Episode 639: Andrew Carnegie: Robber Baron or Hero of Capitalism?

Guest: Samuel Bostaph

WOODS: It's been quite a while since I've seen or spoken to you, and then this book of yours I just told people about on Andrew Carnegie came out, and as I was looking through it I noted that I forgot I was actually on the advisory board for the book series this is a part of. Well, they didn't ask my advice, as it turns out, but if they had I would have told them to go ahead and publish this. I really like it. What made you think to choose Andrew Carnegie in particular as somebody to take a closer look at?

BOSTAPH: Well, it's one of serendipity things. A few years ago in the summer I was working on another paper, and my phone range, and it was an acquisitions editor for a west coast publishing house. And he didn't really explain why he called me. I might have been the 100th person he called. But he had a project in mind, and that was that he would like for his press to publish a series of books about prominent figures in business. Well, we talked about that for a while, because he was looking at contemporary figures, people like Bill Gates or some fashion designer, and I said I really wasn't too interested in doing anybody who was still living, because who knows what I might say and what their lawyers might say.

So we went back and talked about several other figures, and Andrew Carnegie's name came up, because he was such a famous industrialist of the 19th century. So we decided that Carnegie would be the one and that I would write a proposal, which I did. I read the main recent books on Carnegie's life, the one by Joseph Wall that was published in 1970 and one by David Nasaw that was published in 2006. And what I noticed about both of those books was that they didn't seem to have much of an understanding of basic economic principles, and so I thought that perhaps a book written about Carnegie or any figure in business by an economist who actually knows something about why people are successful in business might be different from what had been out before, and indeed, I found that to be the case since then.

But I wrote the proposal and submitted the proposal a couple of months later, and he went to his editorial committee, and they said, no, we don't like this whole idea very much. So it sat there for a while, and I thought, you know, there are other publishers in this world, and perhaps another publisher might be interested. And I chatted with Ed Younkin at Wheeling Jesuit —

WOODS: Yeah, there you go.

BOSTAPH: — and he said, hey, why don't you send it to Lexington, they might be interested. So I did that, and they immediately said, hey, we like this idea, and sent me a contract. And so I thought, oh God, I'm trapped, now I have to write the book.

WOODS: Yeah.

BOSTAPH: So that's what I did. In my spare time over the next couple of years I wrote it. I thought it would take a year; it turned out it took two years of spare time, and submitted it to them last summer, and they published it in October.

I think one of the reasons it took me so much time to actually write the book was that, since I was writing as an economist about a figure in business, I needed to know something about the businesses that they were in, so I learned a great deal about the steel-making process and the steel industry and the railroad industry and especially the Pennsylvania railroad and the telegraph industry and the bridge-building industry and the skyscraper industry and coal. And this took quite a while of reading, but it was fascinating stuff. I'd never done that much in depth research into historical topics before. So that's how it came to be.

WOODS: Now, there's a lot in the book, there's a lot of material on Carnegie as a young man, as a very, very young man and then as a young man. And I think like most people, I want to focus on what he did in the steel industry as an adult, but I am curious, if you had to summarize, what are some of the things that he learned and how did he learn them as he was a young man that would serve him well in the future?

BOSTAPH: Well, one thing he always had was initiative, and that's one of the reasons why I did spend so much time on his childhood years, was because he exhibited a great deal of initiative from the very, five or six years old stage. And he was in a very poverty-stricken situation in Scotland, Dunfermline, Scotland, and so I was curious as to how his personality had formed. And as I watched him develop, I discovered he was highly intelligent, he had a tremendous amount of initiative. He was in an Israel Kirznerian sense always alert to opportunities, and he took them. He was a very hard worker, and he early on realized that it would be very helpful to him to have mentors,

And that's one of the reasons why he ended up as a 17-year-old telegraph operator working for Thomas Scott, who superintended the western division of the Pennsylvania Railroad. And it was that association with Scott that really put him on the road to success, in that he learned a great deal about railroads, but he also learned about other things that the railroads needed, and that's where he developed his idea of ventures into the iron industry and later iron and steel and bridge building. And the experience with bridge building was a natural translation into building the super structures for skyscrapers when the Chicago School of Architecture began to build those buildings in Chicago.

