

Founding Errors:
Making Democracy Safe for America

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John Joseph Wallis

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Although this is a second draft, it is still rough and there are a number of places where my speculation outruns my knowledge. Any sources, comments, and suggestions will be extremely helpful. Sorry the paper is so long.

Social scientists have come to a rough consensus that political and economic development must occur together, neither is sustainable by itself. The relationship between the two, however, remains a mystery. This paper looks for connections between economic and political developments in the early 19th century United States. Our modern, accepted ideas about the interaction of political and economic organizations in a democracy are drawn from ideas held by the founding generations. In practice, however, the founding ideas turned out to be grossly in error. The basic thesis of the paper is that working out the implications of their errors produced the symbiotic systems of competitive politics and economics that characterize America after the 1840s. The interactive changes occurred almost exclusively at the state level, not at the national level. The language of democratic discourse did not change over the early 19th century, but the substance did. Because we still operate within the intellectual framework established by the founding generation and because American history focuses most of its attention on the national level, it is difficult for us to see how relationships between economic and political organizations actually changed.

The simultaneous development of political and economic systems in the early nineteenth century United States is indisputable. In contrast, whether politics and economics co-evolved in a sympathetic and reinforcing manner or whether the developments ran in parallel, but essentially antagonistic, paths continues to be a major question in American history.

Fundamental question concerning the nature of economic and political development remain unanswered. Does economic development result from institutions and norms that favor the accumulation of wealth which favors the already wealthy and powerful, whether a Marxist process in which the state privileges and sustains the capitalists or a neo-classical process in which the state secures property rights and order benefitting those with the most property and the most to lose should disorder break out? If so, is economic development basically at odds with political development that results from institutions and norms that decentralize and distribute power, gradually empowering those that were previously excluded by giving them political voice? Although flat and stereotypical, the tension depicted in the preceding sentences resonates with ideas throughout the social sciences and history.

A rough consensus has emerged among some economists and political scientists that economic and political development cannot occur independently, that they are two sides of the same process. Unfortunately, these social scientists remain virtually clueless about how such co-evolution occurs. History and historians, obviously, hold the key, with American historians in the cat-bird seat. Close connections between economics and politics have been carefully drawn by Americans since before the Revolutionary War. The connections provide a framework for telling American history. Emerging political and economic competition are the overarching themes of American history: the rise of competitive national mass political parties and

democracy, and the rise open access competitive firms and a national markets.¹ National politics, national markets; competitive political parties, competitive corporations; the pieces of the puzzle all fit nicely together to support a national political economy explanation of American development.²

¹“The rise of political parties is indubitably one of the principal distinguishing marks of modern government. The parties, in fact, have played a major role as *makers* of governments, more especially they have been the makers of democratic government. It should be stated flatly at the outset that this volume is devoted to the thesis that the political parties created democracy and that modern democracy is unthinkable save in terms of the parties.” Schattschneider, 1942, p. 1.

²Many historians use economic development to frame political and social development. For the early national period Appelby’s title conveys the essential connection, *Capitalism and a New Social Order*. McCoy begins his study of political economy in Jeffersonian America by noting that “after independence when the thorny issues related to social and economic development became central to intellectual and political debate, Americans could agree almost without exception that the new nation should be republican, but within that broad and increasingly ambiguous consensus they differed over a wide range of issues... Thus to the Revolutionaries in America, the notion of ‘political economy’ reinforced the characteristically republican idea of a dynamic interdependence among polity, economy, and society.” (1980, p. 5 and 6). For Sellers, in the Jacksonian era, land and market are the two economic poles of social development, “In the beginning was the land... Understanding of both the world they lost and the world we have gained begins with understanding the differences between the cultures of land and market.”(1991, p. 4 and 6). Meyers consciously adopts an economic frame to explain *The Jacksonian Persuasion*: “I have thus far treated economic processes as somehow external to the Jacksonians who experienced and judged them. If, however, I am right that the Monster Bank of Jacksonian rhetoric represented – in fact and vaguely in perception – pervasive qualities of an altered economic life, then the case is far more difficult.” (1957, p. 121) To his credit, Meyers wrestles with the possibility that economic and political change are endogenous.

Not all histories take an economic background as given, but many do. For the Jacksonian period see Schlessinger 1941, Meyers 1957, Pessen 1985, McCormack 1986, and Sellers 1991. These histories all take distinctively different views of how national political and economic development interrelate and all use economic processes and problems to frame political development. For histories of Jacksonian politics that take a national view see Altschuler and Blumin 2000, Feller 1995, Kohl 1989, Wilson 1974, and Watson, 1997. Another large literature in political science studies the rise of national parties. For the early period, see the papers assembled in Banning’s 1989 anthology and for the whole 19th century the papers assembled in Chambers and Burnham’s 1975 anthology. The new political history spans history and political science, particularly the work of Silbey 1985 and 1991, and Formisano 1971 and 1983. In

Such a history should reveal the deep underlying relationships between economic and political development, but it has not so far. The lack stems from two flaws in the national history linking political and economic development. The first is that the Founding Fathers feared the dangers to liberty presented by organized interests in general and in particular any close links between political parties (or factions) and economic corporations. They were paranoid – to borrow Bailyn’s phrase – about the possibility that political factions would use organized interest as a tool to subvert democracy. These fears were not merely muttered under the breath of a few elite members of the Constitutional Convention, they were broadcast wholesale from the 1770s up through the 1850s. The fears were based on a set of intellectual beliefs, developed first in England as Whig or Commonwealth theory, which Americans used as a lens to interpret events in Britain in the 18th century, eventually led them to revolt, and then profoundly affected political thinking after independence. Bailyn’s *Ideological Origins of the Revolution* and Wood’s *Creating the American Republic* articulate how Commonwealth ideas shaped America’s founding. The ensuing understanding of the republican synthesis has dominated American history for the last fifty years.³ The Founders worried that political factions

economic history, the classic statement on the importance of the national economy is Callender 1902, which is taken up by Schmidt 1939, North 1961, and Fishlow 1964; and is the centerpiece of Fogel’s 1964 study of the railroads. Despite some challenges to the details of the Callender framework, the importance of the national economy remains central to American economic history.

³On Commonwealth ideas in America see Bailyn 1967 and Wood 1969. For England see Robbins 1959 and Weston 1965, and in the wider European context the work of Pocock 1973, 1975, 1977, 1985, and 1987 and Skinner, whose little book on *Liberty before Liberalism* is a lucid short introduction to the language of the Commonwealth thinkers. For application to the first party system in the 1790s see Banning 1978, McCoy 1980, and the bibliographic essays of Shalhope, 1972 and 1982. As Murrin 2008 p. 1 notes, the republican arguments about the origins of the revolution have so carried the day that “the coming of the American Revolution

would use the creation of economic and other privileges to create interests that could be used to dominate the government.⁴ They were much more concerned that politics would corrupt economics than our modern concerns that economics would corrupt politics. Given their deep fear of organized interests, of parties and corporations, as threats to liberty and democracy, we must ask how such a society came by 1850 to have the world's first mass political parties, ten times more corporations than Britain and France combined, and the first institutions that allowed free and open access to the corporate form?⁵ Why did the Founders make such a foundational error about parties and corporations? Fundamental as the question is, it has received very little attention from general historians and almost no attention at all from political and economic historians.⁶

The other caveat grabs even harder, for it concerns the direct relationship between government actions and economic outcomes. In order for there to be a profound link between political and economic development, governments must actually do things that effect the

has almost ceased to interest professional American historians.”

⁴Wallis, 2006, uses the term “systematic corruption” to denote the Commonwealth fears that a faction would use political manipulation of the economy to secure political power, in contrast to the modern notion of “venal corruption” in which economic interests distort the political process to obtain economic benefits.

⁵For estimates and counts of the number of corporations for the U.S. see Wright 2008, for Britain Harris 2000, for France Freedeman 1979, and the comparative work of Guinnane, Harris, Lamoreaux, and Rosenthal, 2007 and Lamoreaux and Rosenthal, 2004 and 2005.

⁶The most obvious exception is Hofstadter's marvelous 1969 book *The Idea of a Party System* and subsequent work by Wallace 1969, Sheehan 1992, and Leonard 2002. Both Madison and Van Buren speculated about the role of parties. Madison in a series of articles written for the *National Gazette* in 1791 and 1792, included in his papers (Rutland, et. al. 1983). Van Buren at length in his *Autobiography* and his *Inquiry into the Origins and Course of Political Parties in the United States*. This literature, however, has only asked questions about the organization of politics, not about the organization of economies nor the interaction of the two.

economy and changes in the economy must effect government actions. At best, there were only weak and general interactions between the policies of the national government and the economy. The national government took so few actions that affected the economy that national history can not give us a clear picture of how government and the economy interrelated. State governments, however, were deeply involved in actions that affected the economy in the early 19th century and were in turn affected by economic changes.

