

The Speculation Economy: How Finance Triumphed Over Industry. *By Lawrence E. Mitchell.* San Francisco: Berrett-Koehler, 2007. xiii + 395 pp. Bibliography, notes, index. Cloth, \$35.00. ISBN: 978-1-576-75400-9.

Reviewed by Maury Klein

This book addresses an important and strangely neglected question: How did the stock market become the center of the American economy? Lawrence Mitchell finds the answer in a transformation that began with the emergence of the giant modern corporation and its effect on the securities markets. “The stock market,” he writes, “started as a tool that helped to create new businesses. It ended by subjugating business to its power. . . . It came to drive their investment, operating and planning decisions, and the path of American economic development itself” (p. 2).

The process began with the late-nineteenth-century merger wave born of attempts to control the destructive competition that plagued many industries. It created giant corporations, whose securities issues changed both finance and the stock market, expanding the latter with large quantities of industrial bonds and stocks. This plethora of securities in a period of prosperity attracted large numbers of new middle-class investors to the market. Ironically, this broadened the base of ownership, even as it concentrated wealth ever more in the hands of those who dominated the giant organizations. As this pattern unfolded, the dominance of the industrialists and manufacturers gave way to the supremacy of the bankers and promoters, who turned speculation—long one of America’s favorite pastimes—into the nation’s most lucrative growth industry.

Mitchell identifies three phases of market development. The first (1897–1907) brought middle-class Americans into the market for the first time, mostly for bonds. The second (1907–1914) witnessed a growth in the number of investors and a shift toward common stock. The third phase opened with the bull market of 1915 and lasted until the crash of 1929. As bankers like Charles Mitchell turned bonds—and then stocks—into consumer products, a growing pool of buyers eagerly waded into the market, until it eventually moved to the center of American life. Investing shifted increasingly to stocks and new vehicles like investment trusts.

The giant new corporations posed threats as well as opportunities. Americans reacted first to the fear of monopoly and sought to control corporate behavior through antitrust measures, which dominated what Mitchell portrays as the first two phases of modern securities regulation. These lasted until 1914 and produced the Clayton Act, the Federal Reserve Act, and the Federal Trade Commission. Gradually, the focus shifted toward investor protection and led to a third phase that culminated with the Glass-Steagall Act of 1933. Between the 1920s and 1970s, which Mitchell characterizes as the “managerial era,” directors and managers sought to keep corporate control out of the hands of stockholders. This strategy, while flawed in some ways, insulated management from short-term market pressures in decision-making. A variety of forces, ranging from increased institutional ownership to the growing use of stock options as compensation, led to the collapse of this approach during the 1970s and the rise of the takeover movements of the next decade.

The result was ever more emphasis on short-term profits and less concern with long-term planning—the triumph of finance over business. “Finance now,” concludes Mitchell, “is vested in a huge, anonymous, constantly changing market of public stockholders ranging from day traders to TIAA-CREF” (p. 278). What they all have in common is the desire for short-term gains above all other considerations; hence the rise of the speculation economy. Mitchell cites a 2005 survey of more than 400 chief financial officers, 80 percent of whom declared that they would “decrease discretionary spending on such areas as research and development, advertising, maintenance, and hiring in order to meet short-term earnings targets” (p. 278).

This summary does scant justice to Mitchell’s detailed and nuanced argument, which includes illuminating accounts of early attempts to impose corporate and market regulation. He points to the World War I Liberty bond drives as the mechanism that introduced many Americans to ownership of securities, but he argues that the investor/speculator base had been broadening since 1897 and included a growing number of women. However, this area remains fuzzy, because no definitive data exist on how many people were actually in the market, let alone who they were. While participation grew steadily, the market continued to be dominated by the professionals. Nor do the data indicate how many stock owners did anything more than simply hold their shares. The number of women owning stock, for example, may reflect inheritances, rather than direct participation in the market. Although Mitchell constructs a plausible argument

on this topic (see chapter eight), he handles the timeline loosely and occasionally contradicts himself.

As always, there are numerous points to debate, but these do not detract from the main thrust of Mitchell's case. He has provided the fullest and most persuasive account of the origins of the modern corporate myopic emphasis on the almighty quarterly bottom line, and of the emergence of everyman (and woman) as speculator. Equally valuable are his insights into the early efforts to address the growing power of corporations and the men who dominated them. Anyone interested in the evolution of modern American business and finance will find this book a rewarding read.

Maury Klein is professor emeritus of history at the University of Rhode Island. He is the author of fifteen books, including Rainbow's End: The Crash of 1929 and, most recently, The Power Makers: Steam, Electricity, and the Men Who Invented Modern America. He is presently at work on the third volume of his history of the Union Pacific Railroad.