So how did he get to the jumping off point, because by the time he was 30 years old, he was a very wealthy individual. And why did he keep doing it? Why did he keep striving to build? And that's another thing about his career that's fascinating, is that at a certain point when you get into the 1870s and early 1880s, he starts spending five or six months of the year in Scotland, renting castles and traveling around. And yet, he's able to continue managing the businesses, the various businesses that he had as an owner, manager, and partner.

Also I was curious about his business philosophy and how it developed. He early on discovered that if you wanted to keep your secrets to yourself in how you were building your business, the thing that you needed to do was to have partners and closely held partnerships, so that the information that the firm had would not go out to the outside world, would not go out to competitors, most importantly. And yet he enjoyed paying spies to gather information on his competitors' costs and prices and business practices and manufacturing practices, as well as buying stock in their public corporations so that he could get their annual repots and the other information they communicated with their stockholders, an advantage that they did not have over him.

WOODS: I want to distinguish between the qualities in Andrew Carnegie that we ought to find admirable and maybe some practices of his that were not so admirable and try and sort it all out. There's usually very little nuance in coverage of people like him in a typical — I remember my own junior high textbook just portrayed all these 19th century figures and entrepreneurs as just impossibly wicked people. So let's start with the bad. He did support steel tariffs at one time.

BOSTAPH: Oh, yes, throughout his career he publicly talked about how tariffs could be reduced, but he was very careful that in his lobbying and in the bribing that he did of members of U.S. Congress to maintain the tariffs, he was careful that they didn't decrease the tariffs to the point that it created competition for him from foreign producers, so the result was that there were practically no British steel rails imported into the United States in the last three decades of the 19th century, as a result of those tariffs. Now, he did not initiate the tariffs. The early government of the United States after the Constitution was ratified instituted the tariff as a revenue raising means, as well as setting prohibitive tariffs on products they wanted to see developed domestically, and in particular the iron industry.

And the result was those tariffs stayed around and have stayed around on the importation of iron and steel products not up to the present day. Their argument for it was what we call the infant industry argument, which argued that in certain highly capitalistic endeavors that domestic firms really have no chance against foreign competition because foreign industries are more mature and have lower cost, and so what you have to do is impose a prohibitive tariff or simply block importation, import controls, in order to get the domestic industry, which is in the beginning at higher cost, a good start. So it's a baby industry, and then it's supposed to grow up, and when it gets mature it will have the same or lower cost than foreign firms and be able to compete and you don't need the tariffs anymore, and unfortunately once the tariff gets established, the industry has a vested interest in it and it wants to stay an infant the rest of its life.

WOODS: Yeah, so here we have a 200-year-old infant.

BOSTAPH: (laughing) Yeah, yeah.

WOODS: All right, so he favored the tariffs, and yet on the other hand, in spite of all that, if you look at the price of steel rails — now, granted all prices are falling in the late 19th century. But steel rails are falling, prices are falling much faster in the last quarter of the 19th century, so he still nevertheless wasn't able to just rest on his laurels.

BOSTAPH: No, he was also a fierce competitor, and steel rails were falling in price, not as fast as British steel rails were falling in price, but they were falling in price domestically. And his business philosophy of high-retained earnings, which were then used for increased capital investment and to create lower cost kicked in to make him very competitive domestically. By the time he sold Carnegie Company to J.P. Morgan to form U.S. Steel, the profits of Carnegie Company were almost the same — net profits — as all the other steel companies in the United States combined.

WOODS: Now, that of course raises question about concentration, in terms of monopoly theory and anti-trust and so on. So what, as an economist looking at this historical case, what do you say about that?

BOSTAPH: Well, Carnegie was a very wily guy, and so he freely entered into pooling agreements with other steel companies where they would act like monopoly, they would calculate their profit maximizing price and output, and then divide up production among the various companies and charge the same price. But there's always an incentive in those sorts of cartel-like activities for cheating and for breaking away from the pack when it suited you, and that's what Carnegie tended to do. When the recession of 1873 came along and other steel companies were hurting, Carnegie, who had so much money available for expansion, was expanding and pushing down the cost of steel even more and breaking away from his competitors in the prices he charged in order to continue taking the market away from him. And then he would participate in pooling agreements later on, which he would then break when it suited him. So he was — I don't know — unscrupulous, even when he was engaged in anti-competitive behavior with his competitors.

