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Capitalism—Concepts and History[1]

By N. S. B. GRAS

Although the system of capitalism may be very old, the concept of such a system belongs almost wholly to the last hundred years. I shall deal with only five views, thereby leaving to others such additions as they think fit.

First, there is the technological concept, namely that capitalism is a system which uses capital in the form of machinery for the production of goods and services. A century ago men were impressed with the revolution that was occurring in manufacture and transportation. The key lay in the use of capital, not of workers. While Adam Smith emphasized that part of fixed capital which consisted of machinery used in manufacture, John Stuart Mill was impressed with the part used in transportation. This emphasis on fixed capital is highly important, at least as a part of an acceptable concept. In truth, however, it should be extended to include the farmer's plow and hoe and the artisan's hammer and lathe, that is, earlier and simpler instruments of production.

Second, the ethical concept of the socialists and communists is of high importance, at least for propaganda. As Marx and others thought of capitalism, exploitation of the workers was the primary ingredient. In the Communist Manifesto of 1848, while the terms "capital" and "capitalist" are used, the term "capitalism" apparently does not occur. The expression there is "bourgeois production." This is a system in which the business man takes unto himself the value created by the worker. Both Adam Smith and John Stuart Mill held to the theory of surplus value. Capitalism then is a system

[1]Editor's note: This article is made up of parts of a much longer paper read by Professor Gras at a joint meeting of the American Historical Association and the Business Historical Society in Chicago, on December 29, 1941.

that is socially iniquitous and should be destroyed. There is something of this in Sombart, especially where he places the origin of capitalism in the unearned increment of urban rent, turned into foreign commerce. This produced a system which came late in human history and should be made soon to take its exit. For most journalists, many historians, and the rank and file of citizens, whether they would fight and die for capitalism or not, this concept of exploitation has become a fixed idea and therefore like religion outside the realm of rational treatment.

Third, capitalism has come to mean individual ownership as against common ownership, regardless of the ethical element. Mingled with this distinction are sundry other ingredients according to the author dealing with the subject. It is hard to justify this use, because individual ownership might be of land and labor as well as of capital. Moreover, capital would be used in a régime of common ownership.

Fourth, capitalism is a system of production in which capital predominates. Nothing is implied as to the ethical aspects of sharing the income from production. Such is the view expressed by Sombart later in his life. It is not objectionable in its direction but is, like much of Sombart's thinking, devoid of clarity and adequacy. If we take the statement literally, production becomes capitalistic when the capital elements are more than one half of the total. This is not very helpful and yet it is suggestive of something we should not forget—increasingly, capital is coming to play a dynamic and strategic part in production. Still, capital alone is barren, a fact that Sombart would not deny if it were presented to him, as his works otherwise show.

Fifth, the concept taken here to be the most significant is that capitalism is a capitalist-administrator system. It is an organization of production in which the owner of capital enters into partnership with the administrator to produce an income for all concerned—themselves chiefly but also for workers and the owners of land and other natural resources as well as the owners of trained abilities. Of course, the owner of the capital and the administrator of production might be the same person, and in fact the two were commonly identical in early times.

The essential element of capital is something produced and then saved, not used up. Into this saving of goods to constitute capital, there goes necessarily a large amount of what is found in administration—planning, forbearance, and management. Business administration, like political administration, is made up of policy-formulation, management, and control. In reality, capitalism is basically psychological. It is production in a certain way with a certain objective. It is the work of the business man who operates in a certain way and for a certain purpose. It is in contrast to the ways and purposes of the proletarians, the landed aristocrats, and entrenched officeholders.

Behind capitalism, then, there is a will to save, to plan, to advance, to accumulate, and to attain security (for the investing capitalists and for the administrators). All persons, including workers, may join the ranks of the capitalists, if they save part of their income and plan their lives. In fact, a large number of workers are psychologically capitalists and, in a small way, actually capitalists. This existence of small owners of capital infuriates the intellectuals who would lead the proletarians into socialism or communism. Most hated by socialists and communists, in fact, are these petty bourgeois who are many in number and firm in their faith in saving and planning and managing. There is no greater error than identifying workers with the proletariat.

If capital is something created by the administrative effort of men, large and small, and if capital to be effectively used must, like labor, be administered, then the essential element in the system of capitalism is administration.

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Since no one, so far as we know, has made administration the basis of capitalism, we have to stop to explain why this has not been done. To a student of business administration, putting the doing of things into the center of the picture, or making it the hub of the wheel, seems natural and inevitable. But clearly this is not obvious to others.

A large part of the difficulty of economic analysis has lain in the disposition to stress the physical. Although the idea goes far back, it was the Physiocrats who gave pointed emphasis to the general theory. They regarded land as alone productive. Adam Smith made progress in adding labor and capital, so that in his opinion there were three agents of production. He made an effort to include the business man but he tripped up badly when, in his analysis of the capitalist, he confused interest with profits and the investing capitalist with the business man. He knew many categories, including artisans, retailers, wholesalers, merchants, and bankers, but the full, well-rounded organization centering in the sedentary merchant he missed completely. He saw the separate parts of the business order but not the combination or living nexus centering in the sedentary merchant. Clearly, he was most impressed with the petty capitalist whose workshop or store he was familiar with. Observing the petty capitalist at work, he emphasized labor without seeing the management involved even in a petty capitalist unit. Nowhere does Smith display an accounting sense. His life was led apart from the profit system, that is, a system wherein costs of operation must be less than sales of services and goods. Perhaps we may say that, if Adam Smith had possessed a feeling for accounting, the history of the modern world would have been somewhat different.

