From social control to financial economics: the linked ecologies of economics and business in twentieth century America

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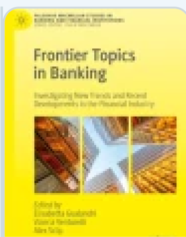
Abstract

This article draws on historical material to examine the co-evolution of economic science and business education over the course of the twentieth century, showing that fields evolve not only through internal struggles but also through struggles taking place in adjacent fields. More specifically, we argue that the scientific strategies of business schools played an essential—if largely invisible and poorly understood—role in major transformations in the organization and substantive direction of social-scientific knowledge, and specifically economic knowledge, in twentieth century America. We use the Wharton School as an illustration of the earliest trends and dilemmas (ca. 1900–1930), when business schools found themselves caught between their business connections and their striving for moral legitimacy in higher education. Next, we look at the creation of the Carnegie Tech

Graduate School of Industrial Administration after World War II. This episode illustrates the increasingly successful claims of social scientists, backed by philanthropic foundations, on business education and the growing appeal of “scientific” approaches to decision-making and management. Finally, we argue that the rise of the Graduate School of Business at the University of Chicago from the 1960s onwards (and its closely related cousin at the University of Rochester) marks the decisive ascendancy of economics, and particularly financial economics, in business education over the other behavioral disciplines. We document the key role of these institutions in diffusing “Chicago-style” economic approaches—offering support for deregulatory policies and popularizing narrowly financial understandings of the firm—that sociologists have described as characteristic of the modern neo liberal regime.



Notes

1. But see Abbott's discussion of the difference between his concept of ecology and Bourdieu's concept of field at http://home.uchicago.edu/~aabbott/Papers/BOURD.pdf (accessed July 1, 2010).

2. Note that what is true of economics is also true of sociology and psychology. Witness, for instance, the development of network analysis, largely a by-product of the migration of sociology into schools of business.

3. For instance, when the Harvard Business School was founded in 1908, the medical school had been around since 1782, the law school since 1817, and the divinity school since 1819.

4. The term "behavioral sciences" was explicitly employed by the Ford Foundation against the older notion of "social sciences," which was deemed too political (Macdonald 1956).

5. Note that many studies have documented the growth of MBAs in American corporations. Mayo et al. (2007) show a significant increase in the education level of American business executives during the 20th century, with the MBA growing fastest among advanced degrees. Additionally, Zorn (2004) has shown that even beneath the CEO level, CFOs have become an important part of the senior executive team and that their backgrounds and training are less likely

to come from accounting and more likely resemble the strategic finance and financial engineering taught in MBA programs.

6. The most conspicuous omission in this panorama is, of course, Harvard Business School, which we have excluded for substantive reasons that will become clearer in the remainder of the article. The fact is that in spite of its pioneering role in establishing business education in the United States, Harvard's trajectory in this domain remained quite disconnected from evolutions at other major schools. Harvard's relative autonomy is attributable largely to its size, financial autonomy from the larger university, preeminent status as one of the oldest business schools in the country, and, finally, to the distinctiveness and success of its clinical approach to business education and powerful connections with the business world, which partly buffered it from the competitive pressures that applied elsewhere.

7. In its early years, the Wharton School was not a separate entity but a department within the university's arts and sciences college.

8. See Locke 1984 for a comparative history of business school systems.

9. Marginal utility theory commonly refers to a set of conceptual and mathematical tools (specifically differential calculus) developed in continental European economics at the end of the nineteenth century to study economic behavior "at the margin" and thereby assess the efficiency of resource allocation. Methodologically, analytically, and sometimes politically as well, marginalist economists often found themselves at odds with economists advocating more institutional and historical approaches to the economy. The fiercest intellectual battles involved the German (historicist) and Austrian (marginalist) schools of economics, but similar struggles took place also in England, France, and the United States.

10. A member of the Pennsylvania Child Labor Committee, Nearing had been

convinced by his work there that local businessmen were responsible for keeping local youngsters in their factories and preventing the passage of laws regulating child labor. During the 1910s, Nearing published a series of works denouncing this practice, and more generally attacking workers' low wages, industrial accidents, monopoly, urban congestion, and sanitation problems as major sources of inefficiency in the American economy (see, for example, Nearing 1911). This position, and later his antiwar views, had irritated members of the state legislature (which partly bankrolled the university), as well as prominent trustees, and Nearing was promptly fired—one of the many victims of the "academic freedom" persecutions so well chronicled by Furner (1975). Also see Nearing (1919). The firing of both Nearing and Patten was officially attributed to their antiwar views.

11. Willits was, in many ways, an example of the consummate academic insider of the interwar period—he worked on Hoover's Emergency Committee for Employment, helped found and presided over the National Bureau of Economic Research, became dean of Wharton during the 1930s and ended his career as a Rockefeller Foundation official.

12. See, e.g., Bruce 2005, on the importance of personnel management concerns in American economics during the 1910s and early 1920s. Also Shenhav 1995.

