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# Deciding for Bigness

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## DECIDING FOR BIGNESS: Constitutional Choice and the Growth of Firms

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This essay draws upon the contractarian distinction between constitutional and operational levels of personal choice and an evolutionary analysis of the growth of firms to illuminate the complex of theoretical and historical issues surrounding the emergence of large-scale economic organization in the United States in the years since 1870. The evolutionary analysis suggests why the individual's economic autonomy must largely be sacrificed for the material wealth made possible by increasing scale in production, and a juxtaposition of the views of F. A. Hayek and Louis Brandeis on this question, seen in the light of the fundamental tenets of American antitrust and corporate law, offers a perspective on the operational and constitutional choices we have made with respect to "bigness" and on the values these choices have revealed.

### Introduction

Building upon the venerable contractarian insights of Hobbes and Locke, Viktor Vanberg and James Buchanan draw attention to the important distinction between two different kinds of personal interests and the corresponding choices they present to free men and women in social life. On the one hand, they write (1988: 140), an individual's

*constitutional* interests are reflected in his preferences over potential alternative "rules of the game" for the social community or group within which he operates. His constitutional interests inform his choices insofar as these choices pertain to the kind of institutional order or order of rules under which he is to live. . . . By comparison, a person's *operational* or action interests are reflected in preferences over potential alternative courses of action under given situational constraints, including the constraints that pertain to the given structure of rules and institutions. [But] there is no reason to expect that these interests will be either in "natural harmony" or "natural conflict". . . . There is nothing "inconsistent" in preferring a certain rule constitutionally and, at the same time, given the situational constraints as they are, violating the rule in pursuit of one's action interests (emphasis added).

But the stability of any preferred constitutional order clearly requires that divergences of this kind be resolved by bringing the constitutional and

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operational choices of at least the great majority of citizens into harmony, and Vanberg and Buchanan devote much of their attention to the various social mechanisms which might be called upon to achieve the necessary reconciliation of these two kinds of interests in cases where they do diverge. My purpose here is to apply this framework to the problem of determining the appropriate size of business firms within a regime of private property and market exchange and, by making explicit both the particular operational and constitutional choices the American people have made in this regard in the years since 1870 and the ways in which they have been reconciled, to reveal some perhaps uncomfortable truths about the values we hold and the kind of social order to which we aspire.

I begin by sketching an evolutionary analysis which relates the organization of economic activity to the costs of exchange in various environments and sees the firm itself as a contract, a complex, multilateral agreement to withdraw certain aspects of production from the market and bring them instead within a matrix of continuing personal relationships and obligations. This image of the firm as a contractual artifact, a real, useful but obviously inanimate construction of the human mind, is then brought to bear in interpreting two related intellectual currents of the second half of the nineteenth century, the "reification" of the corporation in American law, the granting to it of both a legal personality endowed with rights and interests of its own and a continuous existence independent of its human constituents, and an emerging managerial conception of the firm as a social machine. I argue that while the links between these two currents have been largely responsible for the particular directions in which the neoclassical theory of the firm and its cognate science of management have evolved in the twentieth century, their effects on the broader economic and political culture of the United States in general, and on the constitutional choices we have made with respect to the organization of production in particular, have been still more profound. The contrasting assessments of two individualist thinkers of "the curse of bigness," one offered at the beginning of the age of concentration by Louis Brandeis and the other at its end by Friedrich Hayek, let us see how deep a mark this history has left on our values and perceptions and bring the choices it continues to pose for us into sharper focus.

### I. Production Contracts and Corporate Personality

The corporation is not a person, but an abstraction, a form of organization. Its essence is the intricate set of relationships between its own-

ers, managers and employees, and not those men and women themselves. Each of these constituents comes to the corporation with unique capacities and a distinctive welter of motives, some as basic as simply earning a living, others more complex, all differently urgent or compelling. What binds them is their reliance upon one another, for whatever personal objectives they may hope to achieve through the corporate enterprise, each knows that he cannot achieve his own ends without the active cooperation of the others. This mutuality of dependence induces every participant to exchange some measure of personal autonomy for the discipline of obligation, to submit to more or less explicit rules and procedures so that the others will be able to predict his behavior in specific situations and adapt their own to it with confidence. Secure in the knowledge of how his fellows will act or react in circumstances where his own interests are at stake, each can see exactly what he needs to do to promote those interests by getting his own job done properly. Submission to the rules and the undertaking of binding obligations thus creates an order which enables all of its participants to pursue their various personal interests with the help, but not the charity, of the others, to cooperate, as it were, in spite of themselves.

All of this amounts to a complex, multilateral contract, based on consent, which governs a specific range of activities and circumstances and regulates the behavior of those who agree to it (Cf. Coase 1937: 390-392). The subject of this contract is how various resources will be combined to produce goods for sale, and to the extent that the order it creates results from voluntary agreements made by self-interested men and women, it can be understood as a "natural" outcome of the market process. Still, its terms must be enforceable if the contract is to have meaning, and insofar as the state is the enforcer of last resort, it can, by choosing which provisions it will enforce or prohibit, effectively regulate the scope and content of these production contracts. In this sense, the particular forms of contractual organization favored by the law are, as Brandeis (1978: 648) put it, "man-made" as well, and the constitutional choices they represent constrain and thus partially determine the actual organization of production.