National constitutional protection of property rights and the national market were surely critical elements in the development of the American economy, but those provisions did not change after 1790. Beyond providing the framework, the national government did very little of economic significance before the Civil War and what it did do changed little or not at all.⁷ Yet, national government involvement in banking, transportation, land development, and international

⁷One can certainly argue that providing the national framework was the single most important contribution of government to development in the early 19th century, but then all of the interesting questions about how that framework was made self-sustaining disappear, since the *action* that sustained the national framework occurred at the state level. The national government chartered two national banks and allowed the charters of both to expire because of political controversy. It invested a very small amount in transportation improvements, about 10 percent of what state and local governments invested, again largely because of unresolvable political complications involved in national provision of transportation infrastructure. When it did invest in railroads in the 1860s it failed spectacularly to get its money back in the case of the Union Pacific. It transferred large portions of the public lands into the hands of private owners and state governments under a policy whose basic framework was laid out by the Confederation Congress in 1785 and 1787. Despite numerous attempts to change land policy, it stayed in place with only minor adjustments until the Civil War. It utilized the tariff as its main revenue source, but again political problems prevented the government from actively using the tariff as a tool of economic policy except in very limited circumstances. The general argument about the lack of national economic activity is laid out in Wallis and Weingast, 2005. A similar, less detailed, argument is made in Formisano, ??? There is a large literature that supplies specifics on each of the topics. For banking Hammond 1957, Redlich 1968, Sylla 1972, and Bodenhorn, 2000 and 2003. For transportation investments see Taylor 1951, Goodrich 1960, and Larson 2000. For the public lands see Gates 1968 and Feller 1984. For trade see Taussig 1931 and Irwin 2008.

trade (where it deserves emphasis) dominates both economic and political history. It is no wonder that Americans commonly believe that *laissez-faire* policies are the natural tendency of American government and that a minimal state promoted economic development. For seventy years after the nation's founding, the national government did very little, but the economy, polity, and society developed nonetheless.

To conclude on the basis of the national experience that *laissez-faire* government policies work best to promote economic growth is a proposition that has never stood up well to historical scrutiny. Callender captured the irony in the opening words of his classic 1902 article: "It is a commonplace observation that the last century witnessed everywhere a great extension of the activities of the State into the field of industry. Americans are not accustomed to think of their own country as taking a very prominent part in this movement, much less as having ever occupied a prominent role in it. To them, as to the rest of the world, America is the land of private enterprise par excellence, the place where 'State interference' has played the smallest part, and individual enterprise has been given the largest scope, in industrial affairs; and it is commonly assumed that this was always so." But Callender knew that states had played a large role in the economy: "It is the purpose of this paper to explain at length the conditions which gave rise to this remarkable movement toward state enterprise here in America, where of all places in the world we should least expect it."⁸

Fifty years later another generation of scholars supported by the Committee on Research

⁸Callender, 1902, the first quote from p. 111 and the second from p. 114. Although there are no obvious connections with Callender, a group of social scientists at Johns Hopkins was also focusing on state level government policy at the turn of the 20th century. See Sowers 1914 and Hanna 1907, this group was associated with Richard Eli and Hollander (need to fill in), see Teaford 1985, for local government studies.

in Economic History, the Handlins, Hartz, Benson, Goodrich, and others revealed again the myth of an early 19th century laissez-faire America. Like Callender, they found that the important interaction of the government with the economy at the state level.⁹ The actions of the states are supported by the numbers: by 1836 the national government had chartered two banks, the states over 600; between 1790 and 1860 the national government spent roughly \$60 million on transportation investments (mostly post roads and lighthouses), state and local governments spent over \$450 million; the national government built no canals, the states dozens; the national government chartered no non-bank corporations, the states chartered thousands.

If democracy and markets are intimately linked in the process of modern development by connections that we do not yet completely understand and it was state governments that were intimately involved in the interaction of economic and government behavior in the United States, then the formative interaction of economic outcomes and government actions should have occurred at the state level. The central hypothesis of this paper is that the interaction of economic and political forces at the state level defined and shaped American development between 1790 and 1850, in contrast to the accepted (and competing) hypothesis that the structure of political and economic development in the United States was determined by national institutions and politics. The second “founding error” has been building our political, economic, and social histories on a national foundation and so missing the close interaction between governments and economies at the state level. In terms of the contemporary research and debate

⁹The research supported in the 1940s by the Committee on Research in Economic History, somewhat confusingly also named the commonwealth tradition by Lively 1955, includes among many others the Handlins 1969 (second edition), Hartz 1948, Benson 1955 and 1961, and Goodrich 1960. The review articles by Cole, 1953 and 1970, give a good overview of the committee’s work.

over development policy in the 21st century: today's developing countries have little to learn about promoting modern development from the national institutions and national government policies in the United States before the Civil War, but they have a great deal to learn about what policies and politics produces modern development if they look at states, state governments, and state politics.

The hypothesis states the important implication about national and state governments, but carries no specific implications. Political and economic competition were made tangible in the form of political parties and corporations, although formal parties and corporations represent only the tips of very large bodies of political and economic organizations as we shall see. Not only did organizations arise, formal institutions, embodied in constitutions and legislation, developed that governed the formation and behavior of organizations throughout American society. The formal institutions tell only part of the story, but it an important part both because it is relative easy to track formal changes and because the effort involved in codifying rules about the structure of organizations reflects the enormous importance Americans attached to these rules. Concrete versions of the hypothesis can be formulated in terms of parties and corporations and verified using the existing historical record. The following paragraphs lay out three connected hypotheses with just a hint of evidence. Each is considered in detail in the following sections.

The first hypothesis is that the founding fears of organizations should have prevented states from creating formal organizations in large numbers initially and that movement towards open access to organizational forms that are formally supported by the state occurred over a substantial period of time against considerable resistance. Fears about organized political parties

were so strong that no state adopted any laws structuring political parties or the nominating process until after the Civil War. The structure of elections may have produced pressures towards a two party system, but in almost all states parties remained outside the formal legal system and rather than well organized two party competition numerous factions competed for control until the 1870s and 1880s.¹⁰ Election law remained primitive. In contrast, state began moving toward open access to the corporate form for churches in the 1780s and 1790s. State policies with respect to business corporations evolved slowly toward more access (most rapidly in New York and Massachusetts) and then suddenly shifted in the 1840s with the widespread adoption of general incorporation acts in the northern states in the 1840s. Likewise corporation policy with respect to cities and municipalities opened early in New England, but slowly moved toward more open access until it to made a discontinuous shift in the 1840s.

The prevalent method by which governments promoted economic activity before the 19th century had been through the granting of charter privileges to corporations. This was true in banking, finance, transportation, and public utilities. Americans who wanted their government(s) to promote economic development wanted governments to create corporations. The creation of corporations, indeed of any type of organization, ran up against the founding fear of faction and economic interests. Fear of parties made corporations the third rail in early 19th century American national politics. If the national government wouldn't or couldn't charter corporations, it would play a limited role in promoting economic development until other tools were found.

¹⁰For theoretical analysis of the number of parties under different electoral regimes see Duverger 1959, Riker 1976 and 1982, and Cox 1997 among many others in the political science literature.

The second hypothesis builds on the obvious fact that states, not the national government, chartered corporations in the early 19th century: states figured out a way to solve the political conundrum of chartering corporations without creating economic and other privileges that distort the democratic political process. The direct connection between economic and government activity comes out crystal clear in this hypothesis. The hypothesis has the virtue of being testable both in substance and in chronology. States determined, through a long process of experimentation, that the way to neutralize the adverse political incentives created by chartering privileged corporations was to make charters available to everyone and to eliminate any special privileges attached to specific corporations.

Constitutional provisions mandating general incorporation laws became widespread in the north in the 1840s and spread through the rest of the country in the 1870s. One of the most famous of all the general incorporation laws, the New York Free Banking law of 1838. The New York case provides a fascinating example of how states solved the problem of corruption and corporations.¹¹ The passage of constitutional provisions mandating general incorporation laws is the most visible indication of institutional change in government policy with direct and enormous implications in the economy. The United States was the first society ever to embody free and open access to economic organizations in its fundamental laws, the state constitutions, a

¹¹General incorporation laws made corporate charters available to everyone who met minimum requirements through an administrative procedure. In contrast, special incorporation required an act of the state legislature. Special and general incorporation will be discussed in detail later. Special and general incorporation are representative of the more general process of special and general laws and legislation, which play a central role in hypothesis (3). “Free banking” is simple a general incorporation law for banks. Benson 1961 makes the passage of the free banking law in 1838 the centerpiece of his analysis of Jacksonian democracy.

feature of that the national constitution lacks to this day.¹²

The third hypothesis concerns the motivation for opening access to economic corporations and other organizational forms: in every case it was motivated by a desire to make democracy work and to prevent the democratic republic that Americans hope to establish from falling prey to the corrupt designs of a single interest. This hypothesis goes directly to the issues raised in the opening paragraphs. Changes in economic institutions were not independent of political developments, but driven by the need to change the environment surrounding democratically elected representatives acting in majority rule legislatures.

Mandatory general incorporation laws were only one part of a suite of constitutional changes that reflected a larger political transition made by American states as they adjusted their fear of faction and organizations to the realities of democratic politics controlling governments that actively pursued economic development. Commonwealth fears that politicians could use any special privilege to create an interest that could be manipulated by the dominant political faction extended well beyond business corporations. In the case of corporations, the evil was not in the corporate form itself (although there were many who argued that corporate privileges were somehow unnatural) but in the special grant to a small group. The solution was extending the corporate form to everyone through general, as opposed to special, incorporation acts. A similar movement occurred in the form of prohibitions on special legislation of any kind, much of which was directed at economic issues. Complete or partial bans on special legislation began to spread throughout state constitutions in the 1840s along with mandatory general incorporation acts and

¹²Britain would adopt a similar registration law in 1844, extend limited liability to corporations in 1856, and France adopted a registration law in 1866. Wallis 2005, provides a detailed history on the constitutional developments leading up to the changes in the 1840s.

provision requiring that state legislatures only pass general laws that applied equally to everyone.