John Stuart Mill followed Smith in accepting land, capital, and labor as the three agents of production. Any other, such as the business man, he set down as definitely unproductive. In truth, Mill had no term for business men as a class: he thought the French lucky in having the word "entrepreneur."

J. B. Say, writing in 1803 and 1814, was in some way the Adam Smith and John Stuart Mill of France, but he accepted the entrepreneur as the fourth agent of production and provides us with an interesting analysis of the business man's functions. But when the American translator of Say's book was confronted with the term "entrepreneur," he was forced to fall back upon "adventurer," a word commonly applied to the sedentary merchant of London in the time of Elizabeth and James I.

A survival of the analysis of a century ago is found in Professor Chester W. Wright's excellent *Economic History of the United States,* published early in 1941. In this book we find a recognition of the existence of the business man and even of business itself under the heading of the "economic order," but business as a factor in production is dealt with in chapters on labor and but briefly. We are reminded of the possible influence of the old terms "wages of labor" and "wages of superintendence" found in some of the texts of classical economists.

In economic history generally there is to this day a holdover of emphasis on the physical that can be traced right back to the Physiocrats. The things that can be seen and the efforts that lie on the surface predominate. Goods are more considered than services. Land, labor, and capital are emphasized to the neglect or exclusion of business. Agriculture, trade, commerce, transportation, banking, mining, and so on are studied with little reference to administrative effort.

By the end of the nineteenth century, economists had generally come to accept four agents or factors of production, one of which was management. But they commonly robbed management (or administration) of its real key position by putting it alongside of capital, labor, and land instead of putting it in charge of the other three. If proletarian workers should turn a nation into a communistic state, they would have to develop administrators in their midst and the people of the new state would have to save collectively the capital necessary to continue operations and expand production.

During the first part of this present year (1941) there appeared in New York a book entitled *The Managerial Revolution* by James Burnham, a former follower of Trotsky. The book attempts to show that socialism is to be the new order and that therefore stockholders and financial capitalists will disappear. In the new order, where ownership will be vested in the state, the dominant position will be occupied by the managers (engineers and business technicians) and by top executives (shorn of their prepossession with profit-making). In other words, control of business in the new order will be vested in managers and executives who will receive the highest reward and become the top social class. Russia, Germany, and Italy already exemplify this change, while America, under the New Deal, limps along in the same direction. While there is much that can be criticized in this book, it deserves attention. Confused as it is in places, it has discovered the importance of management and control, or as these might better be called "business administration." Mind you, the author does not expect to see either politicians or bureaucrats occupy the seats of the mighty but the departmental managers and top executives of units of production. This work of Burnham followed by two years my book *Business and Capitalism,* which emphasizes business administration as a key to business history.

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And now we turn to the history of business itself, or rather the history of capitalism, a large part of which is occupied by the history of business. I believe that the development of capitalism can be better grasped by looking at it in a very broad way, at least at first. As I see this development, there are three types: pre-business capitalism, private-business capitalism, and public-business capitalism. The first is largely prehistoric; the second constitutes the substance of business history up to date; and the third belongs largely to the future, if indeed it is to have a future.

Pre-business capitalism is that early part of human experience which we learn about from the analogy of primitive peoples, not from history. During this era, man made tools and weapons for production and defense. He learned to save food for a difficult season. He planned his crops or his nomadic pastoral pursuits. In pastoral nomadism, indeed, primitive man was quite a capitalist. His flocks and herds were meat, drink, clothing, and defense, all in one. We do not need to stop to dwell upon this pre-business capitalism, the longest period in human history, but we can note that it saw considerable progress essential to all subsequent growth and that it lived its life entirely in the era before economic towns. It was characterized by the absence of regular exchange, market price, and high specialization in production. It did have a sense of values and fluctuating supply, as seasons helped or injured production. Such was the age when men exercised their individualism more in battle than in peaceful production. It was not so much an age of little capital as of nontechnological capital objects. Accumulations in cattle and sheep, horses, and goats were sometimes large, but there were no well-filled storage houses for trade and no well-equipped workshops.

Such was not the pre-capitalistic era of Sombart which, if understood literally, is fantastic. It was not the time when man walked with God and lived at ease with his neighbor. It was a healthy beginning of something better to come, but it was a time of little supply and scant variety. What was obtained might come with great care or even prodigious labor, but it was uneven and uncertain. Business was still unborn.

The second big type is private-business capitalism. Men saved as before but now they increased their production and therefore their capacity for saving. They produced for sale to someone else. They became specialists and therefore dependent upon others. Each man or family sought an ever larger capital for himself and in this way there was more for all. Regular exchange of goods was established and market prices gradually developed. All this took place in centers that were, or were becoming, towns. These towns were to become the centers not only of material production but of general cultural creativeness. The broad base of a material foundation was being laid for subsequent civilization. After centuries of town life, metropolitan communities were to arise, and at this point we are in the midst of our own times.