WOODS: What does an Austrian have to say about pooling agreements?

BOSTAPH: Well, they tend to break down. They tend to break down, because firms will cheat on each other, unless they can get the government to enforce the pooling agreement. There's always a chance of new firms coming in, and indeed, new steel firms that weren't part of the Bessemer Steel Association did come into existence and were able to survive despite their opposition until Carnegie bought them. So the agreements tend to break down. Also, if you're charging a high price for your product, besides an invitation to competition from new firms, it's an invitation for other people to come up with good substitutes for your product. So I'm sure that Carnegie's efforts and the efforts of other members of the Bessemer Steel Association to cheat the price of steel up was of great help to the aluminum industry and the industries for other metals that could be substituted in certain uses for steel.

WOODS: But yet, again, it looks like the overwhelming pressure with regard to steel prices is in a downward direction, and if you were to read a typical textbook treatment of what we ought to expect to happen when you have somebody like Carnegie, who was completely dominant — I don't know what percentage share he had, but it was absolutely overwhelming — we should expect the opposite. We should expect him to raise his prices dramatically because he's the dominant competitor and no one can touch him. But this is not what actually happened.

BOSTAPH: No, it's not. He was a strange combination of extortionist and entrepreneur. He didn't mind taking advantage at all of the tariffs in order to keep the price of steel higher than it would otherwise be, and therefore his profits higher than they would otherwise be, but at the same time the guy was relentless in introducing innovation in the method of making steel. He always had the latest equipment. Charles Schwab, who was eventually the first president of U.S. Steel said that Carnegie told him he wanted to build a steel plant — I've forgotten which one — and to build it as cheaply as possible. And so Schwab did that, and at one point he went to Carnegie and he said, you know, if we had built this a different way, and I can think of a better way to do it, it would have saved us about twice what we have been saved by building it the way we're currently building it. And Carnegie said, and you mean to tell me that you could rebuild this thing and it would be even more profitable, and Schwab said that's correct, and Carnegie said, tear it down and build it up again.

WOODS: Whoa.

BOSTAPH: Yeah.

WOODS: Okay. Talk for a minute, you have a whole chapter, I think, if I'm remembering this right, just on his philanthropy.

BOSTAPH: Oh yeah.

WOODS: How do you devote a whole chapter to his philanthropy? There's that much of it?

BOSTAPH: Oh, $350 million worth in 1900 dollars, and that's a chunk. We're talking about a period when the average unskilled laborer made $1 a day, and he was giving away and eventually did give away $350 million, which an historian friend of mine uses the rule of 30 to take a 1900 price. He says if you multiply that price by 30 you'll get close to the modern day equivalent, so if you multiply $350 million by 30, you get quite a few billion dollars. So I was interested in his philanthropy. First I wanted to know why he did it, and frankly, nobody really knows why he did it.

WOODS: Oh, that's the answer? Nobody really knows?

BOSTAPH: Nobody really knows why he did it; we just know that he did it. And the interesting thing is that he started early. He started when he was barely 30 years old by giving away a bath to his hometown, a bathing facility to his hometown. And then in 1881 he gave them a library. But he wrote a memo to himself when he was living in a hotel in 1868, in which he told himself that — and he kept focusing early on making money. He said it was bound to corrupt his soul. And so what his life plan was, since his income at that time was about $56,000 a year — that's a lot of money in 1868 — he told himself that he was going to retire from active business, live in $50,000, go to Oxford University, and become a public policy person and devote the rest of his life to making the world better. And he was going to give away the rest of his income in philanthropic endeavors. Well, that memo was found in his desk after he was dead in 1919, so nobody knew about it, and he didn't follow it, as we know. He devoted the rest of his active business life after 1868 to making money.