Bans on special legislation have been interpreted as part of a larger movement to limit the discretionary authority of legislatures.¹³ Legislative restrictions were embodied in other institutional reforms as well. Constitutional changes restricted the appointment powers of legislatures, for example, through direct popular election of judges; transferred discretionary authority from legislatures to governors through direct reallocation of functional powers between the legislative and executive branch; and strengthened gubernatorial veto powers over legislative acts. Bans on special legislation and the reduction of legislative discretion were a deliberate attempt to reduce the impact of special (economic) interests in the legislative process. By limiting how the legislature could manipulate the economy, the new reforms hoped to reduce that adverse political incentives that led to systematic corruption. It was an economic solution to a political problem.

This way of viewing the connections between economic and political development provides an answer to why Americans have never thought the Founder's were wrong about the dangers of organized political factions or economic interests. In the 1790s and 1800s the Federalists and Republicans each argued that the other group was attempting to manipulate the political system to their own ends through organized activity. Divisions and debate between the Whigs and Democrats in the 1830s and 1840s were even more intense, essentially each side of the political debate accused the other of leading the American political nation into abject

¹³See Tarr's 1998 history of state constitutions for the overall theme of limiting legislative discretion in and after the 1840s.

submission to tyranny and slavery. A fear of organized political and economic interests lingers in American society today.

Sorting out how fear of faction and corporations eventually produced profound institutional changes in the organization of the American polity and economy is almost impossible if our focus remains on the national level and the national government. The overriding concern of early American politics was not the coming of the Civil War, it was the impending corruption and ultimate destruction of the democratic American Republic by organized political and economic interests. Americans figured out how to stop that from happening at the level of state constitutions and state institutions because it was at the state level that economic and political interests interacted intensely.

The following section documents the paranoia over parties and corporations in the early 19th century. Then we examine more closely how corporations and parties developed in the states between 1780 and 1820. Then we move to the entanglement of state public finances, state investments, state politics, and state corporation policies that eventually led to a conceptual solution to the political dangers of parties and corporations in the late 1830s and 1840s. The constitutional changes that implemented these new ideas are tracked from the 1840s to the 1870s.

Americans initially believed that political and economic organizations sanctioned by governments represented a dire threat to republican government. They feared parties, corporations, and organized interests of many types. The electoral rules adopted in the state and national constitutions made some kind of organized political competition inevitable, but Americans resisted the formation of explicitly political organizations. They gradually figured out

ways to make access to economic organization open to all who wished to form an organization as a way of saving republican democracy. When special economic organizations were eventually eliminated altogether, it was then safe to begin forming more durable political parties after the Civil War. By then, democracy had finally become safe for America.

II. Fear of Faction, Party, and Corporation

An enormous amount has been written about Commonwealth or Whig ideas, their origins in Europe and Britain in particular, and their spread and influence in the colonies that became the United States.¹⁴ The ideas were neither homogenous nor held by everyone. They generated controversy, a revolution, and continuing debate over how basic ideas about republican democracy should be implemented in concrete political and economic institutions. Several elements of Whig thinking were not internally consistent with each other, conflicts that became clearer as Americans actually tried to make some of the ideas work in a real society. When Alexander Hamilton and James Madison described the evils of faction and how the Union would “form a barrier against domestic faction and insurrection” (Hamilton) or have a “tendency to break and control the violence of faction” (Madison) through the agency of a “confederate republic” (Hamilton) or an extended republic (Madison) in Federalist papers #9 and #10, they drew on Whig ideas, the best political theory of their time.

¹⁴Pocock’s work on the European origins of Commonwealth ideas is central, 1973, 1975, 1977, 1985, and 1987 but embedded in a much larger body of work, including Robbins 1959, Weston 1965, Skinner 1978 and 1998, Kramnick 1968 and 1990. Bailyn 1967 and Wood 1969 are the pole stars of the American literature, with again, a vast array of complementary and competing work, including Shallope 1972, 1982, and 1990, Banning 1967 and 1995, McCoy 1980, and Appleby 1984. For an alternative to the Roman centered version of the republican tradition see Nelson, 2004.

The concept of corruption was central to Whig thinking and they conflated two different concepts of corruption in the same word. One may be called systematic corruption, which occurs when a political faction creates economic privileges and then uses the distribution of those privileges to build a coalition that secures control of the government. The other may be called venal corruption, which occurs when an economic interest bribes or influences government officials to provide special treatment. Systematic corruption is the construction of private interests through government policy to maintain a coalition in power. Venal corruption is the use of public office for private gain.

Republican democracy, a political system with democratic choice of representative political leadership through elections, can operate quite effectively in the presence of venal corruption. Republican democracy is a system of balanced contending interests and the interests do not only have to be expressed only through voting. Early American politicians were more concerned with republics and less concerned with democracy that we are today. Even without the democratic element, the republic conceived by classic European political theorists like Machiavelli maintains a balance of interests, including interests expressed through venal corruption. Systematic corruption, however, makes both classic republics and republican democracy unworkable. The essence of systematic corruption is the creation of economic interests that interlock with political interests, destroying the larger social balance by concentrating in one faction, control of the interest that motivate the polity. Thus the fear of faction and corruption in western political thought from Machiavelli to Madison. In a democratic republic, if one faction can manipulate interests in this way it renders the expression of economic interests through voting moot. Russia under Putin and Venezuela under Chavez are good

examples of systematically corrupt democracies.

The welter of ideas that made up Whig thinking contained insights about both systematic and venal corruption. Unfortunately, the use of the same term for both types of corruption leads to quite a bit of confusion. The confusion is compounded by the ever present manifestations of venal corruption in our world, even in 21st century America. Basic human nature makes venal corruption inevitable. The electoral rewards from successfully painting one's opponent as venally corrupt explain its continued salience in political discourse. Corruption never disappeared from the lexicon of American politics. Fears of systematic corruption, however, virtually disappeared from discussions of corruption by sometime in the late 19th century, the time when systematic corruption had largely been eliminated from American political and economic institutions through the changes identified in this paper.¹⁵

While late 18th and early 19th discussions of corruption usually mixed venal and systematic concepts, the overriding concern with systematic corruption usually showed through the rhetoric. Political and social leaders saw systematic corruption as the primary threat to republican democracy.¹⁶ Not only do their words document their concern, their actions demonstrate it. This section documents their words, largely the words of national politicians in printed and widely circulated documents intended for public reading. The remainder of the paper documents their actions, largely those of state governments. Ultimately, by their actions Americans devised a form of republican and democratic government that eliminated systematic

¹⁵Wallis 2006 provides a more detailed historical discussion of systematic corruption in western political thought.

¹⁶“Corruption on an eighteenth-century tongue – where it was an exceedingly common term – meant not only venality, but disturbance of the political conditions necessary to human virtue and freedom.” Pocock 1985, p. 78.

corruption and dramatically reduced the possibility that it would return.

Fear of faction, party and organization stand out in George Washington's farewell address. After his plea to appreciate the value of the Union and his prescient prediction that geographic divisions could imperil it, he went first to the danger of faction combined with organized interests:

All obstructions to the execution of the laws, all *combinations and associations*, under whatever plausible character, with the real design to direct, control, counteract, or awe the regular deliberation and action of the constituted authorities, are destructive of this fundamental principle and of fatal tendency. *They serve to organize faction; to give artificial and extraordinary force; to put in the place of the delegated will of the nation the will of a party, often a small but artful and enterprising minority of the community, and, according to the alternate triumphs of different parties, to make the public administration the mirror of the ill-concerted and incongruous projects of faction rather than the organ of consistent and wholesome plans, digested by common counsels and modified by mutual interests.*

However combinations or associations of the above description may now and then answer popular ends, *they are likely in the course of time and things to become potent engines by which cunning, ambitious, and unprincipled men will be enabled to subvert the power of the people, and to usurp for themselves the reins of government, destroying afterwards the very engines which have lifted them to unjust dominion.* (Richardson, 1897, vol.1, pp. 209-210; emphasis added).

“Combinations and associations” reflect more than business corporations, of course. The Whig concern about corporations was part of a larger concern with the danger of organizations in general. If politicians could use the powers of the state to form organizations, even if the organizations themselves “answered popular ends,” then the politicians had potentially created the means by which a political faction “of artificial and extraordinary force” could be forged to control the state. In the key passage, Washington argues that combinations and associations “serve to organize factions.” It isn't just that factions may use organizational privileges to grant special favors to interest groups, which is venal corruption, but that the organizations themselves

are tools to organize political factions.

Then Washington moved to the dangers of party:

I have already intimated to you the danger of parties in the State, with particular reference to the founding of them on geographical discriminations. Let me now take a more comprehensive view, and warn you in the most solemn manner against the baneful effects of the spirit of party generally.

This spirit, unfortunately, is inseparable from our nature, having its root in the strongest passions of the human mind. It exists under different shapes in all governments, more or less stifled, controlled, or repressed; but in those of the popular form it is seen in its greatest rankness and is truly their worst enemy.