The third type is public-business capitalism, or complete socialism or communism. This may be the goal, or the doom, of society but there is no evidence of such an end. The little local communistic communities have disappeared one after another. The big experiment of Russia has been able to keep up the pretense of communism only by going over to semi-socialism, and this may be on the way out. Many have discerned in Russia a transition to private-business capitalism, as a middle class of officialdom arises ready to become a middle class of business men. At any rate, Russia has been eminently capitalistic throughout the experiment: only the capital, which has been scarce, has been public, and the control part of administration of the capitalistic system has been political. The top executives have been politicians and not business men, the chief difference in this case being that the politicians are more greedy and less qualified for their work. It has been necessary to line them up against a firing wall to bring about reform. Probably there have been fewer changes at the departmental level, where technicians predominate, than elsewhere in administration.

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Obviously our interest lies in the second type—the type of private-business capitalism and the accompanying flowering of our intellectual and artistic culture. The simple formula for this dual success seems to be that, when many men specialize in business, they so increase production that many others can devote all their time to art, letters, philosophy, and science. Little need be said of this, for the fact at least is history: it is a record which anyone may read, not in unbroken flow but still with remarkable growth, as business and culture rise in or near Asia Minor and spread to the ends of the earth.

Business history is not the over-all study of the getting of a living but the study of getting a living during the private-business and public-business régimes. It rises with the business man seeking private profit and it will go on to the politician seeking public profit. It concentrates on control, policy, and management. It works on, and from, the inside. Accounting is more to the point than economic geography. Internal organization of masters and men is more to the point than legislation or piracy.

The most summary, and I think the most fundamental, treatment of business history must concentrate on the interwoven strands of efforts by business men to produce a profit through service. Although local conditions may vary, there is a general pattern for types of concerted effort and for change from one type to another. I have presented this subject in a book, to which I may refer any one who is interested.[2] The essence of this presentation is that there are five stages (or succeeding phases) of business, which tend to cover shorter periods of time as they come down to the present.

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The first stage in business history is petty capitalism. As we know it from the records of ancient and mediaeval towns and from its recrudescence in early American history, it was a system of small shopkeepers, storekeepers, hucksters, pedlars, and traveling merchants. The capital of each was small and the emphasis of the group was on economic equality which was normal and threatened only on rare occasion until the system came near to the end. Each small business man learned his job with or without apprenticeship and in due time became a small master in his own right. Where conditions were favorable, these small masters formed gilds for protection, mutual aid, and monopolistic advantages. The

[2]*Business and Capitalism* (New York: F. S. Crofts & Company, 1939).

products were sold on the town market, in stores, in shops where made, or from house to house. Although wholesaling existed, it was in conjunction with retailing.

The small business man owned the capital, had full control, formulated policies, managed everthing, and was the chief workman. His records were scant and his system of bookkeeping crude though adequate. His home and place of business were under one roof, unless he was a huckster, pedlar, or traveling merchant. His wife, son, and one or two apprentices constituted his helpers. Skill was personal but technique was traditional. As time went on, in towns at least, there was leisure for banquets, public discussion, holiday parades, training of military bands, musical contests, and the like. Relative variety, specialization in small enterprises, and moderate status in life were outstanding. The existence of scores of groups of specialists characterized the petty bourgeois society of this stage.

These petty capitalists created three principal orders or disciplines: the first was the business of the town, the second the government of the town, and the third the humanistic and scientific culture of the town. All put together, these constituted urban civilization, which has been dynamic and progressive, fructifying and continuous.

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The new mercantile capitalism, the longest-lived of any capitalistic régime since the ancient period, grew upon the backs of petty capitalists. It was a system of wider trade, larger amounts of capital, and unprecedented growth of control, of policy-formulation, and of management, all centering in one office—a counting house. The central figure was the sedentary merchant, a merchant too wise, too occupied, too economical to travel. His distant connections were maintained by agents, traveling or resident. This sedentary merchant grew up in the ancient period but apparently had a short life in that era. In the later period he flourished from about 1300 to 1800. The outstanding sedentary merchants were called merchant princes. Some mercantile families actually attained political power and princely status. Their tastes and culture were the object of public admiration and their friendship sought by princes and emperors far and wide. Holding the purse-strings, they were often the arbiters of considerable international contests. Those who grew to be bankers loaned money to rival princes and helped decide rivalries of lasting importance, such as the imperial election of 1519.

Sedentary merchants (mercantile capitalists) came into being because of one great paramount need that the petty capitalists were area and the town group. On the one hand, there were products within the town economic area that needed an outlet and, on the other hand, that area could use goods from other districts far and near, particularly if they could be procured at a lower price. Of course, it is obvious that widening the market would provide the group that accomplished the feat with large rewards in the form of profits. It is an old story that the class that takes the risks earns the profits, if it is on the right track. In this case it was.

Sedentary merchants organized the existing facilities of production and marketing into a larger pattern, in which importing, exporting, and wholesaling constituted the key or center. In a general way, this meant that favorably located towns would grow into larger centers and a few, later, into metropolitan cities. This meant that just as petty capitalists became subordinated to mercantile capitalists so did small towns become subordinated to larger towns. Hand in hand with this process came the gradual extension of trade in large volume to most distant seas; finally, through discovery and exploration, completely around the world. It was only through the work of mercantile capitalists that the foundations were laid and the immediate preparations made for the discoveries of America. We think of kings, the pawning of jewels, the bulls of popes, the daring of captains, without looking under the surface to the basis on which the action of all the others depended—the construction of a deeper, stronger, and richer capitalistic system to provide a surplus large enough to support not only artists, scholars, and philosophers in large numbers but also trained navigators and explorers. I do not wish to dwell upon this point, but I believe it to be true that the civilization of the late Middle Ages and the early modern period rested on the work of sedentary merchants or, in other words, on big business.