13. Roswell McCrea, who followed Patten as Dean of the Wharton School, argued: "Economics, where ever else it may or may not belong, does belong in the school of business. Both business and economics need to be saved from themselves. Without the presence of economics in some vital form, the work of a school of business is likely to degenerate into detail description of business organization and procedure, with no organizing principle other than the possible one of search for effective competitive devices, and with no clear vision of the social goal of business activity. And economics, divorced from business, is too likely to spend itself either in closet philosophizing by traditional modes, altogether too little affected with a present interest, or in

fortifying predilections regarding public policy with broadly garnered data too remote from the intimate, work-a-day world of fresh experience to yield much more than a crop of articles, books, and book reviews. If schools of business realize their opportunities, the economic theory of the future will grow out of their researches and will be formulated by their teachers. The joining of socially motivated thinking with a knowledge of concrete, shifting reality, such as can be effected in a school of business, may well escape the puttering of the strict vocationalist on the one hand, and the futility of the closet philosopher on the other. The foundations of wise business policy can be laid in this as in no other way." (McCrea 1925, p. 222) The University of Pennsylvania is indeed one of the few elite universities in America whose economics department originated from within the business school: it was only in 1974, in fact, that Wharton economists decamped to the school of arts and sciences.

14. For example, the University of Mississippi's business school, whose pre-Depression mission statement emphasized narrow technical skills, revised it to include the advancement of knowledge on "fundamental questions of economics and philosophy which influence the course of a dynamic age." The University of Oklahoma's business school, whose mission statement, prior to 1930, stressed the economic value of its degree, shifted to wanting to "enable [students] to understand the public problems, particularly those having to do with the interrelationships between different businesses, between business and government, and between the employer and employee." Similar changes could be found at the University of Michigan, New York University, and the University of California.

15. One response from the business world and foundations was to sponsor new economic research institutions, the most important of which was the Committee for Economic Development, a think tank filled with economics faculty and graduates from the University of Chicago, some of them closely affiliated with the Graduate School of Business (Collins 1978).

16. Bach described an incident in his economics class where “the professor was explaining that theoretically there couldn’t be a lasting depression in a competitive, capitalist-type economy. I looked out the window at a long line of unemployed men, waiting to apply for two WPA jobs the town government had managed to get.” Bach thought there “must be a better way” for economics (Bach in Gleeson and Schlossman 1995).

17. Interviews carried out by Marion Fourcade with American economists confirmed that as late as the 1970s–1980s, business schools were not considered highly reputable places for young economics graduates to start a career. (The Chicago GSB changed all that.)

18. There was particular hostility toward Harvard Business School and the academic disciplines. Harvard, the GSIA faculty felt, impressed through expensive neo-Georgian architecture and elegant faculty offices, not intellectual rigor (Leavitt 1996, p. 290). The need to differentiate the GSIA from Harvard even manifested itself in the design of the school's physical building, where a culture of austerity dictated that there not even be an elevator, although the institution was on sound financial footing. The GSIA faculty saw this as a badge of true seriousness.

19. Quoted at http://www.gsb.stanford.edu/history/timeline/faculty_bach.html, accessed June 6, 2006.

20. “Can You Teach Management?” *Business Week,* April 19, 1952, p. 126.

21. Donald K. David, “Business Leadership and the War of Ideas.” Paper presented at the Magazine Forum, April 27, 1948. In a 1947 article, *The New York Times* applauded Harvard Business School’s brief pamphlet *Education for Business Responsibility* as an intellectual turning point for developing a free-market retort to those academics calling for greater governmental

involvement in the economy. (Russell Porter, “Stress Social Responsibility as Factor in American Life,” *New York Times*, September 7, 1947, p. F1.)

22. See Lagemann 1987. Amadae (2003, p. 38) dates the sharp shift to the right of the Ford foundation policies and intellectual agenda from the replacement of Paul Hoffman by H. Rowan Gaither, Jr., as president of the Ford Foundation in 1953. Under the latter’s leadership, the Ford foundation decisively reoriented its activities toward national security and the arguably rather anti-democratic vision of a society managed by experts. Also see Tadajewski (2009).

23. According to an internal review (Wheeler 1965) the Ford Foundation spent about $19 million altogether on the business school program, or about $138 million in 2011 dollars. Only five schools (Harvard, GSIA, Stanford, Chicago, Columbia) received major grants, totaling about $15 million. To put these numbers in perspective, Carnegie’s GSIA was founded with a $6 million grant in 1949: the Ford grant essentially doubled the amount available for funding the school. Again, to highlight the significance of these amounts, Harvard Business School’s main fund from alumni donations had totaled $2.5 million from 1908 to 1959.

