

FACULTY RESEARCH EDITION
of
The Savannah State College Bulletin

Published by

The Savannah State College

Volume 21, No. 2

Savannah, Georgia

December, 1967

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Table of Contents

The Pedagogical Interrelationship Between Mathematics and Science Prince A. Jackson, Jr.	7
Educating Parents and Teachers for Intelligent Use and Support of Good Preschools Sadye A. Young	17
On Strengths of Shock Waves with Respect to Thermodynamic Parameters Nazir A. Warsi	35
Efforts to Prevent Negro Revolts in Early Savannah Austin D. Washington	39
White Professors and their Students in Southern Negro Colleges Carroll Atkinson	43
The Feasibility of Establishing a Library-College in Predominantly Negro Colleges Elonnie J. Josey	45
An Enrichment Program: Industrial Arts and Elementary Education Richard M. Coger	55
Far Infrared and Raman Studies on The O-H---O Bond Stretching Vibrations in Crystals Venkataraman Ananthanarayanan	60
The Distribution of Income in a Highly Industrialized Society Sarvan K. Bhatia	66
The Evolution of Free Enterprise and Capitalism in the United States Sarvan K. Bhatia	70
On Shock Strengths with Respect to Flow Parameters Nazir A. Warsi	75
Keats' <i>Endymion</i> : A Critical History Dennis A. Berthold	78
<i>Paradise Lost</i> and the Modern Reader: Five Approaches Dennis A. Berthold	89
A Design for Campus Libraries Based on the Favorite Study Habits and the Preferred Study Locations of Students at Fayetteville State College Charles I. Brown, Nathalene R. Smith, and Charles A. Asbury	100
Apartheid and Morality David S. Roberts	106
A Study of Psycho-Social Behavior of College Freshmen— 1966-67 Lawrence C. Bryant	109

Table of Contents – (Cont'd.)

<i>Who's Afraid of Virginia Woolf?:</i> Some Factors that Generate and Sustain Dramatic Conflict Ollie Cox	114
Five Selected Poems Gershon B. Fiawoo	119
The Modern Dramatic Hero As Seen in the Plays of Brecht and Betti William T. Graves	124
Noah Webster as a Lexicographer William T. Graves	129
Whitman on Whitman: The Poet Introduces His Own Poetry Dennis A. Berthold	137
The Theory and Practice of Freedom David S. Roberts	143
The Nature of the Dispute Between Moscow and Peiping Liu Shia-ling	155
What Does it Matter to You? Samuel Williams	165
Ong, McLuhan, and the Function of the Literary Message Dennis A. Berthold	172
<i>In Vitro</i> Persistence of <i>Salmonella</i> Typhimurium in A Dually Inoculated Medium. I. With <i>Proteus Morgan II</i> Joseph L. Knuckles	177
<i>In Vitro</i> Persistence of <i>Salmonella</i> Typhimurium in A Dually Inoculated Medium. II. With <i>Aerobacter Cloacae</i> Joseph L. Knuckles	185
Experimental Transmission of Enteric Pathogens from Fly to Fly by Aseptically Reared <i>Phormia Regina</i> (Meigen) Joseph L. Knuckles	192
Mathematics in the Renaissance William M. Perel	193
Synthesis of Kaempferol-2-C ¹⁴ Kamalakar B. Raut	198
A Refutation to the Objections of Business and Vocational Subjects in the Secondary School Curriculum Mildred W. Glover	200
Teacher Personality and Teacher Behavior Shia-ling Liu	208
Poem: Epithalamia Luetta C. Milledge	222

The Evolution of Free Enterprise and Capitalism in the United States

by

Sarvan K. Bhatia

Less than two hundred years ago, a very short time in the span of history, the United States consisted of thirteen states lined up against the eastern seaboard. In front of these states was nothing but a hostile sea, and there was nothing behind them except the raw, natural resources which required the greatest determination of any human will to work with. And yet we find that during the course of last two centuries, the United States has become one of the greatest powers on earth. At present, the United States has only six per cent of the total world population and almost an equal area. Yet, the United States produces more than one-third of total world production. A question may therefore be raised appropriately as to how this growth has taken place.

The answer is not a simple one. A number of factors have accounted for this tremendous growth. The capitalistic system and the various basic tenets of it are part of the explanation. Some of the other equally important factors which have contributed to this economic development are the rich and varied economic resources with which nature has endowed the United States, the abundance of capital, training facilities and a highly skilled and efficient labor force, free enterprise and the market economy. Although there is no neat and universally accepted definition of capitalism, the framework of capitalism embodies the following institutions and assumptions: private property, freedom of enterprise and choice, self-interest as the dominant motive, competition, reliance upon the price system, and a limited role for government.¹

When we happen to look at the history of the last two hundred years, we find that new and different forms of economic organizations have presented themselves in a challenging and bewildering array. The nineteenth and early twentieth centuries were the era of capitalist growth. Within a century of its first full bloom in the industrial revolution, capitalism had reached out to become the commanding economic structure of a large part of the world. Most of Europe and North America in the early stages of industrial revolution became market-oriented, profit-stimulated, and industrially-based economies. These countries in turn exerted their influence over a vast portion of the non-capitalist world, that is, over its unindustrialized areas.