The alternate domination of one faction over another, sharpened by the spirit of revenge natural to party dissension, which in different ages and countries has perpetrated the most horrid enormities, is itself a frightful despotism. But this leads at length to a more formal and permanent despotism. The disorders and miseries which result gradually incline the minds of men to seek security and repose in the absolute power of an individual, and sooner or later the chief of some prevailing faction, more able or more fortunate than his competitors, turns this disposition to the purposes of his own elevation on the ruins of public liberty.

Without looking forward to an extremity of this kind (which nevertheless ought not to be entirely out of sight), the common and continual mischiefs of the spirit of party are sufficient to make it the interest and duty of a wise people to discourage and restrain it. (Richardson, 1897, vol. 1, pp. 210-11.)

Washington neatly lays out the case against parties. First, organized factional competition can, and often did in history, lead to internal violence and civil war and a most “frightful despotism.” But this leads to an even more “formal and permanent” danger when one faction forms durable enough arrangements to elevate themselves to permanent power.¹⁷ This is the deepest Whig fear. That a group within society will use the manipulation of organizational

¹⁷ In the way of his time and ours, Washington’s use of the words “an individual... or later the chief” reflect the strong attraction of reification and metonymy: identifying the existence of a coalition of individuals who actually control the state with a single individual. This produces statements like “George Bush invaded Iraq,” even when we are perfectly aware that it was the United States government, specifically its army, that invaded Iraq. This shorthand way of referring to factions has dangers for us, however, as focus on a single individual quickly leads us to forget the insight of the first quotation: that deliberate manipulation of combinations and associations enable the organization of faction, which is what creates power.

privileges to create a set of interlocking interests. When such a pattern of interest combines with the popular fear of disorder and civil war, a stable coalition of interests arises that is not subject to political competition through electoral means and directly leads to the destruction of public liberty. Washington was warning against the dangers of systematic corruption.

It bears repeating that the Whig fears expressed by Washington are not fears about bad outcomes, they are not fears that special interests will have disproportionate influence in the political process. They are fears about the very existence and survival of a democratic republic itself.

Washington had first hand experience with the power of formal economic organizations to both create political interests and to incite factional conflict. The first challenge facing the new national government was getting its finances in order. The Constitution of 1787 was motivated, in part, by the need to give the national government an independent power to tax in order to raise revenue to repay debts from the Revolutionary War. When the first Congress met, the new Treasury Secretary, Alexander Hamilton, proposed a three part scheme. All of the existing national and state debts would be refunded into a new set of bond issues, with the national government assuming responsibility for existing state debts. A national bank, the Bank of the United States, modeled on the Bank of England, would be chartered by the national government and act as the government's financial agent in servicing the new bonds. Finally, a moderate revenue tariff would be established on imports and excise taxes would be levied on alcohol and other commodities to service the bonds and supply the national government with revenue. All three elements of Hamilton's plans passed Congress in March of 1791.

Washington's endorsement of Alexander Hamilton's plan for refinancing the national and state

debts and chartering the Bank of the United States produced the first factional party split in American political history, between the Federalists and the Republicans.

Hamilton's arguments for America's new financial system contained ominous overtones to Whig ears. In the *Report on the Public Credit* in January 1790, Hamilton proposed that "If all the public creditors receive their dues from one source... their interests will be the same. And having the same interests, they will unite in support of the fiscal arrangements of the government."¹⁸ Hamilton proposed to create precisely the type of factional interest in support of the government – an alliance with the monied interest – that Whigs feared in Britain.

Opposition to Hamilton's plan centered on the power of the national government to create corporations. When considering whether to sign or veto the Bank bill, Washington asked Hamilton, Jefferson (his Secretary of State), and Randolph (his Attorney General) for their opinions. Hamilton vigorously encouraged Washington to sign the bill. Jefferson and Randolph opposed it. Their arguments were couched in constitutional terms: the Constitution did not explicitly give the national government the power to create corporations, therefore the national government did not possess the power. Hamilton argued that the powers were implied in the constitution.¹⁹ Thus was launched one of the most enduring political debates in American history about the powers implied by the Constitution.

¹⁸"Report on the Public Credit" *American State Papers, Finance*, Vol I, p. 15. See Ferguson, 1961, for an analysis of how constitutional issues and the public debt interacted in Hamilton's thinking.

¹⁹"That every power vested in a government is in its nature *sovereign*, and includes by *force* of the *term*, a right to employ all the *means* requisite and fairly applicable to the attainment of the *ends* of such power, and which are not precluded by restrictions and exceptions specified in the Constitution, or not immoral, or not contrary to the *essential ends* of political society." McKee, p. 101, emphasis in the original.

As Banning noted, it would have been difficult to consciously design a financial program that provoked Whig fears of executive influence distorting the constitutional balance more directly than Hamilton's.²⁰ The debate about the implications of the financial plan after it was passed in 1791 opened a division within the national government.²¹ On the Federalist side the Adamses, joined by Hamilton, praised the British constitution and argued against extending democracy too far. On what would become the Republican side, Jefferson and Madison, abetted by Thomas Paine and Phillip Freneau, attacked the Adamses as monarchists and Hamilton as an aspiring Walpole. The Republicans castigated the financial plan as an attempt by Hamilton to use his position as Treasury Secretary to secure control of the government through systematic corruption. Public acrimony between the participants set in motion the formation of distinct Federalist and Republican factions in national politics. The debate placed systematic corruption in government promotion of economic development at the center of American politics for the next seventy years. When parties first appeared in the national elections of the 1790s they were not yet legitimate and corporations remained a threat to republican principles.

In the intense and occasionally vicious contest between the Federalist and Republican persuasions, it is easy to lose sight of the staunch anti-party and anti-corporation stances taken by both sides of the debate. It was here that one of the fundamental inconsistencies in Whig thinking produced a political crisis. The Federalists proposed one national corporation, not a

²⁰ "It is hard to imagine how by deliberate intent, Alexander Hamilton's economic program for the new republic could have been better calculated to exacerbate these [commonwealth] fears... they inevitably brought to mind the entire system of eighteenth-century English governmental finance, with all the consequences that entailed for minds shaped by British opposition thought." Banning, 1980, p. 128.

²¹The events of 1791 and their subsequent impact on national politics are described in Banning, 1978, and McCoy, 1980.

policy of generous or widespread incorporation, and did so on the grounds of public utility. Responsible government should be able to pursue policies that increase the general welfare. Hamilton's eloquent defense of the Bank as a means for increasing public well being was undercut by his political blunder of invoking the Bank of England.²² The Republicans countered that the Bank was an instrument of systematic corruption, not of venal corruption. The Republicans were not worried that Hamilton and his friends were making too much money, they worried that Hamilton was a budding Walpole, using his control of the Bank's activities to build a dominant coalition within American politics. The formation of a political party to oppose these corrupt practices gave rise to the Republican party and put anti-party ammunition in the hands of the Federalists. Anti-party arguments were almost as powerful for the Federalists as the anti-incorporation ammunition possessed by the Republicans.

Neither faction was pro-incorporation or pro-party. The dynamic relationship between factional interests in the presence of electoral rules for the Presidency that produced strong incentives to organize voters into two competing groups, led the both the Republicans and Federalists to accuse the other of committing a mortal sin, the use of organized interest to control the government. The Republicans had organized a political party and the Federalists had chartered a powerful corporation operating throughout the country. Both sides were vulnerable to charges of systematic corruption. The charges took on particularly heated meaning, since the inevitable implication of systematic corruption in classic Whig thinking was tyranny, slavery,

²²Hamilton earned the admiration of generations of social scientists who value financial development, but he also earned the unending animosity of social scientists who value democracy. Since most people value both, Hamilton's position in the American pantheon has always been a bit problematic.

and the end of all public liberties.²³ Thus a debate over a single corporation and the formation of one political party took on an apparently apocalyptic dimension: apocalyptic because it was not a debate about what was happening now, but how the end of American republican society would transpire if actions were not taken today to check the actions of the other side of the factional fence.

The contest between the Federalists and Republicans in the 1790s was not carried out in a unemotional manner by disinterested statesmen. Both sides had legitimate complaints about the other and neither had any claims to a strong policy position. Only a few attempted to justify positively what were, after all, very dangerous political positions. Hamilton's "Report on the Public Credit" laid out the positive case for the Bank and Hamilton continued to support corporations, but at some political costs. James Madison, attempted to lay out a justification for political parties in a series of pieces in the *National Gazette* in 1791 and 1792.²⁴ Positive spin did not dominate the struggle, however. This was an internal argument within a closely knit

²³Skinner 1998, is particularly helpful in understanding the language and logic of this argument. Because tyranny and slavery *would follow* this was not an argument about what the Federalists or Republicans were actually doing, it was an argument about what would happen next if the other group wasn't stopped. The argument, as a result, took on a character which can appear to be both paranoid and excessive to our ears. Bailyn makes a similar argument about the exact same fears expressed by the colonists in the 1760s and 1770s: "I began to see new meaning in phrases that I, like most historians, had readily dismissed as mere rhetoric and propaganda: "slavery," "corruption," "conspiracy." These inflammatory words...meant something very real to both the writers and their readers; that these were real fears, real anxieties, a sense of real danger behind these phrases, and not merely the desire to influence by rhetoric and propaganda the inert minds of an otherwise passive populace." (1965, p. ix).