But not all production contracts create the specific entity that the law recognizes as a corporation, nor is it obvious why any explicit contractual arrangements at all are needed to organize production. Why not leave the task to the "invisible hand?" Part of the answer, but only part, must lie in a finely wrought division of labor, as Adam Smith well

understood. Because "it is the power of exchanging that gives occasion to the division of labour, so the extent of this division must always be limited by the extent of that power" (Smith 1937: 17). At any given time and place, factors such as population density, topography and available technology are important determinants of the kind of specialization observed and the degree to which labor is divided, and as these factors change, the organization of work changes with them (Smith 1937: 17-21). As the division of labor evolves over time, that is, the precise forms it assumes are sensitive to the environmental conditions in which exchange is carried out, and as these conditions change, the qualitative details of the division of labor are adapted more or less successfully to them by its participants. Thus, as Smith's successors in this evolutionary economics have argued, it is neither the division of labor *per se* nor, indeed, any universal or immutable characteristic of markets, but the relative costs at the margin of organizing production by market or contract in various environments that induce the growth of firms. To be sure, the relative costs and benefits of leaving the terms of specific business transactions to the spontaneous processes of the market or bringing them within a purposefully constructed production contract may vary with time and place and change, often rapidly, with shifts in preferences or technology. And though, as we shall see, the practical differences between the two cases may be great, the relevant operational choices may in principle be made either by living men and women responding to complex personal motives and purposes or by collectives motivated solely by profit maximization. But the nature of the organizational decision itself remains constant. Where previously independent agents see the benefits to them of governing their relations by contract to be greater than those of flexible operation in markets, firms will grow, vertically along a single chain of production or horizontally across competing sellers; otherwise, they will stop expanding or shrink by returning operations organized by contract to the market. The search for equilibrium size implied by this continuing attempt to weigh the costs of alternative forms of organization makes clear that, as Ronald Coase (1937: 389) noted with surprise more than fifty years ago, "In a competitive system there is an 'optimum' amount of planning!"

This process of organizational evolution reaches into every corner of the market. Under the constant pressure of competition, innovative experiments in the organization of all kinds of work in changing exchange environments are continuously conducted and evaluated. The

relative success of some of these experiments in enabling their participants to meet their own objectives is observed; these are copied or adapted by others with similar problems in similar environments and "survive" to provide the raw material for adaptive "mutations" yet to come, while those seen to fail in this sense are soon abandoned.<sup>1</sup> It is, moreover, the self-interested actions of free men and women that drive this process, and their preferences, superimposed upon environmental circumstances, that determine its outcomes. Where they see their own interests in production as better served by the discipline of contractual obligation than by the freedom of action characteristic of markets, their operational choices will organize work accordingly. And where the value they place on personal autonomy is less than the material rewards of limited submission to the orders of others, there will be hierarchy. So, in the evocative words of Dennis Robertson, there come to be firms, "islands of conscious power in this ocean of unconscious co-operation like lumps of butter coagulating in a pail of buttermilk" (Coase 1937: 388).

The factors which drive the organization of work from markets to production contracts arise in a broad range of exchange environments, and some useful generalizations can be made. For example, the intensity and duration of the relationship between the parties to an exchange clearly influence their choices as to how their dealings will be governed. Imagine a spectrum of transactions distinguished in this way. At one end are "discrete" exchanges, involving strangers whose relations begin and end at the instant the trade is consummated; an example might be the cash purchase of an inexpensive souvenir by a traveler who expects never to return, though even here respect for property rights and the use of money signal the prior existence of a matrix of social conventions to which both sides subscribe. Toward the other pole lie "relational" exchanges, in which the parties are bound by a complex of relations which each wants to preserve and thus conditions their behavior in negotiations. Discrete transactions can be isolated in time and regarded as substantially independent; relational transactions are part of a larger, continuing network of personal bonds which form a context for the exchange and influence the terms of future transactions, just as they themselves have been influenced by transactions in the past (Macneil 1978).

<sup>1</sup> Compare Alchian (1950) and Winter (1975). On the application of models of natural selection to social systems, see generally Adelstein (1981).

The value of this vocabulary becomes clear when we consider that the laboratory conditions of "perfect competition" which neoclassical theory shows to be most favorable to the operation of markets correspond closely to the characteristics of perfectly discrete exchanges. As we leave the artificiality of these ideal constructs by introducing the environmental imperfections associated with buying and selling goods in the real world, transactions move toward the relational end of the spectrum, where the difficulty of organizing them in markets makes production contracts an increasingly attractive alternative to the parties involved. If, for example, traders are "perfectly rational," as in the competitive model, their ability to project their preferences into the future and to assess the likelihood and present value of all possible outcomes enables them to reduce all the uncertainties of the future to a distribution of probabilities known in the present and to incorporate them in the terms of a single, discrete exchange (Macneil 1978: 862-865). But real people are not so prescient. As they do business, they must constantly account for contingencies whose likelihood or effects cannot be foreseen. Because they do not know exactly what the future holds, they can at best decide now on the *procedures* they will use to fix the terms of exchange under those contingencies they can foresee and resolve other disputes as they arise. To the extent that they do so, they must agree in the present to constraints on their behavior in the future, and commit themselves to a continuing relationship with one another which will almost certainly color subsequent dealings between them. And as the relevant future becomes less certain or more distant from the present, the duration of this relationship and the complexity of its terms become ever greater. The procedures they devise, moreover, may be consensual, in that they require all concerned to concur in whatever decisions are made, or hierarchical, in that they vest in some a limited power of command, as the parties wish. The contract itself determines the political (or moral) quality of the order it creates.