But he started giving it away, and after he — when he got married his wife signed a prenuptial agreement that entitled her to a permanent income, but she would have no claim on the rest of his estate, because his plan was to give it away, and she signed it and agreed with it. And he then after he sold his company to J.P. Morgan, he set out to do it. And he published what's now called *The Gospel of Wealth* in the 1880s, in which he argued that wealthy people have an obligation to help their fellow man become better and they should give their money away in such a way that it helps others to help themselves. And that's what he saw had happened to him. He had been helped by others, and he had helped himself unto his vast riches. So he wanted to hand out to other people, and that's why he did his — why we can find his philanthropy in things like libraries, medical schools, medical research, recreational facilities, museums, art museums, public parks, and so on, because he thought that this would give other people an opportunity that they otherwise wouldn't have to make something of themselves.

One last thought on Carnegie's philanthropy, and is that is that when he died, he had, of his fortune, which at one time was close to half a billion dollars, he had about 30 million left, and he gave 10 of that away also in his will. So basically he took a vast fortune and managed to whittle it down to where there was only 20 million left for his family.

WOODS: That is pretty much what the textbook authors will concede about him. You know, he gave away — they'll say that about the others. Not so much Cornelius Vanderbilt. He didn't — I think he gave away $1 million to start the university. But basically they'll concede the philanthropy, but they won't concede the work that the person did in the private sector.

I want to ask you about maybe the biggest black mark on Carnegie's record and memory, and that is the handling of the Homestead strike. Now, you describe this early on in your book; you describe your treatment of this question as being neither exoneration nor censure, and I think you do more or less manage that. My own view is that I think the traditional version of the story is extremely misleading, and I think the

Frick and Carnegie version of things is not totally unreasonable. Can you share your perspective on this for us?

BOSTAPH: Certainly. I really didn't know much about the Homestead lockout and strike when I started researching it, and I was frankly surprised at what I found. Most historians tend to take the side of labor in these early labor disputes and knew the workers as having been in some sense in the right against management in their attempt to better their conditions. Well, that's not what I found in the case of Homestead. For one thing, even before the lockout and strike, Carnegie's skilled laborers were making 50% higher wages than were being paid by Carnegie's competitors. And the unskilled or semi-skilled workers were also being paid above market wages, so as far as their economic situation was, compared to their contemporaries they were in a better place.

But they had the 19th century workers' view of where corporations' profits come from. They basically believed and said that their profits are created for the businesses by the workers, who are the source of the value that the businesses are able to monitor. And so the workers in effect are being short changed. The crudest version of this is Karl Marx's idea of labor exploitation, that laborers are paid subsistence, and the Mr. Moneybags, the owners and capitalists, skim off all the rest. So despite the fact they weren't underpaid, they still considered themselves underpaid compared to what they should have been. And they also had a view that they built the factories, that these jobs were created by their hard work, and that they were entitled to keep those jobs and that they were entitled to good incomes and comfortable circumstances and so on.

And so Carnegie and Frick decided, because they were having a lot of problems with the union at Homestead interfering in managerial decisions, decided that they were going to break the union and lower the wages, not all the way to market, but lower them, because, after all, the source of the higher productivity that workers were being paid more for came from the capital investment that the firm was making. And of course Carnegie and Frick knew things to the opposite direction from the workers. As far as they were concerned, they generated the business that made it possible for those workers to have jobs, so the workers should be grateful to them for that fact. And they then went in to the bargaining situation with the labor union in the spring of 1892 with the attitude that they were going to make contracts with the individual workers if the union did not meet their terms, and they didn't expect the union to meet their terms. They expected the union to resist, and they expected to break the union.

And indeed, that's what happened, but the kicker in this situation is that, although Carnegie and Frick agreed at the outset what they were going to do, it was Frick, because Carnegie was away in Scotland for the summer, it was Frick who was the man on the scene and who was going to have to handle the negotiations first with the union, and then when that broke down, with the individual workers. And it was Frick who had to prepare for what he was expecting, which was violence. He had had several incidents of workers in his coal fields striking and engaging in mob violence in the 1880s, and this particular union at Homestead had shut down the plant and the town on two previous occasions, in 1882 and 1889. And Frick expected them to do the same thing, and indeed, that's what happened.