In the early years of mercantile capitalism, the sedentary merchants openly and competitively purchased their supplies of manufactured wares from petty capitalists—artisans in the town or in the country. Commonly it was services that were purchased, or work on material supplied, as when the master saddler employed joiners, painters, and lorimers to work on his saddles. In the towns, such artisans were protected by their craft gilds; in the country there could be no effective gilds. A conflict in ideals and attitudes soon became apparent. As a petty capitalist, the artisan was slow moving, not very ambitious, working according to routine techniques. He could be little influenced by a sedentary merchant who wanted the products of his hands and his skill. Indeed, there was a conflict of management between the two classes of business capitalists. These conflicts were long and in places they were loud.

In the end, the sedentary merchant won and many petty capitalists lost their economic independence: they came to be tied to sedentary merchants and forced to work as directed. In other words, the sedentary merchant introduced into manufacture the draw of the market; enthroned demand, if you will.

The sedentary merchant was the key pin of the system. He was the great policy-formulator, manager, and controller. He laid the foundations of extended trade, big business, big cities, exploration, and general culture. This is not to say that many other workers and sundry other disciplines did not enter into the building up of the material and cultural world. It was the sedentary merchant's consummate administration that made so much of so little at a time when resources were scant and heaps of jobs lay waiting to be done—but only at the magic touch of an administrator. Workers, engineers, soldiers were all necessary but individually and collectively helpless without the sedentary merchant.

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The time came, however, when the key to business lay more in manufacture and transportation. A new group of business men arose to create an industrial revolution, the Industrial Revolution; and this destroyed the sedentary merchant. In other words, mercantile capitalists gave way to industrial capitalists. These industrial capitalists were specialists in the new techniques of power-machine production—railroading, steamship operation, distribution in inland as well as coastal regions, and so on. With the specialization went increasing size. Capital and permanently employed workers were required in business units as never before. The old scattered, flexible, almost invisible régime of mercantile capitalism was giving way to a concentrated, rigid, and strikingly prominent industrial capitalism. Factories and railroads were two of the visible evidences of the new system of production.

For centuries, mercantile capitalists had put pressure on petty capitalists to produce more and more, to get more out of themselves and out of their workers. The effect of this on manufacture has been studied. Here we can note that it caused the petty capitalists, and some workmen capitalistically minded, to turn to mechanical devices for automatic machine production and for the use of water and later steam power. There is no need to rehearse the early part of the Industrial Revolution. Only let us *not* think of the activity of Kay, Arkwright, Hargreaves, and others as labor. Their efforts lay clearly on the management side of business turning to new productive devices. Nowadays, the manager would call in an inventor. In those days the manager, or the would-be manager, turned his own mind and fingers to work to contrive a new mechanism.

We are recovering from the past a fuller knowledge of the industrial revolution which still affects us. We are commonly more interested, however, in the temporary ill effects of the revolution on the workers than we are in the social revolution in the field of administration. In fact, the world witnessed a revolution in administration without seeing it. The long submerged or controlled class of petty capitalists found their opportunity. The new production was along their line. From tools to machines was a big but a logical jump. They could make it, and in doing so they could regain their economic independence. They could overthrow the long-hated mercantile capitalist. They could attain social justice, in fact the only kind of social justice that evolving society seems to accept. A sentimental outcry may lead to a political revolution but not to an economic revolution. It is only the substantial contribution that the broad selfish view of men, in their everyday life, accepts as a worthy basis for social justice. To be sure, times may change; I do not prophesy as to the future, merely try to sum up the past.

The new industrial capitalists, whether they came from petty capitalists or mercantile capitalists, proved to have two elements of strength—one in production, the other in marketing. Perhaps the former came from the ranks of petty capitalists, while the latter descended from the mercantile capitalists. At any rate, the industrial capitalists prospered enormously in their competition with the survivors of the older régimes which still used older techniques. When the older forms of business had disappeared—by the 1860's, then competition became more and more between industrial capitalist and industrial capitalist. The spirit of ruthless competition, when exerted against the old order, merely hastened the incoming of the new; but, when directed against other members of the industrial capitalistic group, it led to diminished profits and threatened disaster. In the deep depressions of the downward secular trend which lasted in America from 1866 to 1897, efforts were made to avert disaster by doubtful practices, such as rebates and particularly drawbacks. It was necessary to resort to consolidations to cut down excessive competition. In spite of these twists and turns, bankruptcy came to many a useful firm.

We see clearly enough now that industrial capitalists, while strong in production and distribution, were weak in private finance. They did not have adequate reserves against depressions. They had no clear-cut vision of a long-run policy as against a short-run policy. They did not distinguish between fixed capital and working capital, at least not effectively. Commonly, they were long on fixed capital and short on working capital. The latter they secured from commercial banks, which in time of depressions had to demand repayment so that depositors could be satisfied.