Similar arguments attach to the other conditions of perfect competition, the clear definition and distribution of property rights, for example, or the free availability of information about the price and quality of goods offered for sale. But the questions most central to the choice between organizing production in the market or the firm turn on the postulate of "homogeneity." The heart of the competitive model is the axiom that the essential qualities of a commodity are independent of

the specific identity of the person buying or selling it, for only where goods are homogeneous in this sense is competition by price possible at all. If the price offered by one seller of such a good is too high, say, the buyer always has the option of purchasing an *identical* product from another; it is precisely this property of goods which enables competition to drive prices to the single, "parametric" value which confronts all traders, whoever they might be.

This assumption fails in most manufacturing environments. To the extent that unfinished goods passing between the stages of production are homogeneous, effective competition can indeed take place, and traders will have little reason to forego the flexibility of markets for the security of contracts. Should the need arise, buyers can find alternative sources of supply and sellers direct products intended for one purchaser to others. But the "specificity" of capital assets, the peculiarities of machines and the idiosyncratic knowledge of people, makes them far more valuable in some circumstances than in others; a person who has spent thirty years making tools on an expensive but temperamental machine, for example, is likely to be worth much more in the short run to the owner of the machine, and vice versa, than any of the available substitutes on either side. The time and effort needed to negotiate the terms of trade in such cases, and the opportunities for strategic behavior and exploitation, with all the corrosive acrimony they create, are a potent inducement to combination, and if the holders of such bilateral monopolies must deal with one another on a regular basis, the pressures to replace recurring costs of bargaining with the security of a long-term agreement will be strong indeed (Williamson 1979; 1981). So we can expect the typical manufacturing enterprise to gravitate from market to contract, extending itself both backward and forward in production by offering the free agents who make the raw materials it buys and who purchase the finished goods it produces the chance to participate in the contract themselves. As long as the relationship at the boundary between the enterprise and a still independent trading partner is a recurrent bilateral monopoly, the line separating them is likely to vanish. But at some point, the exchange at the boundary will lose this quality. Toward one end of the chain of production, the firm will find itself in the market for a good, such as oil or raw metal, that is sufficiently homogeneous to support competing suppliers able to sell to a range of buyers; at the other, it will offer a product of its own, like nails or

automobiles, that buyers find sufficiently like those made by others that competition on both sides again becomes possible.

Centralizing forces much like these had produced manufacturing enterprises of considerable size well before 1800. In textiles, for example, the system of "putting-out," in which an entrepreneur bought raw yarn or cloth, delivered it to workers who turned it into finished goods in their homes for piece rates, and then sold the goods, was common. *Verlagswesen* was big business in eighteenth-century Germany, and its methods were imitated by scores of smaller but similarly organized ventures in America, which produced clothing, furniture and household goods by the 1790s. But despite their size, organizing these pre-industrial enterprises posed few problems. The work rarely required costly machinery and was done at home by workers who owned their own tools, so there was no need to tie up capital in expensive equipment or a central workshop. Nor was administration of a precise or detailed production schedule necessary. Even with many workers involved, the distance between raw materials and finished goods could be closed in just a few steps, and with production committed to men and women who combined it with farming or housework, the timing and pace of work, within limits, were necessarily left to them as well (Henderson 1975: 65; Chandler 1977: 53-54).

But large scale production which did presage the nineteenth century was achieved in some German enterprises well before 1800 (Henderson 1975: 25, 56), though the engagement of the state in most of these ventures and the continuing influence of feudal bonds in the others suggest the strains imposed on the production contract as it expands. The rough equality of authority and consensual decisionmaking possible in small groups must yield to more hierarchical forms as the number of workers grows; "democracy" in the small gives way to "centralism" in the large. For if every operating decision requires the concurrence of every participant, the monopoly each has in his or her own consent simply reproduces the opportunities for strategic bargaining that induce the contract itself. With markets no longer mediating the conflicting interests of large numbers of people, command may be the only alternative to chaos. The choice between consensus and command in the firm is thus intimately bound to the question of size. Where a common production schedule governs the labor of just a few people, they may decide that the sense of equality and solidarity fostered by a regime of consensus justifies its costs. But even a small firm will find such an

atmosphere hard to sustain without crippling losses in efficiency, and a steel plant employing five thousand will surely find it impossible. The state as entrepreneur may look to the army or the court as a model for a practical system of authority in an organization of this size, and feudal societies may rely on submissive habits and attitudes to enforce order in large enterprises. But as the mills and factories of the new century replaced the smaller, simpler workshops of the old, and craftsmen who owned the means to their own livelihood became laborers earning their living on the machines of others, Americans found their answer in the modern corporation.