Once he closed the mill, the workers took over the town, formed a governing committee of about 35 or 36 people and proceeded to occupy the town. Meanwhile, Frick had hired 300 Pinkertons to come guard the plant, and when the Pinkertons arrived on the scene on the morning of July the 6th, the workers attacked them. They started shooting at them, and a full-scale battle broke out. So the Pinkertons ended up marooned in two barges that were tied up to the company's wharf, which was on its private property, which the workers had broken in to, and the mob that gathered around on the shore then proceeded to try to murder all of the Pinkertons by some outrageous means: throwing dynamite at them, shooting at them with cannons, pouring oil on the water and lighting it —

WOODS: Yeah, yeah, I mean, they opened fire — I mean, the Pinkertons returned fire, but they had been attacked first. But tell people, not everybody's going to know who the Pinkertons are.

BOSTAPH: The Pinkerton Agency was a detective and security guard agency that many businesses used to guard their plants when there were worker shutdowns or mob violence, and they also hired them and used them as spies to keep track of the labor unions or to find out whether or not the men that were working at the plants were trying to form a labor union.

WOODS: And also there was the point — well, a couple things. They were being used because the local sheriff was often either unable or unwilling to protect private property. This had happened in 1889 with another strike at the Homestead plant. But then the other thing is there were 3,800 skilled workers but only 800 of them had failed to come to an agreement with the company. That was the Amalgamated Iron and Steel Association. But then when those people struck, all the others struck with them, and the question arose, was that a spontaneous display of labor solidarity or was that because they had been intimidated into doing it. So there are legitimate reasons that you might want the Pinkertons, frankly, to engage in spying to find out are people being intimidated into acting in ways not compatible with their welfare.

BOSTAPH: I tend to agree with you on that point. And it was even worse after the union leader came to Homestead and talked the mob into making a truce with the Pinkertons, because then they formed a line of several hundred yards of workers on either side of the road that led up from the shore, and as the 300 went between the workers' line, they were beaten, robbed, arms broken, eyes gouged, their clothes pulled off. And 150 or so of them ended up in the hospital as a result of the violence of that mob of thousands of workers. So it just, the whole scene got out of control, and the deep-seated anger that must have been on the side of the workers, particularly unskilled workers that lived in terrible conditions in the worst parts of town with no running water or toilet facilities, it must have been very deep.

And yet, you have to take the perspective that, well, yeah, that was the situation. At that date, working conditions were pretty miserable everywhere, and yet they were better off than their peers over at the competitors. But we can take that perspective. At the time, of course, they don't. I know from working within companies myself earlier in my career, before I got into academic life, that the employees always look on management as someone that doesn't have their welfare particularly in mind, unless you have an outstanding owner or manager for a firm.

WOODS: I'm also thinking about the fact that it wasn't just the Pinkertons of course who were the victims here. There were non-union workers who were attacked in various ways. But it did eventually wind down by the end of 1892, and the plant was basically victorious and got what it wanted, and the workers entered into their individual contracts with the company, and that was the end of it. Now, you, looking at this as both, frankly, historian and economist, how would you then, after studying this to a great degree, writing a whole book on Andrew Carnegie, how do you balance it? I mean, the good and the bad, what's your overall appraisal of the man?

BOSTAPH: Well, I have to say that because he and his company and his workers and all of his partners benefited from the tariff situation, that there was a tremendous distortion of resource allocation during this period away from other industries and into the steel industry and iron industry. And at the same time, within that context, Carnegie was tremendously successful. He did produce a quality product. He did make markets work better, increase coordination in the market. That is, those who needed iron and steel products got them, and apparently at prices that made it possible for them to do what they were going to do. So it's a real mixture. As I said at the beginning of our conversation, he was a mixture of extortion artist and entrepreneur, and very successful at both, as a matter of fact.

So on balance, we have absolutely no idea how the U.S. economy would have developed without Andrew Carnegie and without those jobs. When you read most histories of that period, at least that I've read, it always makes it sound like a big success story for the U.S. economy that it grew the way it grew and that the industries, the iron and steel industry and other large industries eventually made the U.S. economy the dominant economy in the world by the end of the First World War. But at the same time, because of the misallocation of resources, as an economist you know that this slowed down the growth rate of the economy and made it develop in ways that it would not have developed otherwise. And consequently, it seems like a lost opportunity to see what would really happen to a free market economy, a reasonably free market economy if it didn't have the degree of intervention that was practiced by the government in maintaining the tariffs and the crony capitalist relations that existed between the firms of that time and various governmental units.