²⁴See Sheehan, 1992 for a discussion of Madison's thinking. The pieces themselves can be found in Rutland, et. al. 1983.

group of leaders who were argued as only family members can.²⁵

A direct parallel developed in the debate between the Democrats and Whigs in the 1830s. Before moving on to the Second Party system and the 1830s, however, three features of the struggle between the Federalists and Republicans should be noted. First, in a struggle where one side charters corporations and the other side organizes a political party the side that sins by building a political organization has a better chance of winning elections. Second, the first party system did not lay down a basis for building a sustainable party system, since both sides remained strongly anti-party. Intense party competition at the national level lasted barely a decade.

Third, while the origins of the party conflict were not economic or social to begin with, the division of the two parties into one that was more intensely anti-corporation and one that was more intensely anti-party created poles of argument that attracted different elements within American society and, ultimately, poles of economic and social interests as well. When Sellers (1991) focuses on “land versus market” he finds justification for the division in the more general support of commercial interests for the Federalist position which, when translated to the state and local level, implied more positive government support for economic organizations. Similarly, the interests of land organized politically and use their numerical superiority to influence government at all levels. As will discussed shortly, while there were economic and social differences between the parties, the differences appear to be the result of the particular

²⁵Smelser, 1958 p. 419,, concludes that “The federalist period of American history can thus be presented as a span of twelve years in which every great public decision, every national political act, was somehow governed by fierce passions, by hatred, fear and anger. Although this view must not be stretched beyond proportion, certain it is that the founding fathers had less confidence in each other and in the Constitution than our generation has in both. From suspicion of each other it was a short step to fear and hate.”

form that factional conflict took, rather than the opposite, that the parties arose from distinct conceptualizations of economic and social interests.²⁶

National party competition subsided in the 1810s, not to rise again until the Presidential election of 1824 produced four candidates and the selection of John Quincy Adams as President in the House of Representatives, despite his receiving fewer popular and electoral votes than Andrew Jackson. When Clay was offered the position of Secretary of State and threw his support and supporters behind Adams in the House to secure Adams' election, Jackson and his supporters cried "Corrupt Bargain." The first true organized party campaign for the Presidency began in 1824 and its theme was systematic corruption.²⁷

When Jackson won the election of 1828 he and his supporters did not dismantle the Democratic party. Jackson's opponents slowly came to realize the need to form a party of their own if they were to successfully contend for political power. The issue, again, was the chartering of a national bank, this time the extension of the charter of the Second Bank of the United States (BUS). The Second Bank had been chartered in 1816, by James Madison, who

²⁶I do not want to push hard on this point, because the actual composition of interests represented by the two parties had to differ along several dimensions. Making clear causal statements about the direction of causation between the existence of party competition and the distribution of interests within the parties is fraught with complexity. I return to the question later in the paper.

²⁷"Look to the city of Washington, and let the virtuous patriots of the country weep at the spectacle. There corruption is springing into existence, and fast flourishing, Gentlemen, candidates for first office in the gift of a free people, are found electioneering and intriguing, to worm themselves into the confidence of members of congress, who support their particular favorites, are bye and bye to go forth and dictate to the people what is right." Eaton, 1824, p. p. 3-4, as quoted in Larson, 2001, p. 154. The quote is from *Letters of Wyoming*, campaign pamphlets that began appearing in 1823, written by John Eaton, later Jackson's Secretary of War. "Eaton was constructing for Jackson out of older republican cloth a coat of virtue and simplicity that made other candidates appear to be draped in ancient, British-style corruption." Larson, 2001, p. 155

had come to realize the public utility of a national bank. Jackson based his political stance less on positive policies and more on opposition to “consolidation,” an expansion of the role of the national government in American life, particularly in the form of national support for internal improvements. Jackson claimed that a moneyed conspiracy, centered on the BUS, was manipulating economic privileges in a bid to gain political control of the government. When BUS president Nicholas Biddle and Jackson’s political rival Henry Clay attempted to embarrass Jackson by forcing him to sign or veto a bill rechartering the bank in 1832, Jackson responded not only with a veto, but with a scathing denunciation of corruption in the Bank and an active dismantling of the Bank’s finances by withdrawing government deposits.²⁸

In Jackson’s Seventh Annual Message, in December 1835, as he urged Congress to change the way in which national governments dealt with the banks, he looked back on the tumultuous battle with the BUS:

After the extensive embarrassment and distress recently produced by the Bank of the United States, from which the country is now recovering, aggravated as they were by pretensions to power which defied the public authority, and which if acquiesced in by the people *would have changed the whole character of our Government*, every candid and intelligent individual must admit that for the attainment of the great advantages of a sound currency we must look to a course of legislation radically different from that which created such an institution...

All the serious dangers which our system has yet encountered may be traced to the resort to implied powers and the use of corporations clothed with privileges, the effect of which is to advance the interests of the few at the expense of the many... The bank is, in fact, but one of the *fruits of a system at war with the genius of all our institutions* -- a system founded upon a political creed the fundamental principle of which is a distrust of the popular will as a safe regulator of political power, and whose great ultimate object and inevitable result, should it prevail, is the consolidation of all power in our system in one central government. Lavish public disbursements and corporations with exclusive privileges would be its substitutes for the original and as yet sound checks and balances of the Constitution – the means by whose silent and secret operation a

²⁸The history of the Bank and the Bank War has been told in many places. Hammond 1947 and 1957, Remini 1967 and 1998, and Temin 1968 and 1969.

control would be exercised by the few over the political conduct of the many by first acquiring that control over the labor and earnings of the great body of the people. *Wherever this spirit has effected an alliance with political power, tyranny and despotism have been the fruit. If it is ever used for the ends of government, it has to be incessantly watched, or it corrupts the sources of the public virtue* and agitates the country with questions unfavorable to the harmonious and steady pursuit of its true interests.²⁹

Jackson excoriated the bank for venality, but more importantly for systematic corruption. It was not the establishment of banks and corporations *per se* that Jackson feared, but the systematic erosion of democracy by a group manipulating the economy “in an alliance with political power” that inevitably would produce tyranny and despotism.

By 1833, Clay and the Whigs had formed an opposition party. In a speech in December 1833 protesting Jackson’s removal of federal deposits, Henry Clay concluded:

The eyes and the hopes of the American people are anxiously turned to Congress. They feel that they have been deceived and insulted; their confidence abused; their interests betrayed; and their liberties in danger. They see a rapid and alarming concentration of all power in one man’s hands. They see that, by the exercise of the positive authority of the Executive, and his negative power exerted over Congress, the will of one man alone prevails, and governs the republic. The question is no longer what laws will Congress pass, but what will the Executive not veto? The President, and not Congress, is addressed for legislative action... We behold the usual incidents of approaching tyranny. The land is filled with spies and informers, and detraction and denunciation are the orders of the day. People, especially official incumbents in this place, no longer dare speak in the fearless tones of manly freemen, but in the cautious whispers of trembling slaves. The premonitory symptoms of despotism are upon us; and if Congress do not apply an instantaneous and effective remedy, the fatal collapse will soon come on, and we shall die – ignobly die – base, mean, and abject slaves; the scorn and contempt of mankind; unpitied, unwept, unmourned!³⁰

²⁹Emphasis added. The quotations are from Richardson, 1897, Volume III, pp. 164-165. Different editions of Richardson have different volume contents and pagination. In the edition available online at the University of Michigan, the quote is in Volume III, pp. 1383-84. Interesting, both forms of the publications have printing dates in 1908! Similar descriptions of systematic corruption can be found in Jackson’s public messages, including Jackson’s Veto Message, July 10, 1832, Richardson, 1897, pp. 1153-4.

³⁰Henry Clay’s speech on the “Removal of Deposits,” December 30, 1833. *Register of Debates*, 21st Congress, 1st Session, p. 94.

In parallel to the debates of the 1790s, Jackson hammered the Whigs for being monarchists and harboring corporations in a bid to control the government, while Whigs hammered right back that Jackson's formation of an ongoing political party which Whigs argued reflected Jackson's overt attempts to subvert American democracy through executive usurpation.

Again, both sides argued the same point: democracy was vulnerable to systematic manipulation of organizations, political or economic, by small groups with their own agendas and their own interests at heart. Both claimed that tyranny and slavery was just around the corner should their opponents succeed in claiming the reins of power. Just like the Federalists, the Whigs were initially handicapped by being an anti-party party.³¹ It was not until the Whigs dropped their promotion of a national bank and seriously began organizing as a party that the second party system appeared in 1838 and 1840. Sustained competition between the Whigs and Democrats as organized parties would last little more than decade, however.

Much more could be said about anti-party and anti-corporation fears in the early 19th century, but enough has been said for now to indicate the pervasiveness of Whig ideas on both sides of whatever political divides arose at the national level.