The first tentative American experiments in limited liability began in 1811, when New York permitted free incorporation for some business purposes (Hurst 1970: 134). But partnerships and proprietorships remained the predominant form of business organization well into the nineteenth century, and while the law had always treated both these older forms to some extent as legal entities distinct from their owners, the links between them and their human counterparts nonetheless remained very close. Neither form had a continuous existence of its own; each was dissolved by the departure of an owner or partner. Personal bankruptcy, moreover, constantly threatened every businessman, for every principal assumed full responsibility for the financial obligations of the business. Not surprisingly, the risks of ambition or innovation in such a world made cardinal virtues of parsimony in investment, modesty in scale, and circumspection in the adoption of untried methods and technologies. But with the rapid spread of the limited liability corporation after 1850, a decisive step was taken in the conceptual separation of the business firm from its human constituents. Stockholders owned shares in the corporation, but they no longer *were* the firm in the eyes of courts or creditors. The corporation took on a legal personality of its own; *it* owned the assets of the business, and *it* was liable for any obligations that might be incurred, even if all the shares were owned by a single person. The corporation itself made the necessary contracts with employees, suppliers and customers, appearing in court in its own right as plaintiff or defendant as the need arose, and with this legal personality came a kind of life itself, a continuous existence unaffected by the death or ruin of any shareholder or by the transfer of shares from one person to another.

Growing businesses of all kinds recognized the virtues of corporate ownership and limited liability as a means to the capital they needed.

At first the states constrained the privilege of incorporation by limiting both the capitalization of business corporations and the scope of their powers, but as ever more firms sought the advantages of limited liability, the states hurried to accommodate them. Registration was made simpler, and with land grants, tax concessions and the relaxation of safeguards against fraud as their weapons, the states were soon embroiled in an unseemly competition for the corporations' favor and registration fees. Statutes authorizing limited liability corporations in manufacturing and commerce were common by 1850; after 1875 a general right to incorporate was recognized by every state, and statutory limits on corporate capital were gradually abandoned (*Liggett v. Lee* 1933: 548-64; Hurst 1970: 131-139). Absent an antitrust law specifically attacking size as such, market forces now became the last remaining check on the growth of firms.

As Morton Horwitz (1985) has shown, the nineteenth century saw a parallel shift in attitude toward the corporation in the federal courts. As early as 1819, the Supreme Court had ratified the precedent of common law by conceding both the personality and the immortality of the corporation. But despite its recognition that the "great object of an incorporation is to bestow the character and properties of individuality on a collective and changing body of men," the Court reflected the popular distrust of the corporation by refusing to endow it with the full range of rights enjoyed by real people, treating it instead as "a mere artificial being, invisible and intangible," existing only in contemplation of law. Since incorporation itself was not a right but a privilege granted only by special legislative charter, the artificial entity thus created possessed only those properties and powers the state chose to give it.<sup>2</sup>

By 1900, however, this conception had been replaced by what Horwitz calls the "natural entity" theory, in which the corporation is fully reified, treated as a real and purposeful creature separate in principle from its participants and endowed with economic interests and constitutional rights identical to those of real people. Here was a theory perfectly suited to the nascent collectivism of the age. Influential American intellectuals had by now begun to conceive of society itself as an organism, a concrete, living entity with purposes and interests entirely its own, distinct from and superior to those of its human constituents. They

<sup>2</sup> *Dartmouth College v. Woodward* (1819: 636); *Providence Bank v. Billings and Pittman* (1830: 562); *Bank of Augusta v. Earle* (1839: 587).

wanted not only to understand the scientific laws which governed modern civilization, but to use them as social engineers, designing politically neutral techniques of administration to control complex social processes in the interests of a reified society (Tariello 1982: 53-69; Lustig 1982: 150-194). The natural entity theory, with its similar affinity to the new science of business management, was the mirror of this collectivist politics in the realm of production, and as it rapidly won acceptance in the courts, it played a major role in legitimating big business.

As the nineteenth century's volatile mixture of limited liability and technological breakthrough produced industrial combinations of unprecedented size and power, this reification of the corporation took on increasing significance. The logic of growth demanded the conscious planning and administration of entire domains of economic life, and managers in large firms increasingly assumed the tasks of coordination once performed spontaneously by the market. The necessary administrative talent was supplied at first almost entirely by engineers, men who brought to the construction and management of business organizations the same confident intellectual style they had applied so successfully to the design of bridges and dynamos, and their approach complemented and reinforced the emerging legal ideology of corporate personality. They saw the firm too as a machine, its operation manifesting the purposes of its designer, its parts constrained to move in concert at the command of a single will. The raw materials might be different, but the objective of control was the same (Aitken 1960: 21-28, 35-38; Haber 1964: 2-3, 19-24). If the task of the engineer was to manipulate stone and metal according to the laws of physical science so as to further the interests of men, the task of the manager was to manipulate men according to the laws of social science so as to further the interests of the corporation.

The problem inherent in such a view stems from the very nature of the engineer's task, which, for social as for mechanical or civil engineers, is necessarily purposive, directed toward the achievement of specific ends which the engineer must know before the job of design can be undertaken. But the attempt to ascribe specific interests or purposes to forms of organization as such posed a hard question for the proponents of the new human engineering. Before the emergence of the great corporations, the "interests" of business enterprises were never an issue; partnerships and proprietorships were simply instruments of coordination, legal devices through which easily identifiable individuals pursued



their own interests in the marketplace. But if the managers were to serve the interests of the new corporate person with the emerging techniques of industrial administration, they first had to know what these interests were. In their earliest days, the corporations, like the small businesses upon which they fed, projected the personalities of their creators. It was still possible to identify the interests of the big corporations with the ambitions of the men who built them; what the Carnegie Company "wanted" or "needed" was nothing more or less than what Andrew Carnegie wanted or needed. But the corporations' newly won legal personality ensured that they would survive their creators to be run by anonymous managers committed to the ideal of scientific administration. By 1901 the Carnegie Company had become the United States Steel Corporation, its shares dispersed among thousands of stockholders and effective control of the firm severed from its ownership. With the tangled, personal motives of an Andrew Carnegie no longer at stake, toward what end was that control to be directed? Was there a collective purpose sufficiently compelling to turn independent artisans and tradesmen into reliable employees, to induce them to trade their freedom of action and the autonomy of their interests for the rigorous hierarchical discipline necessary to organize production at the scale required by the new technologies?