I remember having a conversation once with Jonathan Hughes, an economic historian, and one of whose books is *The Vital Few*. And in that book he devotes a chapter to Carnegie. And we were chatting at a conference years ago, and he said, you know, most people look back at the 19th century, and they use this term laissez-faire to describe the U.S economy. But it wasn't like that. There was tremendous government intervention, and especially at the local level there was a tremendous amount of intervention. So how would a free market economy that was truly a free market economy have developed and how much faster and what would have been the outcome at the beginning of the 20th century absent all of that intervention? The imagination runs wild. There's just no way to know what would happen.

Carnegie could have become a wealthy individual simply as an importer of steel and iron products, using them in construction, rather than barreling the industry that produced those products. But who knows? I think he would have been successful whatever endeavor he went into. He was certainly successful as a boy. In his first job, which he started when he was 13 years old making $1.20 a week, within a year he was making $2 a week, and then he was making $4 a week. And within four or five years of his starting work, by moving from bobbin boy to errand boy, message boy for a telegraph company to telegraph operator to personal assistant for Thomas Scott, he had moved all the way up to $35 a week within five years, and considering that the price level throughout the 19th century was basically stable, so that by the beginning of the end of that century the price level actually went down to somewhere, estimates give between 2 and 5%, that was a tremendous increase in his income, form $1.20 a week to $35 a month in five years.

WOODS: Well, the book is *Andrew Carnegie: An Economic Biography*, by Samuel Bostaph. In a way I guess you kind of wish you could have a less ambiguous conclusion. You could just say, this is a great guy or this is a villain. But I think that's part of the fate that we have as good historians and good economists, that we have to take the good with the bad and we have to be nuanced and see what we find. But I think the book does help us understand Carnegie a lot better and all the economic questions that are raised by a figure like Carnegie. And I also think that your discussion of the Homestead strike is extremely important, because it's such an important corrective to the standard received view of all this. This is why I think that, whether you think of it this way or not, I think it's a really important revisionist study, in the best sense of that term, about Andrew Carnegie. Now, if you feel like I've misstated what you've accomplished, feel free to say so. Otherwise, just accept it as the compliment that I intend it as.

BOSTAPH: I do appreciate the compliment, and I just want to say that, in closing, that what I did in this book, or what I do, I should say, in this book, is to view Andrew Carnegie as an economic actor, one who is alert to profit opportunities and is successful in dealing with uncertainty. Most of the innovations that he made were in fact successful, although a couple of them were not. And he had both positive and negative effects on the general economy. So as we look at him, we look at a successful entrepreneur who was a mixture of qualities that we admire, as well as qualities that we don't admire. And he could be mendacious. He could be vindictive. He didn't mind using bribery, whether it was congressmen or a spy in some other person's firm. And he took advantage of his partners on several occasions. So being around him must have been both enervating and challenging for those who survived as partners and prospered as he did. I suppose that's [inaudible]. I wanted to tell why was Carnegie successful. You read a lot of biographies of people, and they talk about what they did, but they don't explain to you why what they did worked.

WOODS: Yeah, good question.

BOSTAPH: And that's what I tried to do with Carnegie. I was not interested in Carnegie as the industrial leader and looking at him leading industrially, but I was interested in why was Carnegie the successful industrial leader. What were the clues to his success? And two things stand out: one, he was a relentless cost cutter, and two, he was a relentless investor in his own firms with his retained earnings. And those two methods worked for him and would have worked for anyone else if they were assiduous enough about it.

WOODS: Well, I guess like most libertarians I'm fascinated by entrepreneurs, dead or alive, and entrepreneurship, which of course is actually one of the key distinguishing features of the Austrian school from other schools. And again, you've done an outstanding job in bringing out Carnegie the entrepreneur. But of course he was also a political entrepreneur, you know, in certain ways. But it's a great study, and I hope people will check it out. Thanks again, Sam.

BOSTAPH: Thank you very much, Tom. I appreciate speaking with you.