III. States and Corporations

Please take as stipulated for the seminar version of the paper that state governors and other leaders shared the same fear of systematic corruption as national leaders and that we can

³¹Holt, 1999, describes the origins of the Whig party as an anti-Jackson movement "concerned primarily with resisting the tyranny of the national executive," (p. 33) and the difficulties the Whigs had transforming their anti-party sentiments into an effective party organization.

document their words if need be.³² Pauline Maier asked “One of the great unanswered questions about the American Revolution is why, during the 1780s, state legislatures began creating corporations in record numbers. With Independence, the legislatures acquired the power to incorporate, which in Britain was a prerogative of the crown. Their willingness to exercise that power remains puzzling, however, since corporations were considered so much a part of the old order that in 1791 revolutionary France outlawed them altogether.” (Maier, 1993, p. 51) Maier’s use of record numbers is appropriate, but only in the context of the colonial precedent where few corporations were created. As Maier emphasizes, questions about corporations must be extended to ask why states chartered the kind of corporations they did and ultimately how those choices led to enormous numbers of corporations being created. Our concern lies particularly with the details of how corporations of a wide variety of types are structured by the law. Corporations should not be thought of only as business corporations, but also churches, municipalities, charitable organizations, a variety of voluntary associations, and (although not before the late 19th century) political organizations.

But first, two clouds of legal and historical obfuscation about corporations need to be gently blown away: personality and contract. Because most corporations are creatures of the states, most important corporation law is state law decided by state courts. The occasions when the national courts have rendered key decisions, however, tend to provide the framework for interpreting corporation law, particularly the *Dartmouth v. Woodward* case in 1819 and the *Santa Clara County v. Southern Pacific Railroad* case in 1886.

³²For examples see Maier 1992 and 1993, particularly the discussion of “anti-charter” attitudes; Handlin 1945, Handlin and Handlin 1948, Handlin and Handlin, 1969; and Hartz, 1948.

The *Santa Clara* case involved the status of a corporation as a legal person. Corporations have always been legal persons in American law, as they were in most of western law back to the Roman Republic. A legal person is any entity capable of bearing rights and responsibilities. Decisions about what or who a legal person is lays within the authority of the courts and the larger political entities in which courts are embedded. Section II, Article IV of the national constitution guarantees that “The *Citizens* of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.” The constitution clearly distinguished between persons and citizens.³³ Citizens all enjoy an impersonally defined bundle of rights, defined in the national and state constitutions, the “privileges and immunities” referred to. The national constitution made explicit that all rights of citizens in any specific state extended to all citizens of the United States when they were in that specific state, that is that citizens rights applied impersonally to all citizens. Corporations were never citizens in that sense and still are not today, since states have always been free to change the nature of legal personhood for the corporations they create and foreign, i.e. out of state, corporations have always been subject to some, although now more limited, discrimination.³⁴

Nonetheless, the 14th amendment declared that “All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the

³³The next clause of section 2 states that “A *Person* charged in any State with Treason, Felony, or other Crime, who shall flee from Justice, and be found in another State, shall on demand of the executive Authority of the State from which he fled, be delivered up, to be removed to the State having Jurisdiction of the Crime.” Slaves were persons, not citizens, as were a number of other individual human beings within the borders of the United States.

³⁴Henderson 1918 is extremely good on foreign corporations and on questions of legal personality and citizenship for corporations more generally.

privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.” The equation of persons with citizens in the amendment was recognized in the *Santa Clara* decision. *Santa Clara* was a complicated property tax case about the assessment of fences along the border of the railroad property decided in 1886, the Supreme Court unanimously agreed that: “The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws, applies to these corporations. We are all of opinion that it does.”³⁵ *Santa Clara* did not imply, however as some have argued, that corporations are persons just like any natural person. The decision distinguished “the case of railroads operated in one county, and of other corporations, and of natural persons...” *Santa Clara* did not imply that corporations enjoyed the same bundle of legal rights as a natural person. *Santa Clara* simply affirmed that, as legal persons, corporations enjoyed equal protection of the law.³⁶

³⁵The details of the case are fascinating if you enjoy the arcana of property taxation, which I will omit here.

³⁶ Just an example, pulled off the web, of how *Santa Clara* is often interpreted. “In 1886, . . . in the case of *Santa Clara County v. Southern Pacific Railroad Company*, the U.S. Supreme Court decided that a private corporation is a person and entitled to the legal rights and protections the Constitution affords to any person. Because the Constitution makes no mention of corporations, it is a fairly clear case of the Court's taking it upon itself to rewrite the Constitution.

Far more remarkable, however, is that the doctrine of corporate personhood, which subsequently became a cornerstone of corporate law, was introduced into this 1886 decision without argument. According to the official case record, Supreme Court Justice Morrison Remick Waite simply pronounced before the beginning of argument in the case of *Santa Clara County v. Southern Pacific Railroad Company* that “The court does not wish to hear argument on the question whether the provision in the Fourteenth Amendment to the Constitution, which forbids a State to deny to any person within its jurisdiction the equal protection of the laws,

Similarly, in the famous *Dartmouth v. Woodward* case decided in 1819, when the Supreme Court decided that the state of New Hampshire did not have the right to unilaterally alter the corporate charter of Dartmouth College without the college trustees permission, the decision was based on the contract clause of the constitution.³⁷ The court interpreted the original grant given to the college trustees by George III in 1759 as a contract and then ruled that the attempt by the state to increase the number of trustees and place certain state officials, like the Governor, as trustees *ex officio* was an impairment of the original contract. *Dartmouth* is often interpreted as a decision establishing the precedent that all corporate charters are private contracts and that charters cannot be altered unilaterally by state governments. The decision clearly states that the charters of “public corporations” could be unilaterally altered by the state and many of the corporations then in existence fit the public category as we will see shortly.³⁸ While the decision clearly states that private corporate charters were contracts, there was nothing in the decision that precluded states from including a provision in every new charter that reserved the state’s right to alter private corporate charters at will. States soon began inserting those provisions in charters and in the 1840s making such charter provisions mandatory in the state constitutions.

The important dimensions on which corporate charters varied in the late 18th and early

applies to these corporations. We are all of opinion that it does...”

Thus it was that a two-sentence assertion by a single judge elevated corporations to the status of persons under the law, prepared the way for the rise of global corporate rule, and thereby changed the course of history.” From Korten, p. 185-6.

Corporate personhood was not invented in 1886, nor were corporations elevated to equality with natural persons.

³⁷Trustees of Dartmouth College v. Woodward, 17 U. S. 518 (1819).

³⁸The distinction between public and private corporations was drawn by Justice Story.

19th century were not legal personality or corporations as inviolable contract. The key dimensions governed the internal structure of corporations and their relationship to the external world. All these dimension were subject to the control of the state, were issues of deliberate state policy, and eventually moved towards a consistent pattern across most of the states. Table 1 lays out the basic dimensions on which corporate charters varied. The only black and white dimension was special or general. A corporation created by an act of the state or national legislature is a special corporation, even if its charter is exactly the same as all charters issued to similar corporations. A general corporation is created by an administrative process open to all who meet certain objective requirements. A “general incorporation act” (or in the case of banking a “free banking act”) make incorporation available to anyone meeting set and impersonal criteria.

Corporations can be open or close or along a continuum between the two extremes. The original charter of Dartmouth College offers a good example of a close corporation. The twelve trustees of the College, along with the President, were given complete authority to act as a corporate body and to chose their own successors.³⁹ Municipal corporations were often close, with alderman and mayors who selected their own replacements or controlled the nomination procedures. Membership in an open corporation was through simple entry, stock purchase or residency, and the governing body of the corporation was subject to periodic selection and

³⁹ The original charter is included in the *Dartmouth* decision. “And also that the said trustees and their successors, or the major part of any seven or more of them, which shall convene for that purpose, as is above directed, as often as one or more of said trustees shall die, or by removal or otherwise shall, according to their judgment, become unfit or incapable to serve the interests of said college, do, as soon as may be after the death, removal or such unfitness or incapacity of such trustee or trustees, elect and appoint such trustee or trustees as shall supply the place of him or them so dying, or becoming incapable to serve the interests of said college;” 17 U. S. 532 (1819).

alteration by the corporation's members. The degree of openness/closeness in a corporate charter varied with internal governance structure as well as external features governing entry.⁴⁰

Internal dimensions of corporate structure refer to aspects that relate only to the members of the corporation, like voting rules. External dimensions refer to aspects that relate to the corporation's interaction with external actors, like limited liability rules. Many aspects of corporate structure blend internal and external effects. For example, liability rules can affect the internal distribution of liability within the corporation as well as external relationships with creditors.

Whether features of a corporation were shared with other corporations or unique (or somewhere in between) applies to almost all aspects of corporate structure. So, for example, a corporation that possesses a monopoly on the provision of a particular commodity, enjoys a unique external privilege. Banks might be chartered with the same internal structure, yet each might be assigned a unique geographic area to operate within. When corporations were rare, just the privilege of incorporating was, itself, a unique privilege that conferred substantial advantages on the incorporators, even if there was nothing unusual or unique about the charter provisions. The extent to which a particular privilege was truly unique depended on the environment in which the corporations operated. Chartered banks in Massachusetts and Pennsylvania both enjoyed the privilege of note issue, but there were many more banks in Massachusetts that

⁴⁰For voting rules in American corporations and their associated degree of openness, see Dunlavy 2004 and Hilt 2007. Guinnane, Harris, Lamoreaux, and Rosenthal 2007 and 2007A have argued that a more close form of business enterprise is actually better suited for most business than the aggressively open form required by most states in the 1840s, and thus that the choices made in the 1840s imposed some costs on American businesses. These issues are also related to the literature on the protection and security of minority stockholders, Lamoreaux and Rosenthal 2006.

shared the privilege, making it less valuable than in Pennsylvania (Wallis, Sylla, and Legler, 1994). Similarly, an open corporate structure made little difference if all the stock was given to a narrow interest group.⁴¹

The terms of charters regulating corporate structure could be flexible or fixed, again with many degrees of variation. Most early charters fixed the amount of capital for each corporation and the lines of business a corporation could engage in, while later charters eased the fixed capital requirements and allowed corporations considerable latitude over their internal structure through by-laws.