The answer, of course, was profits. The more there were, the more could be distributed to owners, managers and workers alike, so it could plausibly be said that larger profits served the interests of all. Less obvious but equally significant was the ease with which profits could be visualized and, with increasingly sophisticated techniques of cost accounting, quantified (Chandler 1977: 464-465). Reducing the myriad ends of the constituents of a complex organization to the maximization of a single number offered a perfect complement to the engineer's metaphor and a natural basis for both a theory of the firm and an applied science of management built on the model of Newtonian mechanics. Theorists would now conflate the peculiarities of human knowledge and experience, the idiosyncrasies of machines and the subtle value of long-term relationships between colleagues, all the qualitative dimensions of working life which give context to the activity of production and largely determine how it is organized, into an abstract "production function" that turned faceless, perfectly substitutable "inputs" into equally homogeneous "outputs" with mathematical precision. Its parts moving in harmony toward an equilibrium in which the unifying objective of

maximum profit is achieved, the firm could become at once the object and the instrument of control, a fictitious personality of concentrated purpose through which the behavior of real men and women could be disciplined. The commanding, lasting influence of this vision in the evolution of modern economic theory is eloquent testimony to its power.

## II. Wealth, Autonomy and the Choice for Bigness

A substantial virtue of the theory of contractual evolution is the plausibility and empirical value of its two central insights, that the costs of exchange in markets which induce the production contract and drive it toward internal hierarchy are themselves opposed by analogous costs associated with organization within the firm, and that the balance of these centripetal and centrifugal forces imposes natural limits on the growth of the enterprise. Some of these costs, as we have seen, arise in consequence of the peculiar qualities of the commodities in question, such as their relative homogeneity in exchange, or characteristics of the environments in which they are traded, the frequent recurrence of similar transactions, for instance, or the available technologies of production and distribution, and the problems they cause seem largely independent of the scale at which a given firm might operate. But others stem from the perceptual and cognitive limitations of managers themselves, their sharply constrained ability to gather and assess the information needed to direct resources by command to their most valuable uses and exercise the control necessary to manage outcomes in complex organizations. "Bounded rationality" is the phrase coined by Herbert Simon (1957: 198) to capture the informational impediments to optimizing behavior imposed by human frailty, and in different ways, both he and Friedrich Hayek (1945) have consistently argued since the 1940s that the difficulties of extracting from those on the periphery the detailed knowledge of particular circumstances necessary for efficient allocation and transmitting it in timely and useful fashion to decision-makers at the center are a strong check on the growth of production contracts. And as Hayek's devastating critique of large scale central planning over the years has made clear (and the collapse of Eastern Europe's socialist economies confirms), the magnitude of these cognitive obstacles to effective monitoring of local conditions and control of individual behavior increases, often rapidly, with the size of the



organization and the scope of its operations, be it a privately held manufacturing firm or the state's central planning apparatus.

This indifference of the effects of bounded rationality and the division of knowledge to the private or public nature of the planning enterprise is the basis of Hayek's approach to the question of how large private firms should be permitted to grow in the market and who, in a free society, should be empowered to say.

The most effective size of the individual firm is as much one of the unknowns to be discovered by the market process as the prices, quantities or qualities of the goods to be produced and sold. There can be no general rule about what is the desirable size since this will depend on ever-changing technological and economic conditions; and there will always be many changes which will give advantages to enterprises of what on past standards will appear to be an excessive size. . . . [Thus] there is as little justification for discrimination by policy against large size as such as there is for assisting it (Hayek 1979: 78).

If, that is, the limits of its knowledge render the state's antitrust division incapable of establishing sound policy on the question of size, then the determination of the most efficient scale of operation for any given production contract must be left instead to those best able to monitor the relevant costs and benefits. Given the existence of competition, when those responsible for such decisions within the firm conclude that further expansion of the contract is unprofitable, they will stop the firm's growth of their own volition. Competition in this sense means simply that firms be able to do what the evolutionary process demands of them, which in turn requires an environment possessed of two critical characteristics. The first, identified by Ludwig von Mises (1920), is that the "islands of conscious power" in fact be surrounded by an "ocean of unconscious co-operation;" unless the firm faces real market prices outside its boundaries, it will have no way of knowing just what the true costs of its alternatives at the margin are, and so be unable to evaluate the relative fitness of the experiments in size and organization it undertakes as it searches for profit. Second, there must be no *legal* barriers to the entry of potential competitors, a situation which clearly may obtain even in an industry currently inhabited by a single firm. "Competition" and "monopoly" may thus co-exist; one need only imagine the fate of a hypothetical monopoly in slide rules before the invention of the hand-held calculator to appreciate the transience of monopoly power where technical innovation is not barred by law.