¹Campbell R. McConnell, *Economics, Principles, Problems, and Policies* (New York, 1966), p. 43.

However, there has taken place a basic change in the economic orientation of the world. It can be described as the collectivization of the twentieth-century economic life. Over a large part of the last two centuries, capitalism was the triumphant and dominant form of economic and social organization in the world; this is no longer true. Today and over the foreseeable future, traditional capitalism throughout most of the world has been thrown on a defensive from which it is doubtful that it can ever recover.²

Along with the change in traditional capitalism has come a change in the free enterprise and free markets. Basically speaking, the United States is still a capitalistic country—but with certain important modifications. What is a free market? It is a way of putting together money, manpower and merchandise to cater to the needs of the customer. Has there taken place any change in the free market? The answer is no. Is the customer under obligation to purchase a specific good? The answer once again is no. It is the sweet will and willingness on the part of the consumer to buy anything he wants, of course at the going market rate. Every business is being tested every day by the free choice of the consumer. And yet there has taken place some profound change. The consumer, through advertisement and promotional sales, is being persuaded to buy a given product rather than what he had been accustomed to buy. New products coming on the market attract the consumer.

The same is true in regard to free enterprise. Webster says that free enterprise is the freedom of private business to organize and operate for profit, in competition with each, without interference by government beyond regulations necessary for keeping the national economy in balance. And yet we know that in a number of more important industries, free enterprise, as defined, does not exist. For example, the first four industrial units in the aluminum industry produce 100 per cent of total output; the same is equally true in respect of the auto industry. With a very slight modification, we observe the same situation prevailing in such industries as linoleum, locomotives and parts, electric lamps, telephone and telegraph equipment, gypsum products, steam engines and turbines. Undoubtedly, therefore, there are a number of operational faults in the free enterprise and capitalistic economy of the United States and much unfinished business still remains to be taken up. Actually, in the free enterprise American society, the only unchanging fact is the fact of change. The economy is flexible and sensitive. It adapts, adjusts, and rolls with the punches. Just as the society has been undergoing an evolutionary change, the same is true with the trend

²For details, see Robert L. Heilbroner, *The Future as History* (New York, 1960), pp. 93-114.

of increasing governmental authority.³ The United States cannot, and would not if it could, turn the clock back to the conditions represented by Henry Ford's Greenfield village.

Correlated with free enterprise is the institution of profits. As a matter of fact, free enterprise without profits cannot be considered; both of them are intricately related to one another. And yet we find that in spite of the fact that free enterprise has been in existence for uncounted centuries, and the same has been true in respect of the profit motive, the word "profit," like socialism, is one of the most maligned and misused words in the English language. However, the chance to make a profit, or the undertaking of risk for making a profit, is the very essence, the very foundation of a free enterprise economy. Through the desire to make a profit, the buyer and seller both gain. If there were no expectation of mutual advantages, mutual profit, there would be no transaction. Then no one has to buy and no one has to sell. No deal can be consummated unless it benefits all parties concerned—that is the creed of free enterprise. The hope for profit also stimulates action. As a result of numerous innovations and inventions, not only do the inventors profit, but the society as a whole also benefits. Instead of the enterprises being owned by sole proprietorships⁴ and partnerships, which was true not too many decades ago, at present there is no enterprise, sufficiently large in size, being owned by one, two, or a few persons.⁵ Most of the enterprises nowadays are owned by a large number of stockholders, there being as many as 20 million stockholders of various corporations in the United States.⁶ In addition to these 20 million stockholders, almost every family has a stake in the success of American free enterprise. Banks, trust and pension funds, and life

³According to J. Irwin Miller, one of the trustees of the Ford Foundation, "Business has brought on itself most of the intervention of government. The income tax started out as a very simple tax. Now it is bewildering, because businessmen discovered a lot of loopholes and these had to be plugged. We did not have a pure food and drug agency in this country until somebody started putting out bad food A great deal of the so-called government encroachment has been asked for by people misusing their freedom." Quoted by Robert Theobald, *Free Men and Free Markets* (New York, 1963), pp. 48-49.

⁴Agriculture and retail trade are the only sections of US economy where more than half of the business done is undertaken by single proprietors and partnerships. Because of the huge capital requirements, both of these forms of business enterprises are losing ground to the corporation. Undoubtedly, unlimited liability and the red tape needed to ensure continuity are the main drawbacks to the partnership form.

⁵In 1964, more than 2.2 million persons had shares in AT&T. The Stock Exchange has a goal of people's capitalism" in which the masses have appreciable ownership of corporate capital.