Finally, states varied in how the allowed entry and exit to take place: the creation and dissolution of corporations. Special incorporation required an act of the state legislature to create a corporation. The New York constitution of 1821 required a 2/3rds majority of the state legislature to charter a bank, at the same time that the state had already established a administrative general incorporation procedure for manufacturing companies. Exit was sometimes mandated at a fixed time in the future in the original charter, many early charters were for specified periods of time (twenty years in the case of the two national Banks of the United States). Charters with indefinite periods of duration and all corporations that might be disbanded before their mandated term, required procedures by which the corporate members or an external agent (like a court or the state) could dissolve a corporation.

If we track how actual corporations and charter patterns changed along these dimensions from the colonial period into the 1840s, we can follow directly what state legislatures were trying to accomplish and explain why they acted as they did, both from inference and by using

⁴¹The Real Estate Bank of Arkansas chartered in 1837 provides a sanguinary example, see Wallis 2008 and Worley 1950.

their own words.⁴² There was never any serious doubt that states had the authority to regulate and structure corporations on all of these dimensions. This was true whether the corporation was ecclesiastic or lay; civil, municipal, business, or eleemosynary; private or public; state owned, private owned, or mixed. The shared patterns over all types of corporations gives us a window into American ideas about politics and economics. It is important to realize that, particularly at the beginning when all corporations were special incorporations, that the details of corporate charters and therefore the internal structure and external relations of corporations could vary widely. It is not appropriate to assert, as Maier does, that all corporations were essentially the same.⁴³

Municipal and business corporations eventually became quite independent of one another and the deep historical connection between the two in the colonial period is often overlooked. Most of the corporations chartered in the 1780s were municipal corporations.⁴⁴ Kaufman provides information on the number of corporations chartered by state in Figure 1 and the share by type in Massachusetts in the 1780s, his Figure 3, and in the 1790s, his Figure 4. Massachusetts led the way in the absolute number of incorporations and they were,

⁴²The traditional focus on personality, contract, and legal theory makes sense for historians of legal theory, but doesn't help us understand the relationship between political and economic factors that shaped the development of the corporate form. Substantial and important changes in the practice of chartering corporations occurred with no associated change in legal theory or practice.

⁴³Maier, 1993, makes the assertion on page 55 citing Williston, 1888. She cites page 104 but her quotation from Williston is from the first sentence of the article on page 105. Williston's comment is essentially about the law of corporations, not about the structure of the corporations themselves. This is not meant as a serious criticism of Maier, for she clearly appreciates that corporations varied enormously in the early period.

⁴⁴Maier 1992 and 1993; Horwitz 1997 p. 112 "the archetypal American corporation of the nineteenth century is the municipality;" Davis, 1917; and Kaufman, 2008.

overwhelmingly at the beginning, municipal incorporations.

It is a serious error to overlook the important economic role of municipal corporations in the 17th and 18th century. As Teaford 1975 emphasizes, American municipal incorporations were patterned directly after English municipal corporations and English municipalities were legal entities with distinct economic functions. English municipalities were most often closed corporations, charged directly with the regulation of trade, the provision of local economic infrastructure, and the provision of order and economic security. Teaford suggests that two-thirds of all English municipalities were close corporations, run by mayors and aldermen who were self-perpetuating, or nearly so.⁴⁵ Corporate membership was limited to freemen, who status resulted from combinations of residence, occupation, and purchase.

American municipal charters and the cities they created also focused on economic issues. The 1686 charter of Albany, for example, gave the city and its freemen a monopoly on the fur trade within the province. City government played a large role in the provision of urban commercial infrastructure “New Yorkers trod through dusty thoroughfares along open sewers to draw putrid water from the city well at the same time that the municipal corporation was constructing wharfs, cranes, jetties, and market houses for the use of shippers and dealers.”⁴⁶ By 1750 there were fourteen chartered municipalities in the colonies, all of them charged with

⁴⁵“By 1700 the rule of approximately two-thirds of England’s municipalities lay in the hands of self-perpetuating oligarchies.” p. 6. Teaford cites Stevenson, 1889, vol. 3, p. 341 which I have not yet checked. For another close (??) municipal corporation directly concerned with economic development see Bogart’s articles on turnpike trusts, 2005a and 2005b.

⁴⁶Teaford 1975, quotation from pp. 18-19, Albany citation p. 21, general discussion of the economic importance and orientation of American municipal governments pp. 16-34.

“stimulating commercial development by regulating and promoting trade.”⁴⁷ The physical infrastructure of commerce, warehouses and market places, were typically owned by the municipal corporations, and these were close corporations limited to freemen of the city.

One exception to the pattern was, surprisingly, Massachusetts where the City of Boston resolutely resisted any attempts to create a municipal corporation and the colony was populated by unincorporated towns rather than incorporated cities. The citizens of Boston refused incorporation on grounds of systematic corruption. Bostonians argued that incorporation would inevitably lead to aristocracy and an elimination of liberty as favored groups used the levers of economic regulation to build an unassailable political coalition.⁴⁸ Boston would not accede to a charter until 1822.

What changed after the revolution, in Massachusetts and throughout the country? We can easily be misled if we accept the implicit assertion that the nature of municipal incorporation remained the same before and after the revolution and explain the rapid increase in municipal and other local government charters after 1780 as pent up demand frustrated by two centuries of intractable English rule.⁴⁹ In reality, the structure of municipal corporations shifted decisively on

⁴⁷Teaford, p. 17. The fourteen cities, with their dates of incorporation, are New York City 1663, 1665 (first English charter), 1686, 1731; Albany, 1686; Philadelphia, 1691, 1701; Chester, Pennsylvania, 1701; Annapolis, 1708; Perth Amboy, 1718; Bristol, Pennsylvania, 1720; Williamsburg, 1722; New Brunswick, New Jersey, 1730; Burlington, New Jersey, 1733; Norfolk, 1736; Wilmington, Delaware, 1739; Elizabeth, New Jersey, 1740; and Lancaster, Pennsylvania, 1742.” Footnote 5 text, pp. 119-120.

⁴⁸Teaford, chapter 3; Maier 1992 and 1993; Lockridge describes the pattern of New England town settlement, which I would like to discuss in detail but will not.

⁴⁹In the end of both of her papers on incorporation Maier concludes that the corporation “was therefore transformed” after the revolution (1992, p. 117) and “the charters granted in the United States after Independence created corporations undeniably distinct from those of an earlier day that had inspired the hostility of Hume, Smith, and the leaders of revolutionary

two dimensions. First, the close municipal corporation began disappearing rapidly after the revolution. Between 1775 and 1789, twenty-five towns received charters and none of them “created a governing body with life-tenure officers chosen by co-option.” Municipal elites in formerly close corporation cities fought rear guard actions, but state legislatures, disregarding the English tradition that municipal charters were inviolate, restructured the charters of Newport in 1787, Norfolk in 1788, Philadelphia after a long struggle in 1796, and New York City in 1803 and 1804 over the strong objections of the existing municipal governments.⁵⁰ This was an expansion of state power over corporations directly at odds with the idea that “rule of law” regarded all contracts as sacrosanct. The exercise of state power over public corporations was explicitly recognized and condoned in *Dartmouth*, the Supreme Court did not take on the growing power of state legislatures in this arena.

The movement from close to open corporate structure was paralleled by a movement from unique to shared features. Maier teases us when she quips that the first general incorporation act in Massachusetts acknowledged by the Handlins, an act incorporating proprietors of common lands in 1784, merely extends a “general incorporation law of 1753 to facilitate the development of land outside constituted towns and precincts,” and then notes that “Neither act specifically used the word ‘incorporate.’”⁵¹ While it is fine for Maier to cite Davis

France” (1993, p. 83-84), but a careful reading suggests that what was transformed was the political situation surrounding the creation of corporations, not the actual structure of the corporations themselves.

⁵⁰Teaford, 1975, quotation from p. 65, discussion of charter revisions, pp. 79-90.

⁵¹Maier 1992, p. 78. The citation is to Handlin and Handlin, 1969, p. 91 and the discussion on pp. 90-92 about the exercise of corporate decision making power in the case of common land ownership.

or Williston as saying that all corporations were fundamentally the same around 1780, it is strikingly clear that acts such as these in Massachusetts began to move municipal corporations into a new form where all corporations were open and whoever received them shared the same features.⁵² The movement to shared features in an environment where anyone, or almost anyone, could get a charter dramatically changed the privileges inherent in the charter. Open entry and shared privileges, even for geographically fixed municipalities, dissipates rents and reduces the benefit of privilege.