A substantial merit of this approach, it can be argued, is its commitment to consumer sovereignty. Given competition and a market cleansed of such evils as coercive price discrimination, it relies on the people themselves to decide just how much fairly earned bigness they want and allows the market to adjust the size of firms to those preferences; as we have suggested, absent coercion, hierarchical production contracts will expand only so long as the individuals involved attach greater value to the material benefits to be gained from contractual organization than they do to the moral and developmental advantages of personal liberty and the atmosphere of "human scale" which must be sacrificed for them. But the experience of a century in which the reification of the corporation and the ascription to it of the unitary purpose of profit maximization have been central elements of the economic environment draws attention to the crucial distinctions between living people and legally recognized collective entities as decisionmakers in this process and calls both the efficacy of Hayek's policy on its own terms and the desirability of its outcomes into question. For it may well be that an important cultural effect of the growth of corporate giants has been to alter the values and thus the operational choices of the men and women who work within and around them, creating Americans more willing than those of Tocqueville's day to trade the economic independence and personal responsibility characteristic of small scale organization for the mass production and consumption of material wealth made possible by bigness.

Perhaps the most striking feature of the system of "putting-out" was the responsiveness of its organizational forms to the needs and preferences of the home workers themselves, and in particular the inability of the entrepreneur, whatever his own wishes might have been, either to specify a detailed schedule of production or to impose a particular pace of work on the independent farmers and housewives who performed it. Here, as in most other forms of small enterprise characteristic of the period, effective power to determine day-to-day working conditions and to specify particular tasks was distributed considerably more evenly among the various individuals party to the production contract than was (or is) the case in the industrial corporation, and the absence of hierarchical authority in these early firms almost certainly reflected the values and desires of their participants as much or more than the requirements of the relevant technology or any of the other, more "objective" characteristics of the work environment.

Organizational decisions at the margin were made by men and women for whom utility in the broadest sense, and not the simple maximization of income, was still the objective; the qualitative satisfactions of personal autonomy and control of one's own time, the demands of family and community life, the need for dignity and recognition that individuals in the workplace were more than simply interchangeable parts, each had their place, even if they could not easily be assigned market values.

But with limited liability and the consequent transfer of economic decisionmaking from independent men and women to ever larger "corporate persons," the ability of these individuals to write their own preferences with respect to the quality of their working lives into the production contract was sharply diminished. Now, the agents facing one another across the boundaries of the contract were not individuals driven by complex, often unarticulated motives which could be expressed only imperfectly, if at all, in terms of dollars and cents, but firms, and the interests of firms, represented solely by profits measured in market prices and having little room for the qualitative aspects of economic organization, became the only consideration in the choices between market and contract made by those in command of the corporations. If this dilemma was itself the result of the operational choices made in markets by ordinary men and women in response to the understandably attractive opportunities for employment and consumption offered by the corporations, the intense national debate surrounding the passage of the Sherman Act in 1890 and its interpretation in the courts in the succeeding thirty years surely offered an opportunity for responsive choice at the constitutional level to limit the size of firms by law and thus resolve the dilemma in favor of the traditional virtues of personal autonomy and responsibility. But this was never done, and by 1920, with the people's apparent acceptance of the rule of reason written into the Act by the Supreme Court in 1911 and premised on the acceptability of large scale organization absent a showing of unfair or abusive behavior, ever greater output at ever lower prices had become the yardstick by which the nation's antitrust policy was evaluated as well.<sup>3</sup>

3 *United States v. Standard Oil Co.* (1911), discussed in Letwin (1965: 253-65). Despite his skepticism of the ability of judges to distinguish "good" trusts from "bad" on the basis of their behavior in markets, Hayek favors a kind of rule of reason as well, though his formulation is cast in terms consistent with the Rule of Law and would deny the state's regulators substantial discretion in enforcement. He too accepts the achievement of greater output or lower prices (as opposed to qualitative improvement in economic organization) as the appropriate criterion for policy and would intervene only where firms

Thus was efficiency reduced to the maximization of wealth, the broad spectrum of human values conflated to mere profit and loss on corporate balance sheets.

If the often bitter struggle over the passage and interpretation of the Sherman Act a hundred years ago betrayed a widespread uneasiness with the apparently inexorable advance of large scale organization and made the moral worthiness of this materialist perspective and its consistency with the political values at the core of the American experiment matters of deep, explicit controversy (Letwin 1965), the intervening century has seen a clear resolution of the dilemma posed by bigness, a harmonization of constitutional and operational choice manifested in the commitment to material wealth at the expense of older values which has permeated the political economy of the United States. Thomas McCraw (1981: 8), speaking for the vast majority of professional economists (and those they influence in the broader culture), puts it this way:

Consumer welfare . . . is obviously not the only criterion against which all public policy should be measured. Neither is economic growth. Both of these goals apply chiefly to "economic man" and say little—at least directly—about aesthetic values, ideological preferences, or any number of other legitimate concerns. [But] in economic theory generally, any policy that promotes growth and consumer welfare carries a strong favorable presumption. Conversely, any policy tending to diminish them should, if it is to be justified, bring with it extremely strong offsetting benefits of a noneconomic nature.