⁶The wide diversification of stockholding has resulted in a separation of ownership and control. Recent studies show that in the typical giant corporation, all management together - officers and directors - hold only about 3 per cent of the outstanding common stock. The largest single minority ownership groups typically hold only about a fifth of all voting stock. Such a small fraction has been deemed more than enough to maintain working control." For details, see A. A. Berle and Gardner C. Means, *The Modern Corporation and Private Property* (New York, 1932), and R. A. Gordon, *Business Leadership in the Large Corporation* (Washington, 1945).

insurance companies, in which all of us have an interest, reinvest our saved money in business as a way to earn a profit—and not only for themselves to continue in business, because a part of these profits is distributed by way of dividends to those who have taken a risk in their enterprises.

But while an investor is free to organize and to operate for profit, the whole process has undergone a profound change. At almost every step, the private investor is being regulated by numerous governmental controls and the very concepts of the proper functions of government have been profoundly changed during the last few decades. Older shibboleths, which hailed the best government as the one which governed least, are now of little use in evaluating the propriety of new functions.⁷ They reflect the rear-guard defenses of dogmatists opposed to the government's assuming any new functions no matter what the national need for such action. The laissez-faire capitalism which continued till the decade of the 1920's has of late been supplanted by various government controls, as stated above.⁸ The pure price economy is now a mixed economy in which elements of government control are intermingled with market elements in organizing production and consumption. For example, no democratic society could afford to sit idle while certain people starve from lack of income and others receive inadequate or excessive incomes. Therefore, the government has to step in with expenditures to supplement the real or money incomes of some individuals. Moreover, government has to provide certain indispensable public services, such as the national defense, internal law and order, administration of justice, etc., without which community life would be unthinkable and which by their nature cannot appropriately be left to private enterprises.

In considering the current status of governmental operations and expenditures, the striking fact is that we have completed what many have characterized as the historic process of divestiture following a sharp upsurge in new governmental functions.⁹ The changes in expenditure and revenue at all levels of government confirm this conclusion. For example, in the year 1902, the total expenditure in respect of all local, state and federal governments amounted to \$1.7

⁷Adam Smith in his *Wealth of Nations* published in 18th century, defined the duties of government as being defense, internal justice, and the erection and maintenance of public institutions and public works, including roads and education. They long served as guides for the students of government. However, since then there has taken place a profound change in the economic functions of government. Perhaps the single most important change is the responsibility of government to regulate the economy with a view to provide conditions for full employment, maintain price stability, and to strive for accelerated economic growth and development besides redistribution of income on a compatible basis.

⁸Laissez-faire capitalism stands for a system of free, competitive markets with virtually no governmental control. In a liberal or democratic socialism, there is a mixture of loose governmental planning and controls and regulation of basic industries with reliance on markets and price mechanism as we find in U.S.

⁹Solomon Barkin, in "Federal expenditure policy for economic growth and stability," a paper submitted before the Subcommittee on Fiscal Policy, Joint Economic Committee, 85th Cong., (Washington, 1957), p. 88.

billion (actual) whereas in the year 1963, it had gone up to \$182 billion. The first and largest increase came about during the First World War period, then the expenditure declined. The upsurge in expenditure started with the decade of the 1930's and the Great Depression, was intensified during the Second World War period, did decline during the second half of the 1940's, but the upward trend was resumed in the 1950's and there does not seem to be any end in sight, whether we like it or not. The end of the second World War witnessed the federal government's being given the responsibility by the Congress under the Employment Act of 1946 "to use all practicable means . . . to coordinate and utilize all of its plans, functions, and resources, for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be useful employment opportunities, including self-employment, for those able, willing and seeking to work, and to promote maximum employment, production, and the purchasing power." The federal government has sought to implement these broad directives. To wit, fiscal and monetary policies have been developed and put into operation so that the people and government do not suffer from the sharp swings of the cyclical fluctuations. Economic growth has been accepted as an essential objective. And the same is equally true in regard to the amelioration of the lot of the poor masses. Helping the poor, the aged, the unemployment and other categories of the unfortunate has come to be accepted as the legitimate responsibility of federal government and the expenditure for this purpose is now by far the largest item of federal non-military spending. The spending for the year 1964 amounted to nearly \$25 billion. Agriculture is still another big single industry where the farmers are the major beneficiaries of the farm aid amounting to almost \$50 billion during the period 1954-64.

In the light of the above remarks we can conclude that whereas a few decades ago, the private sector of the U. S. economy played a predominant role in the production and distribution of goods in the way it wanted to, this freedom has now been circumscribed by various governmental controls. Moreover, the U. S. government at present accounts for more than one-fifth of the gross national product. The government today has to play a positive role in the economic affairs and certain positive functions have to be performed by it. They are a far cry from the modest list of governmental responsibilities recognized before 1929. Whenever there are any gaps or shortcomings in the functioning of the economy, the government has actively intervened during the last three decades to help the nation realize the goals. The private, free enterprise economy has thus been modified by governmental intervention.