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To many persons, Wall Street was a Trojan Horse which brought dangerous gifts. Gratitude is not a well-developed human emotion. It has little existence in business or politics. The fact that Wall Street was in New York, was rich, and contributed financial services—never well understood by a debtor people—made it an easy mark for politicians, journalists, and reformers who spent more time in denouncing than in studying.

Let there be no mistake about Wall Street. The investment bankers who led it were selfish and not public spirited. They were touched off by their own interests. They ignored the feelings of the public. They were negligent of petty capitalists, including farmers. And, for a long time, they cared little about workers, who were regarded as articles to be bought at the market. And yet, the investment bankers, who wanted profits for the buyers of the securities which they sold, were doing much for America when they provided for the effective flow of savings and earnings into business. While emphasizing the fees from the sale of stocks and bonds and their profits from buying and selling stocks, these investment bankers were serving America even more than themselves. In ignoring the feelings of the people they were undiplomatic, but future historians will show that they were more up to date in their business policy than the public in its emotional thinking. In ignoring petty capitalists and neglecting labor, financial capitalists proved themselves short sighted and without a political sense. In going beyond the bounds of ordinary competition in reaching out to get from one another large masses of property in a way that disturbed the smooth operation of business, especially the working of the money market, they uncovered weak links in policy just as the industrial capitalists had disclosed weakness in their policies. It was the financial weakness of industrial capitalists that gave to investment bankers, who represented the owners of business as against the administrators, the opportunity they seized. When Wall Street gained control, financial capitalism was born. This does not mean what has been called "security capitalism"—buying and selling securities—which has been developing since at least the fifteenth century. It does not mean simply the building up of firms with colossal assets. That is incidental, not essential. It means the influence or control of investment bankers in the interest of the owners of the securities which these bankers originate and continue to sell.

Let us briefly put down some of the major policies and methods of financial capitalists: (1) to provide adequate working capital for the firms in which they were interested, (2) to build up reserves against disaster, (3) to create integrated units in order to insure supplies at reasonable costs and to prevent squeezes from the outside, (4) to diversify products in the interest of survival during depressions, (5) to give up excessive competition where that system made profits impossible, and (6) to put profits above wages.

The heights of financial capitalism were reached in America under J. P. Morgan, Sr., about 1893-1913, and under his son about 1914-29. Wilson threatened it in 1912-14, but only the depressed years 1929-33 and the New Deal régime of 1933-39 saw its eclipse. Whether under a revised form it will ever be given another chance to operate, remains to be seen. I do not mean to question the present functioning of Wall Street, though it operates at a low ebb. I deal simply with the question of predominance in business.

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The latest stage in the history of private-business capitalism began about 1920. It grew to some maturity in Italy beginning in 1922 and in Germany and America beginning in 1933—in the first instance in the primary postwar depression and in the second instance in the secondary postwar depression. There is some question as to whether it should be called national capitalism or state socialism. This issue is not wholly a matter of words but largely a matter of emphasis. The central figures are not business men but political leaders. So far they seem to be aiming at national capitalism. Ownership and management are vested in private individuals. Control and policy-formulation are lodged in politicians of the dominant party. True, there is some nationalization of business services, but this tendency is restricted. Although we now have national capitalism in America, there is a considerable group in the dominant party that would welcome a larger measure of state socialism.

To me, there seem to be four clear facets to national capitalism. First, there is a cardinal urge to destroy financial capitalism—international Jewry in Europe and Wall Street in America. Second, the government will coöperate, must do so in times of war, with industrial capitalists. Third, there is a real desire to aid petty capitalists whether in shops or farms, though this aid is likely to be sporadic and at times a delusion. Fourth, the cream of the benefits of the new régime is to go to the new party leaders who alone can be trusted. Fifth, these leaders will share the freshly distributed benefits with the workers—the chief electorate—either directly as in Europe or indirectly through unions as in America.

The long-run tendency is to subordinate individualism, selfreliance, and saving for risk ventures in favor of a universal dependence upon the national government. Bound up with the whole régime is a degree of financial recklessness that knows no precedence. And always inherent in such recklessness is the recourse to international war.

Discussion by Raymond de Roover

Professor Gras' paper is so full of new concepts and ideas that it is very difficult to make any useful comments in a few minutes. I shall, however, try to discuss a few points which appear to me worthy of special emphasis because they may require a revision of accepted interpretations.

THE COMMERCIAL REVOLUTION OF THE THIRTEENTH CENTURY.

Professor Gras makes a distinction between petty capitalism and commercial capitalism and between the traveling and the sedentary merchant. The transition from the first of these systems to the second gave rise to a "commercial revolution," which occurred about the end of the thirteenth century and which cuts the Middle Ages into two periods: an earlier period up to about 1300 and a later period which includes the fourteenth and fifteenth centuries.

By a commercial revolution I understand a complete or drastic change in the methods of doing business or in the organization of business enterprise just as an industrial revolution means a complete change in the methods of production, for example, the introduction of power-driven machinery. The commercial revolution marks the beginning of mercantile or commercial capitalism, while the industrial revolution marks the end of it.