In the forty years before his death in 1941, justifying precisely such an alternative, urging his countrymen to purchase the "noneconomic" virtues of small scale economic and political organization at the price of the material wealth which undeniably flowed from bigness, was the task set for himself by Louis Brandeis.<sup>4</sup> First as "the people's attorney" in a variety of causes and then, for twenty-three years after his appointment by Woodrow Wilson in 1916, from his seat on the Supreme Court, Brandeis put his considerable powers of analysis and advocacy in the service of Jefferson's vision of free, self-reliant men and women joined in small institutions which devolved some measure of responsibility

discriminate in the pricing of output, on the ground that such behavior unjustifiably damages the competitive environment. (Hayek 1979: 80-1).

4 On Brandeis' life and thought generally, see Strum (1984) and Adelstein (1989).

upon each of them, nurturing their talents and developing their capacities. "Remember," he wrote informally in 1922, ". . . that always and everywhere the intellectual, moral and spiritual development of those concerned will remain an essential—and the main factor—in real betterment."

This development of the individual is, thus, both a necessary means and the end sought. For our objective is the making of men and women who shall be free—self-respecting members of a democracy—and who shall be worthy of respect. Improvement in material conditions of the worker and ease are the incidents of better conditions—valuable mainly as they may ever increase opportunities for development.

The great developer is responsibility. Hence, no remedy can be hopeful which does not devolve upon the workers participation in, responsibility for, the conduct of business; and their aim should be the eventual assumption of full responsibility. . . .

But democracy in any sphere is a serious undertaking. . . . It demands continuous sacrifice by the individual and more exigent obedience to the moral law than any other form of government. Success in any democratic undertaking must proceed from the individual. It is possible only where the process of perfecting the individual is pursued (Brandeis 1978: 45–46).

Would the Americans Tocqueville admired succumb to the alluring but perilous bargain of material wealth for industrial hierarchy now offered by bigness? Or could they find a way to enjoy the fruits of industrialism without becoming, as Brandeis put it, "a nation of slaves," cogs in a mass production machine driven by remote managers toward profit and growth? If there was such a way, he believed, it lay in small, locally administered economic and political institutions which preserved the crucial links between liberty, democracy and responsibility forged in a simpler time. Just as increasing scale in politics reduced active citizens to mere voters, the exchange of economic autonomy for the illusion of security produced men "dependent for mere subsistence upon somebody and something else than [their] own exertion and conduct" (Brandeis 1925: 58–59). "I have considered and do consider," he said in 1911, "that the proposition that mere bigness can not be an offense against society is false, because I believe that our society, which rests upon democracy, can not endure under such conditions" (McCraw 1984: 109).

Brandeis made the reasons for this pessimism clear in his impassioned dissent in *Liggett v. Lee* (1933), decided in the depths of the Great Depression. The Florida legislature, responding to the rapid spread of

chain stores in the state, had passed a complex licensing system for retail establishments whose effect was to impose a heavier fee on chain outlets than on independent retailers. The chains argued that the scheme denied them equal protection, and the Court considered the claim on well settled principles. It upheld the gradation of fees according to the number of stores under common ownership, but struck down the provision penalizing operation in more than one county as arbitrary and unreasonable. Brandeis would have upheld the entire statute. The precedent cited by the Court concerned rights of real people rather than mere privileges the states might choose to grant to corporations and so while analogous discrimination in the taxation of individuals might indeed be unconstitutional, the statute was "valid as applied to corporations," (*Liggett v. Lee* 1933: 543–544). "Its chief aim," he said pointedly, "is to protect the individual, independently-owned, retail stores from the competition of chain stores. . . . by subjecting the latter to financial handicaps which may conceivably compel their withdrawal from the state" (*Ibid.*: 541). But the legislature's purpose may have been "broader and deeper" than this.

They may have believed that the chain store, by furthering the concentration of wealth and of power and by promoting absentee ownership, is thwarting American ideals; that it is making impossible equality of opportunity; that it is converting independent tradesmen into clerks; and that it is sapping the resources, the vigor and the hope of the smaller cities and towns (*Ibid.*: 569).

If so, Brandeis argued, Florida was acting within a long and honorable tradition of state regulation designed to limit the privilege of incorporation. For despite the form's utility, "incorporation for business was commonly denied long after it had been freely granted for religious, educational, and charitable purposes."

It was denied because of fear. Fear of encroachment upon the liberties and opportunities of the individual. Fear of the subjection of labor to capital. Fear of monopoly. Fear that the absorption of capital by corporations, and their perpetual life, might bring evils similar to those which attended mortmain. There was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations. So at first the corporate privilege was granted sparingly . . . (*Ibid.*: 548–549).

But in weakening their control, the states had allowed this "Frankenstein monster" to grow so large, to exercise such control over the lives of men, and to concentrate such wealth and power in the hands of a

few, that first a feudal plutocracy in the last century and now a terrible depression caused by the maldistribution of income had been the result. Perhaps, he seemed to say, that crisis itself would at last bring the states back to their senses and the nation back to the liberal principles of its youth.

There is a widespread belief that . . . by the control which the few have exerted through giant corporations individual initiative and effort are being paralyzed, creative power impaired and human happiness lessened; that the true prosperity of our past came not from big business, but through the courage, the energy, and the resourcefulness of small men; that only by releasing from corporate control the faculties of the unknown many, only by reopening to them the opportunities for leadership, can confidence in our future be restored and the existing misery be overcome; and that only through participation by the many in the responsibilities and determinations of business can Americans secure the moral and intellectual development which is essential to the maintenance of liberty. If the citizens of Florida share that belief, I know of nothing in the Federal Constitution which precludes the state from endeavoring to give it effect . . . (*Ibid.*: 580).

