they would all know what each other liked and would bring food that met each other’s tastes. The decisions of how the dinner would be organized take place under the rules of the moral economy, with the tasks of cleaning up being assigned somehow. The members of the family would be motivated by mutual bonds of love and affection. There might be a family member who did not contribute to the meal but who still enjoyed it. Other members of the family would know the person well enough to either take measures to prevent a repeat occurrence at future meals or to accept the transgression good naturedly. The dinner plans might call for more food than was necessary, but family members could share the leftovers. If the family members did not like the meal they could make a case for changes in next year’s meal to those who planned the meal.
The family in our hypothetical example exhibits the features of a system of planning. There is an overriding group goal of a happy family dinner. Someone gathers information about what family members want to eat. That information is then assembled into a menu that sets priorities in terms of whose wants will be met first. The decisions in making the plan can be made cooperatively by all of the family members or by delegation to a subset of them. These cooperative decisions will determine what is to be produced, who will produce it and who will get what share of the final output, the dinner. The process of allocating or rationing the food is relatively easy to accomplish in a family without using prices or monetary incentives, although we have left out the problem of how the raw material for the meal was produced. In the household economy of Plato and Aristotle it was produced on self-sufficient estates through the work of slaves.

The question that proponents of the moral economy need to address is how the moral economy of the family can be scaled up into plans for an entire economy. Businesses in a market economy are always using innovation to scale up to a national level. They can scale up by expanding an existing facility or opening one or more duplicate facilities. As long as there are no barriers to entry, other potential businesses can add to the totality of economic production. This spontaneous expansion of business will depend on economic incentives of profits; a savvy owner will also work from a business plan that estimates those profits. Plans that go wrong will be eliminated by bankruptcy. The market treats failure less kindly than a family would, that is, the moral economy is much nicer than the market economy.

Advocates for the moral economy desire to restore the kindness of family relations to a national economy. To do so, however, they believe that the best approach would be to let businesses scale up their operations to a national or even a global scale through the operation of the market economy. Then society, somehow, can take over those businesses and transform them into the moral economy. That was the approach Marx eventually set forth and we shall see in this book that a variety of Progressive thinkers took the same approach, pushing for the nationalization of existing industry as the path to the moral economy.

This point makes it appear that the moral economy and the market economy must operate as separate spheres. Throughout this book we shall describe advocates for a moral economy who were satisfied to use planning to coordinate market activities into a cooperative system that combined morals and markets into a mixed economy. They cited the lack of overall planning in market activities as adequate evidence that markets needed to be regulated or supplemented by government programmes of the moral economy. Two important assumptions in this anti-market attitude were that the government’s behaviour is more moral than business behaviour and that
the persons being helped by the government recognize the mutual obligation to behave morally. Advocates of a moral economy believe that humans are basically good and the social institutions of the moral economy will bring about moral behaviour automatically, without investigating the validity of their underlying assumptions.

The issues we raise regarding the risks of immoral behaviour in the moral economy have a name: moral hazard. A moral hazard takes place when a person has an incentive to behave immorally, as is the case when the person is protected from the negative consequences of bad decisions; the hazard means that she will not take as many precautions to avoid the risk of her behaviour because her damages will be limited by the protection. Such a person, it is argued, has no incentive to behave responsibly. Once the government begins protecting society from the risks of the business cycle, its members may no longer take steps on their own to protect themselves. Advocates of the market economy assume that humans have a variety of character flaws that tempts them to anti-social behaviour. Consequently, they believe that government planning is not feasible because there is a moral hazard that irresponsible behaviour will make government programmes costly and ineffective. They also find a moral hazard attached to the political leaders in government, who may expand government programmes to fight a recession as a way to keep themselves in office by appealing to a broad range of voters. Market activities can include immoral behaviour from business. But bringing in the government to replace markets with morals and planning may simply substitute one form of moral hazard for another. Blending morals and markets may bring about the best features of both but runs the risk of irresponsible politicians and a populace not imbued with a sense of mutual obligation turning a moral imperative into a moral hazard.