In the twelfth and thirteenth centuries the fairs of Champagne were the great gathering place which attracted traveling merchants from Flanders and Germany on the one hand and from Provence and Italy on the other. At these fairs Flemish cloth was exchanged for spices, silk, and other luxury articles from the Levant. Historians have attributed the decline of the fairs to certain ill-advised fiscal measures of the French kings, to the beginning of regular voyages of galleys between Italy and Bruges, and to the social troubles in Flanders and the war between that country and France. None of these explanations is quite satisfactory, for reasons which we cannot stop to consider here.

The real cause for the decline of the fairs of Champagne lies in the fact that the Italian merchants became sedentary, established permanent agencies in Bruges, and began to buy Flemish cloth in the centers of production. This new form of business organization came into being because new techniques for control and management had been gradually developed:

(1) Instead of forming partnerships for the duration of a single venture, a new type of partnership agreement was evolved: the terminal or permanent partnership, which was to last for a number of years unless it was prematurely dissolved by the death of one of the partners.

(2) The traveling merchant knew the "letter obligatory" either given under seal ("letter close") or given under the form of a deed ("letter patent," notarial act). This instrument was inadequate when merchants ceased to attend the fairs and began to work with agents and correspondents abroad. The "letter of payment," or bill of exchange, was developed to meet the need for a more practical instrument. It made possible the transfer of money from place to place without the shipping of actual coins.

(3) The greater security along the roads made it henceforth unnecessary for the merchants to convey their goods themselves and to travel in armed caravans. Goods could safely be entrusted to specialized common carriers on land as well as on sea.

(4) The development of maritime insurance made it possible to shift the sea risk to the underwriters, and consequently it was no longer necessary to divide that risk by shipping goods on different ships and by entering into partnership with several traveling merchants.

(5) The bookkeeping of the traveling merchant had been crude, though adequate for his purpose. Accounting records were merely memorandum entries of credit transactions; no record was kept of cash or barter transactions. Accounts between partners were settled very simply by deducting the expenses from the proceeds of each venture and by dividing the rest among the partners according to the rules agreed upon. This could be done on a scrap of paper.

In the late thirteenth and early fourteenth centuries, accounting advanced with great strides. One innovation of major importance was the current account kept in bilateral form, that is, the personal account divided vertically into two columns, one for the debit and one for the credit. Later, double-entry bookkeeping was introduced by adding impersonal accounts to the existing personal accounts. Good methods of bookkeeping were essential in order to keep accounts straight when two persons, residing in different cities, had numerous business dealings with each other. Merchants had to know where they stood, and accounting served as a guide by revealing profits and losses.

All these techniques were merely tools for control and management. They did not replace intelligence and common sense in the conduct of business enterprise.

The consequences of the commercial revolution may be summarized as follows:

(1) The Italians were the first to master the new techniques just mentioned. As a result, foreign trade in Western Europe became virtually an Italian monopoly. Italian supremacy did not break down until well into the sixteenth century, long after Italy itself had declined as a consequence of the geographical discoveries.

(2) The traveling merchants of Flanders, who used to visit the fairs of Champagne, were entirely eliminated. Foreign trade was taken out of the hands of the Flemings, who ceased to play an active rôle and confined themselves to acting as intermediaries. The native upper class in Bruges, during the fourteenth and fifteenth centuries, was not made up of merchants but of brokers, innkeepers, *drapiers,* and commission agents.

(3) Any investigation into the origins of capitalism should concentrate on Italian practices. There is in America a tendency to overrate the importance of England. Until the reign of Elizabeth, England was commercially backward. (It was mainly an agricultural country with wool as its principal product for export.) One example will suffice to bring this out: the bill of exchange remained unknown to English merchants until the fifteenth century.

(4) The Italians controlled foreign trade in the Levant, in Southern Europe, in France, in Flanders, and in England. For various reasons they did not penetrate into Germany. The Baltic trade, in particular, remained the monopoly of the Hanseatic League.

ITALIAN VS. HANSEATIC BUSINESS METHODS.

From an economic point of view the mediæval European world did not form a geographic unit after 1300, but was divided into two areas: one under Italian influence and the other under the sway of the Hanseatic League. The principal difference between the two areas is that business methods in the Hanseatic territory were much behind Italian methods. In 1500 there was perhaps a lag of two centuries. Sweden, for example, remained in a stage of natural economy up to the end of the sixteenth century. In other words, the Hanseatic merchants were still in a stage of petty capitalism long after the Italians had reached the stage of commercial capitalism.

Nothing brings out this fact more clearly than the crudeness of German methods of bookkeeping as compared with Italian methods. Hanseatic partnerships were formed for a single venture or were loose associations involving one merchant operating from a certain trading center and another merchant from another center. In partnerships of the latter type the settlement of accounts was sometimes postponed for years. The late Finnish historian, Gunnar Mickwitz, attributed the bankruptcy of Hildebrand Veckinchusen to defective methods of bookkeeping and control. Veckinchusen was a prominent Hanseatic merchant of the early fifteenth century, whose account books are extant in Reval and whose business correspondence has been published by Wilhelm Stieda. The Hanseatic system of keeping books was more or less satisfactory as long as only two partners were involved, but it was entirely inadequate when partnerships became three- or four-cornered affairs. Accounts would soon become hopelessly entangled and lead to lawsuits and even to more serious difficulties, as the story of Hildebrand Veckinchusen exemplifies.