For Brandeis, then, the "curse of bigness" was the threat it posed to the development of the individual and the ideal of democracy. He would not have hesitated to use the full powers of government to fight it, indirectly by taxation as in *Liggett* or more forthrightly by setting statutory limits on the size or capitalization of corporations as the states themselves had once done, strategies which might easily have been pursued within the Rule of Law and which would, with open eyes, have reversed the trend toward bigness and shunned its material rewards in favor of the moral and developmental advantages of individual empowerment and small scale. Still, for all the ideological and practical subsumption of individual choice in the prerogatives of corporate collectives, free men and women are never mere spectators of an autonomous evolutionary drama which forces large scale organization upon them against their will. It remains always within their power, in their roles as both workers and consumers on the one hand and citizens on the other, to choose otherwise and manifest their preferences either operationally through the market values which alone are intelligible to firms or constitutionally through statutory limits on corporate growth of the kind envisioned by Brandeis. But if they have not, and the market has in fact accurately registered the people's preferences with respect to

scale by giving them the bigness they want, pursuing the Brandeisian ideal requires the state to act explicitly against the will of its citizens.

Brandeis himself seemed to recognize this. "The statement that size is not a crime is entirely correct . . . from the point of motive. But size may become such a danger in its results to the community that the community may have to set limits" (Brandeis 1934: 80). But who is "the community," if not the same little people who had traded their birthright of economic liberty and responsibility for the "mess of pottage" (Brandeis 1925: 261) offered by bigness, and how are they to express themselves with regard to size, if not in markets or popular legislation? Brandeis' answer, that despite the obvious potential for error and corruption, legislatures must sometimes overrule the people on this question and push them toward their own best interest in spite of themselves, betrays a frustrated, even despairing distrust of the little people he claimed to represent. Reflecting on his differences with Wilson as they battled the trusts together, he said, "In my opinion the real curse was bigness rather than monopoly. Mr. Wilson (and others wise politically) made the attack on lines of monopoly—because Americans hated monopoly and loved bigness" (Brandeis 1978: 482). Their unthinkable swap of personal autonomy for mass production had turned responsible, self-reliant Americans into "consumers," whom he contemptuously described to George Soule as "servile, self-indulgent, indolent, ignorant" (Brandeis 1978: 92). "It's clear, I think," he told Felix Frankfurter in 1925, "that the gentle enslavement of our people is proceeding apace . . . and that the only remedy is via the individual. To make him care to be a free man and willing to pay the price" (Brandeis 1978: 1931). But the people seemed to want the material bounty of corporate bigness more than the elevating rigors of economic liberty, and a short time later, he captured the essence of the matter as he made his anger plain:

Isn't there among your economists some one who could make clear to the country that the greatest social-economic troubles arise from the fact [that] the consumer has failed absolutely to perform his function? He lies not only supine, but paralyzed and deserves to suffer like others who take their lickings "lying down." He gets no worse than his just deserts (Brandeis 1978: 207).

Charles E. Lindblom (1977: 95) has described the displacement in virtually all fields of production of the small, often family-centered firms

of nineteenth century America by the huge corporate enterprises of our own time as a kind of silent revolution:

Never much agitated, never even much resisted, a revolution for which no flags were raised, it transformed our lives during those very decades in which, unmindful of what was happening, Americans and Europeans debated instead such issues as socialism, populism, free silver, clericalism, chartism, and colonialism. It now stands as a monument to the discrepancy between what men think they are designing and the world they are in fact building.

But if this were ever true of Europe, the tortuous history of the antitrust movement in the United States and the fruitless, frustrated struggles of those, like Louis Brandeis, for whom opportunity and self-reliance were still the animating ideals of the American experiment make clear that the decision for bigness in this country was made by a people fully aware of the choices before them, choices at both the operational level of markets and the constitutional level of antitrust policy. The world in which we live has not been forced upon us, nor has it overtaken us in silence or stealth. For good or ill, unwilling to sacrifice our material interests in consumption and employment for the older virtues of individual autonomy and personal responsibility, we and our predecessors in this century have chosen to create it.

For all the austerity it would demand and all the illusions of omniscience and control it would force us to relinquish, there is much in the economics of decentralization and dispersal of power to attract us today, all the more so when it is extended, as Brandeis did, to politics and becomes a coherent political economy with free men and women at its center. But in the compass of his own lifetime, and to his deep disappointment, the people chose a different way. If his calculation of the little people's interest and its relation to bigness ultimately contradicted the desire for material comfort expressed by the people themselves, it was nonetheless a perfect complement to his own commitment to the moral advantages of smallness and the increasing material asceticism of his later life. In *Liggett* he had shown how great a price the pursuit of productive efficiency would exact from a free people, a price acknowledged by Hayek as well.<sup>5</sup> But as his increasingly lonely struggle

<sup>5</sup> "...the danger arising from the fact that constantly increasing numbers of the population work in ever larger corporations, and as a result are familiar with the organizational type of order but strangers to the workings of the market which co-ordinates the activities of the several corporations" (Hayek 1979: 79).

to preserve the liberal values of an earlier time against the organizational pressures of the industrial age made clear, Brandeis, unlike Hayek, was unwilling to pay it.

What would he say if he could see us now?

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