24. The idea that Harvard would not be part of the Ford Foundation program would have threatened the legitimacy of all of Ford’s reform efforts. Though Ford ended up supporting HBS more heavily than any other school, our evidence suggests that foundation officials remained much more hands-off in their dealing with the institution, using the connection essentially as a way to legitimate their involvement in business education and treading carefully around the tight personal connections between HBS and the board of the Ford Foundation. As one member of the foundation’s program on business education described the situation: “[T]hat first year and a half or so was a continuing sort of running skirmish between Don [Donald David, Harvard Business School former dean who went on to become executive chair of the Ford Foundation] and the Program where Don was pushing the Program—

where in effect, I think it's fair to say that Don was saying: "Look we can easily make a deal here. Just deal us in and I'm your friend. If you deal us out, I'm going to oppose you at every turn."" (FFA, Oral History Project, Berelson 1972) As a result, Ford support for Harvard Business School was directed largely toward increasing the school's endowment and diffusing its case study method, whereas everywhere else the foundation was much more actively pushing schools to embrace a social science model. HBS was thereby essentially able to maintain its clinical focus and mute any attempt to change its program, while other schools rapidly moved toward professionalization along scientific-academic lines.

25. The AACSB was originally set up in 1917 by the founding deans of the leading business schools to help spearhead the professionalization of business education and management as a profession. In the 1950s, the organization shifted its focus to serve as an accrediting institution for business education. Still, it was relatively weak and increasingly perceived as irrelevant by the better business schools.

26. See http://www.tepper.cmu.edu/about-tepper/history/the-b-school-change-agents/carnegie-connections/index.aspx.

27. Kydland was Prescott's student in the early 1970s, and also earned the Nobel Prize in economics with his mentor in 2004.

28. Robert Lucas, for instance, said that "one can see the extent to which Muth was influenced by and reacting to Herbert Simon's work on behavioral economics, and how this led him to such a radically non-behavioral hypothesis as rational expectations. (I once tried to discuss this with Herb, thinking of it as an instance of the enormous, productive influence he had on all of us, but he took offense at the suggestion)" (McCallum 1999).

29. A similar story would play out later at the Chicago GSB, where behaviorism

faced the strong opposition of economists (Van Overtveldt 2007).

30. The Chicago GSB was renamed the Booth School of Business in 2008. However to avoid anachronism, we use its old name throughout this article.

31. Hayek, however, taught in the Committee on Social Thought, having failed to secure an appointment in the economics department.

32. Over the years, the Chicago economics “nebulae” would end up providing a host of Mont Pèlerin recruits, such as Gary Becker, Ronald Coase, James Buchanan, Gordon Tullock, Harold Demsetz, Armen Alchian, and Richard Posner, to cite only some of the most well-known. The first three of these men also won the Nobel Prize in economics.

33. On this topic, also see the work of Stigler’s colleagues at the GSB, Sam Peltzman, and Merton Miller.

34. See, for example, Nelson (1987), Noll (1985) on the deregulation movement, and Mercuro and Medema (1997) on law and economics in the United States.

35. Starting in 1959, the investment bank Merrill Lynch, whose officials had developed an interest in modern financial theory, supplied the GSB with a series of grants to set up the Center for Research in Security Prices (CRSP). Over a period of 22 years, the center would receive a total of $1 million. The CRSP was devoted mainly to gathering the prices, dividends, and rates of return of all stocks listed and trading on the New York Stock Exchange since 1926.

36. See MacKenzie 2006; Whitley 1986. Other achievements of financial economics—all based on the view of efficient financial markets—did not fare much better: the capital asset pricing model (Sharpe 1964), for instance,

held that the only optimal portfolio was the entire market—which analysts found unhelpful at first.

37. This was an explicit policy (See Emmett 2007). As Wallis said: “If a person wasn’t good enough in his field to be welcome in the appropriate department, we did not want him either” (Olkin 1991, 136). In 2008, economics or finance PhDs represented 62 % of the faculty at the Chicago Booth School (the GSB’s new name). In other top US business schools, these figures hovered around 45 %, with the notable exception of Harvard (30 %). (authors’ calculations)

38. The accountants were perhaps the most creative. They borrowed from Friedman’s appeal to Popper in his “methodology of positive economics,” as well as from their Rochester colleagues’ ventures into “positive political theory,” to craft a new science they dubbed “positive accounting.”

39. When an activist investor group or corporate raider seeks to purchase a firm through a hostile takeover they typically need to remove the old board members in order to vote in favor of the takeover. One often used tactic is the nomination of an alternate slate of directors who are presented to shareholders. Since most shareholders are interested in receiving the higher price being offered by the hostile takeover firm, shareholders will often vote in favor of the new slate of directors. Directors on this new slate are chosen on being favorable to the takeover event and are usually selected and paid by the hostile takeover firm. See Baker and Smith 1998.

40. Michael Ver Meulen, “The Iconoclast of M&A,” *Institutional Investor,* vol. 19, issue 8, August 1985, p. 71. Jensen focuses on three benefits of takeovers, stating that they do not harm shareholders and are an efficient use of a company’s resources. Golden parachutes, which guarantee multi-million dollar payouts to CEOs in the event of a takeover, are defensible, in Jensen’s view, since shareholders still benefit when a firm is taken over.

41. Michael Jensen, “A Helping Hand for Entrenched Managers” *Wall Street Journal*. (Eastern edition). November 4, 1987, p. 1.

42. Industrial settings were another place where these ideas evolved (see Shapin 2008).

43. These citations studies show that marketing, management, operations research, and especially accounting and finance cite economics heavily, but that the reverse is not true.

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