No Commercial Revolution in the Sixteenth Century.

Some historians have expressed the opinion that there was a commercial revolution in the sixteenth century, but it seems that there is little evidence to substantiate such a view. First of all, it should be clear that a shift in trade routes does not necessarily mean a change in business organization. The discovery of America did not lead to any new methods in management and control, at least not immediately. On the contrary, since the newly discovered continent was inhabited by savage tribes, an organization had to be built up from scratch, and at first it was necessary to revert to methods in use in the thirteenth century. Lately historians have come more and more to the realization that there was no breach of continuity between Bruges and Antwerp. Italian preponderance in international trade did not abruptly come to an end either, but it is true that the knowledge of accounting, of insurance, of the law merchant, of business administration spread to other European nations during the sixteenth century. Writers like Malynes and private schoolteachers were instrumental in diffusing this knowledge.

Professor Nef has pointed out that, during the period from 1540 to 1640, England overtook the other countries and became the most industrialized nation of the time. There was a considerable increase in the amount of capital invested in industry and in the size of industrial enterprise. Methods of production were greatly improved. Such progress also required increased efficiency in management and control. A study of the literature of the time would indicate that Italian methods became known in England chiefly through the translation of French and Flemish (Dutch) works published in the Low Countries.

THE IMPORTANCE OF THE PUTTING-OUT SYSTEM.

Another topic which seems important for the history of capitalism, and which is closely related to the changes brought about by the commercial revolution of the thirteenth century, is the advent of the putting-out system in the textile industries. As long as petty capitalism prevailed, the artisan sold directly to the consumer or to the merchant; that is to say, industrial production was still in the retail handicraft and independent wholesale handicraft stages. The traveling merchant, being constantly on the road, was not in a position to extend his control over manufacturing. This situation changed when the sedentary merchant appeared on the scene. He began to organize production, frequently through a hired manager or by entering into partnership with someone who knew the technique of the industry.

The most outstanding work dealing with the putting-out system is still Doren's book on the Florentine woolen industry. Doren, unfortunately, was under the influence of Marx. He overlooked the fact that the Florentine cloth manufacturer did not have any influence on the price which was offered for his product or on the price which he had to pay for wool, his principal raw material. These were determined by market conditions over which the individual producer had no control. Wages also were determined independently by supply and demand, though gild regulations may have had some influence here. In any case, the Medici Manuscripts in the Selfridge Collection at the Harvard Business School do not prove that the Florentine cloth manufacturers enjoyed monopoly profits derived from an oppressive labor policy. Frequent unemployment and low wages were apparently the result of adverse business fluctuations which affected the sale of Florentine cloth. The individual producer was not responsible. The Florentine woolen industry is an early example of competitive conditions rather than of monopoly.

The existence of a competitive market with price as the regulating factor is characteristic of the capitalistic system, a point which Doren apparently missed. Price does not, of course, play any rôle in other economic systems, such as a closed village economy and a manorial economy. Under a competitive system the main task of the capitalist administrator is to bring price and cost in equilibrium.

CAPITAL UNDER MERCANTILE CAPITALISM.

From the standpoint of the economic theorist an essential difference between industrial and commercial capitalism depends upon the nature of capital accumulation under both systems. Under mercantile capitalism, capital is largely a stock in trade or a revolving fund which is used to buy raw materials and to pay wages and which is replenished by the sale of the finished product. Little is invested in productive equipment, with perhaps two notable exceptions: the shipping and the mining industries. Industrial capitalism, on the contrary, presupposes large investments in equipment before production can really start. Depreciation, maintenance, and overhead thus become important elements in figuring cost. An example will make this clear: depreciation in one of the sixteenth century Medici partnerships for the manufacture of woolen cloth was less than one per cent of cost. In other words, depreciation was practically negligible. Overhead amounted to only ten per cent. Direct costs were consequently the determining factor.

* * *

To conclude, I should like to point out that many of the statements which I have just made are generalizations and may need to be qualified, since there are always in history many exceptions to the rule. Synthesis, however, is not possible without some general concepts and a method of approach. Professor Gras provides both by his emphasis on forms of business organization and on the problems of management and control. Professor Gras is right in placing the rise of the sedentary merchant in the focus of our attention. He thereby makes a contribution of great value which, in my opinion, gives the clue to a correct interpretation of mediæval economic, social, and business history.

Discussion by Henrietta M. Larson

I should like to emphasize three points dealing with the general subject of the significance of the administrator concept in the study of capitalism.

First: the study of the administrator deals with man, that is, man at work. Among economic historians the Classical School, the Marxians, the Historical Economists, and the Social Economists have generally either overlooked man as a factor in economic life or have seen him as a passive element, acted upon rather than acting.

It should be noted positively that this is not a revival of the old biographical interpretation of history. That interpretation unquestionably had some truth in it. The very fact that it went so far in its claims, while it was in reality so vague and unanalytical, brought a reaction which obscured even the germ of truth that it contained. The administrator approach to business history does not interpret history in terms of great leaders. On the other hand, the administrator concept maintains that administration is more than the mere routine job of following immutable economic laws;

that it is a series of efforts driving toward an end. This involves taking risks, assuming responsibilities, making decisions, and effecting countless adjustments, in individual and larger relationships, within the business unit and in its external relations, but always with the object of getting something done. Business administration is creative, not the creativeness of the few but of the many on whatever scale or level they operate in business life. Some business men, it is true, have more influence than others; but all, large or small, contribute to the total result of the economic effort of society. In this point of view, I believe, may be found a pattern for a revived biographical approach which has value.