The point we are making is that the intersection between morals and markets is a fine line not easily drawn. The moral economy requires that all of its members share the moral imperative that mutual assistance is the primary goal of society or else it will too easily fall prey to moral hazard where persons who receive assistance do not take the steps needed to make that assistance unnecessary. The market economy avoids this difficulty by making each individual responsible for his own assistance and for the risks of not living up to that responsibility; but without morals the individual may become unscrupulous in how he meets that responsibility. A mixed economy that combines morals and markets, by trying to play two roles, may instead play neither role convincingly.
OVERVIEW OF THE BOOK

In this book we shall examine the intellectual history of business cycles and planning during the Progressive Era and the New Deal from a variety of perspectives captured in our stereotypes of the moral economy versus the market economy. The moral economy is represented by the Progressive reformers, willing to plan the economy in order to avoid business cycles, and our focus is on them. We shall not, however, forget advocates for the market economy who opposed the moral economy with its government planning and we shall also let them have their say. We shall explore these opposing views on the relationship between business cycles and planning by considering a variety of views on the nature of business cycles and the programmes for dealing with them. Those programmes would require intervention by government, which raises an issue about the ability of government to plan the economy.

Our focus is on the discussion of business cycles and planning by selected economists, pundits, politicians and business leaders. In choosing the subjects of our study our goal is to incorporate the leading ideas on both sides of the fence behind the movement to reform the market economy in the first four decades of the twentieth century. Chapter 2 introduces two important individuals behind the debate over the effectiveness and the morality of a market economy, Edward Bellamy and William Graham Sumner. Bellamy, we argue, provided a model of the moral economy that formed an intrinsic, if tacit, part of the reform side of the moral economy; Sumner countered Bellamy with a socially informed exposition of the market economy. Chapter 3 explores the nature of business cycles and planning as a solution to them from the moral economy perspective of Thorstein Veblen, Theodore Roosevelt, Wesley Clair Mitchell and John Maurice Clark. Chapter 4 examines the main ideas behind the causes of business cycles from a market economy perspective, as found in the ideas of Irving Fisher, Henry Ford, William T. Foster and Waddill Catchings, and Joseph A. Schumpeter. Chapter 5 discusses the idea of planning, starting with the scientific management of Frederick W. Taylor and exploring the ideas of socialist intellectuals and the Progressive intellectual, Walter Lippmann, culminating with government planning in World War I with the War Industries Board (WIB). Chapter 6 continues the study of planning in the 1920s through consideration of Herbert Hoover, Rexford Tugwell, Stuart Chase and Walter Lippmann. Chapter 7 summarizes this debate by way of a general overview of the Great Depression and the way in which Progressives focused on the underconsumption theory of Foster and Catchings as an explanation for the depression; we also review efforts to use the
WIB as a model for how to use planning to end the depression. In Chapter 8 we present the political and economic background of Franklin D. Roosevelt and describe his attitude towards government planning. Chapters 9–11 look at the debate over the New Deal’s fledgling experiment in planning under the National Industrial Recovery Act (NIRA) and the National Recovery Administration (NRA). We shall see that many participants in the debate over the moral economy versus the market economy judged this programme of planning to have been inadequate even before it was declared unconstitutional by the US Supreme Court. When it ended, the Roosevelt administration was left with fiscal policy as a way to control the business cycle and Chapter 12 considers the contribution of John Maynard Keynes to fiscal policy, including his advocacy of planning, as well as how his ideas were initially received in the US. Chapter 13 presents an assessment of the New Deal by key figures from previous chapters. We conclude with an Epilogue that draws lessons for today from the legacy of the New Deal and the failure of planning.

In each chapter we shall be reviewing interpretations by supporters, opponents and analysts of the Progressive Era and New Deal policies and programmes aimed at economic security through control over the business cycle by planning. We offer a representative sample of the variety of points of view that were expressed at the time, and we must stress that there was a great deal of variety. Our selection of subjects ranges from well-known politicians and business leaders to obscure economists. Where possible we have tried to give biographical details of each person. Although the persons whose writings we review had a diversity of views on the reforms of the Progressive Era and New Deal, some of them unique, we have divided them into our two polar fields of the moral economy and the market economy. Not surprisingly, the proponents of the moral economy favoured the planning efforts of the New Deal in the NIRA, even though many of them thought it did not go far enough towards their ideal. Advocates for a market economy retained their belief in the effectiveness of the market economy and highlighted the flaws in the NRA. The issue, then as now, was learning to draw the line between the moral economy and the market economy while avoiding the middle ground where moral imperatives become moral hazards.