The second thought that I want to emphasize is this. The administrator approach to the study of the history of capitalism makes possible a more realistic and a more nearly complete description of capitalism as a functioning thing than have the old concepts or methods of presenting economic history. Professor Gras has given us a picture of the administrator as organizing and managing the various factors in the process of production. In other words, the administrator, or administration, is the means that brings together the various elements that operate in capitalist effort and guides them in operation. Unlike other approaches to the study of capitalism, the administrator study does not deal only with production, with institutions or machine techniques, or with prices, labor, distribution of profits, or other partial considerations. It is not satisfied with isolating ethical considerations and passing judgment on the basis of inadequate information. Moreover, it does not consider business change as something to be measured quantitatively only. And it does not content itself with description of economic stages as separate and static entities. What it *does* attempt to do is to see all the elements in their relationship in the actual operation of business and to measure results from the view of the whole.

It is helpful to think of business as it is represented in the operating statement of the enterprise. On one side are costs; on the other, income figures; at the bottom, totals. In order to have capital with which to continue operating, the administrator must over a period of time have greater income than costs. This means strictest concern with a great number of costs and with sources of income. It is obvious, therefore, that to consider only one element or anything short of the total gives but an incomplete picture.

Let us be warned that the administrator approach to the history of capitalism is not an easy one to follow. It is much simpler to write history to fit a theory or to consider only a narrow and partial aspect of the subject. Nor are the results of the administrator study what one would like them to be; there are too many intangibles of human personality that cannot be reconstructed. At least, however, this approach should not lead to that over-simplification which discredits so much that has been written on the history of capitalism.

And now to pass on to my third and last point. It is the conviction of those of us who have worked with Professor Gras that the study of the administrator at work has particular value for our time. This type of study does not aim to *defend* private enterprise; it *does* aim to work toward that full description of how business operates which is the only adequate basis for understanding how our capitalist system has operated in the past and how it operates today. It frankly proceeds on the assumption that such understanding will help to secure more effective, because wiser and more responsible, administration.

It cannot be stressed too strongly that, whatever be the system of capitalism under which business operates, its success depends in large measure on how it is administered. A system of capitalism is, after all, only a way of organizing, guiding, and managing economic effort. Unless that effort is effectively administered, society will inevitably stagnate or go backward. We shall need administrators of the system whether we continue to live under a system of private business capitalism, but with a lessened degree of freedom in capitalist enterprise, or under a system of national capitalism (with control, policy-formulation, and some management in the hands of the government), or under public capitalism, that is, communism (with ownership, policy-formulation, and management in the hands of the state).

This is to us no mere academic concern. We Americans have been fortunate in having such resources and such freedom in the past that we have been able to muddle through with much carelessness, stupidity, shortsightedness, and even dishonesty in our administration of business and in the regulation of business by our government. We can no longer afford to be as prodigal as we have been with our resources, capital, and energy. Moreover, the burden of administering our business system becomes heavier as it becomes more and more integrated, as rigidities increase, and as the size of the business unit becomes larger. Under the present growing concentration of control of capital and of policy-formulation and even of management of business in the hands of government, the problem of administration is reaching proportions beyond anything we have ever experienced.

Of one thing we may be certain. The old days of *laissez faire* are gone. A new age or system is in the making, which Professor Gras calls national capitalism, in which control and planning are largely in the hands of government and only routine management to any great extent remains to private business. This growing union of business and government is probably no temporary development —the changes represent not only current difficulties but a new situation. The *trend* is obvious; we do not know how *far* it will go.

It is a grave question whether capitalism, as we have known it, can hold up under the growing administrative burden. It is no idle thought that we may go on to communism, and even to its breakdown. If our schools continue to deal with politics and business according to the old concepts, we may well fear for the future. There is at least a chance that a more analytical approach may help to provide that responsible and wise administration which we now need and shall increasingly be needing.

If there is any validity in this thought, it has serious implications not only for the student of economic history but also for the economist, the political historian, and the student of government.

The Effect of Managerial Policy Upon the Structure of American Business[1]

By RALPH M. HOWER

The object of this paper is to present for discussion the thesis that the managerial policy of individual entrepreneurs has been one of the principal factors determining the structure of American business.

Let me explain what I mean. The traditional account of our economic history emphasizes geographical situations, natural resources, technological developments, and the growth of population. I do not wish to deny the influence of such factors or to minimize their importance. The individual enterprise can no more divorce itself from its economic environment than a man can lose his own shadow. But I suggest that these factors operate only through the thought and action of the business administrator, and that to a considerable extent such men shape our economic environment.

Historical knowledge in this area is, unfortunately, exceedingly limited. However, by presenting a number of concrete examples, drawn from historical material which is more or less familiar, I hope to show that there is evidence to support my thesis. It will take hard work on the part of many investigators to provide us with any comprehensive and conclusive analysis.

[1]Editor's note: Here cut to about half its original length, this article was read by Professor Hower at a joint meeting of the Business Historical Society and the American Economic Association in New York on December 28, 1941.