The two movements, from close to open and from unique to shared, would prove to be significant innovations in the structure of American corporations. In initially quite small ways states began to pick up this pattern of chartering. In 1784, New York passed a general incorporation act for churches, followed by soon thereafter by several other states.⁵³ A general regulatory act was a form of structuring the chartering process that still required an act of the state legislature, so it was technically a special incorporation, but provided fixed guidelines for the form the corporation could take, and so charters under regulatory acts became a shared and much more fixed. New York passed general incorporation acts or general regulatory acts for county loans officers, colleges and academies, municipal corporations, overseers of the poor, and medical societies between 1784 and 1808. Massachusetts and New York both passed general

⁵² “The most striking peculiarity found on first examination of the history of the law of business corporations is the fact that different kinds of corporations are treated without distinction, and, with few exceptions, as if the same rules were applicable to all alike. Subdivisions into special kinds are indeed made, but the classification is based on differences of fact rather than on differences in legal treatment.” Williston, 1888, p. 105.

⁵³Seavoy 1982, pp. 9 - 12, New Jersey and several other states followed with general incorporation acts for churches, but I cannot put my hand on the reference.

incorporation acts for manufacturing firms, Massachusetts in 1808/9 and in New York in 1811.⁵⁴ Massachusetts created general regulatory act for banks in 1820 (? Handlins, 1969, pp. 162-170) and essentially allowed open entry into banking thereafter (Wallis, Sylla, and Legler, 1994).

Changes in the underlying structure of corporations were beginning to shift ideas about the danger posed by corporations to republican democracy. It took time. Henderson points out that the courts “have been but slow to grasp” the implications of a “general right open to all” to form a corporation. But as “one far-seeing judge saw it while the change was in its infancy,” commenting in 1822 on the 1811 general incorporation act for manufacturing, Chief Justice Spencer of New York wrote:

The object and intention of the legislature in authorizing the association of individuals for manufacturing purposes, was, in effect, the formation of partnerships, without the risks ordinarily attending them, and to encourage internal manufacturers. There is nothing of an exclusive nature in the statute; but the benefits from associating and becoming incorporated, for the purposes held out in the act, are offered to all who will conform to its requisitions. There are no franchises and privileges which are not common to the whole community. In this respect incorporations under the statute differ from corporations to whom some exclusive or peculiar privileges are granted.⁵⁵

The move to more open and shared corporate forms began with municipal corporations. As cities both moved to open corporate forms and their populations grew, functions that were previously the purview of municipal authorities began to be contracted out to private groups. New corporations to provide infrastructure, sometimes induced by special charters to provide public services, began to increase as a percentage of all charters in the 1790s (Figure 4). Banks and insurance companies, as well as water companies, bridge and turnpike companies, and even

⁵⁴For dates in New York see Seavoy, 1982, pp. 283-285. For Massachusetts see Maier, 1992, Handlin and Handlin, 1965, p. 127.

⁵⁵Quotes from Henderson, p. 68, Spencer quotation pp. 68-9 citing *See v. Bloom*, 19 Johns. 456 (1822).

canal companies began to proliferate. The movement to incorporate churches through general acts spread more widely into open incorporation for voluntary associations, which given its important connection with political associations are discussed in the next section.

The early movement toward general incorporation hardly swept all before it, however. Only a few states adopted general incorporation procedures, notably New York and Massachusetts, and they did so only for limited and specific purposes. There were no general general incorporation acts. Every states continued to create corporations with exclusive privileges, Massachusetts included, like the Massachusetts Bank 1784, the Charles River Bridge 1785, the Beverly Cotton Manufactory in 1789, and the State Bank in 1812. The need for better overland transportation led states to corporations that were doubly privileged by exclusive special charters and state investment as well. The political advantages of creating economic privilege were not lost on American politicians. As Whig theories of systematic corruption predicted, states were jealous of their chartering privileges and quite easily drawn into them for financial and political advantage. States could not credibly promise not to create special corporations to provide valuable public services at no or low costs to taxpayers (although perhaps higher costs to users), the political advantages of such arrangements were simply too attractive. Neither could state legislatures made up of many competing factions pass up the opportunity to cement a coalition of interest through the granting of corporate privileges to all coalition members. Special incorporation and the real fear of systematic corruption were far from dead in 1830.

IV. Parties and Associations

When we turn from corporations to parties in the early nineteenth century there is a curious disconnect. The growth and development of political parties, party competition, and political leaders at the national and state level is the best developed part of American history and American political science; students of corporations can only dream of such a rich and detailed literature. Yet, while there is an extensive legal history and case law of corporation law and practice, there is no comparable legal history or case law of political parties 19th century. There simply appears to be no significant law of political parties in the United States until after the Civil War.⁵⁶

The absence of formal institutions governing political competition goes past the case of a dog that doesn't bark in the night and into the realm of immaculate conception. The United States somehow managed to obtain a system of intense and sustained political competition without any visible institutional supports, except for the call in national and state constitutions for elections at the national, state, and local level. These early 19th century developments stand in sharp contrast to politics after 1880 or so, when party competition was not only intense but institutional change in electoral systems played a key role in changing systems of representation and party competition. Institutions like the Australian ballot required states to intervene directly in the management of elections and to institute procedures by which parties were legally recognized.

Exactly how the United States managed to sustain political competition in a nascent

⁵⁶For the law of political parties, what they call the *Law of Democracy*, see Issacharoff, Karlan, and Pildes 2007. For a detailed discussion see Issacharoff and Pildes, 1998. Despite the appearance of parties in the 1790s, the 1820s, the 1830s, or the 1850s (depending on the observer and the definition of parties), there appears to be no formal law that regulates parties or the nomination process until the 1880s. For the early laws regulating parties in the late 19th century see Argersinger, 1980 and 1989.

democracy, when the failure rate for new democracies throughout history has been so high, is not a question that will be completely answered here. But elements of an answer will be advanced.

One element is the evidence in support of hypothesis (1). States were reluctant to create legal recognition of some types of organizations, particularly political parties in the late 18th and early 19th century. The strong anti-party sentiments of the founding generation inhibited the overt formation of political organizations at the local level. The clearest example is the brief appearance and rapid disappearance of “democratic-republican societies” in 1793 and 1794, which are discussed in this section. Popular aversion to overt political organizations did not prevent those who sought office from coordinating their activities in the legislatures, but they had to do it through existing social institutions. Deferential politics, a politics in which the leading elements of society advanced names and individuals for public consideration in the electoral process, was capable of manning the offices of government while keeping a strict eye out for factions and parties. But deferential politics was not a long term solution to implementation of broad based democracy in a republic. Political networks, based in the growing numbers of voluntary associations formed for a civic purpose and sanctioned by the state governments, were quite fragile coalitions of disparate interests.

The second element is that American states began opening access to a variety of formally recognized organizations, beginning with churches followed by the more general “voluntary association” that were deemed to serve a valuable public purpose. The years following the revolution saw a marked increase in general incorporation acts and general regulatory acts for churches, library societies, militia societies, fire societies, and the like throughout the colonies, particularly in New England and the Mid-Atlantic regions. These were organizations of public

utility, formed not as alternatives to government action but as private initiative explicitly supported by government sanction.⁵⁷ These voluntary organizations were pebbles of local interest that could potentially be tied together in a loose political network or coalition.

The third element was the creation of formal political organizations in the form of municipal government organized with open structures and shared features that made them more transparent vehicles for expressing the popular will (at least in theory).

The final element was the almost irresistible pressure States found themselves under from their citizens to provide for infrastructure investments in finance and transportation, whether those investments came from the private or public sector. On the one hand many highly regarded individuals urged the projects for the best reasons and on the other hand the projects themselves held out the specter of systematic corruption on a scale not seen before. It was here that the greatest dangers lay. The British and colonial corporation model in which useful public goals were attained by granting corporate privileges that were special, unique, and limited in order to induce private actors to provide public service was an essential ingredient in the founder's understanding of systematic corruption.⁵⁸ The successful revolution and subsequent

⁵⁷The civil society literature stresses the importance of independent private organizations to discipline and check the government, but in fact the existence of a rich and varied network of private organizations requires at the very least the tacit approval of the state. As Novak 2001 describes, in early 19th century America there was much more than tacit support for private organizations, few of which existed as truly voluntary associations with no assistance from the state.

⁵⁸As Maier, 1993 p. 55, put it “Nowhere were corporations more alike than in the requirement, based on English precedent, that they serve a public purpose, which the acts of incorporation often specified.... By granting charters, then, legislatures could enlist or encourage private efforts to improve or develop their states and in some instances spare taxpayers the cost of such projects.” But then on page 56, “That a particular venture would benefit the private estates of individuals seems to have been no concern – or to have been a positive consideration – as long as the public's welfare was also served.” Creating private interests was of *central*

independence required a tremendous effort to coordinate political, economic, and social resources within the American colonies. The danger of consolidation, of creating a uniform and despotic national government remained a live issue long after the revolution was won, but it contended with the equally powerful realization that coordinated public action was necessary to win American freedom and would continue to be necessary to protect and sustain it.

The process of realizing the founder's errors and correcting the structure of American institutions to ensure the survival of a democratic republic proceeded through the operation of these elements. First, political parties were not only disorganized, they were positively discouraged. Second, political organizations were forced initially to operate without legal sanction through a network of voluntary organizations. Political organizations were rarely actively persecuted, the glaring example of the Alien and Sedition Acts being the exception proving the rule at the national level.⁵⁹ The voluntary organizations were not privileged in any sense other than their ability to draw on the organizational resources of the state.

It was not a reluctance to legislate about electoral affairs that kept states from legitimizing political parties. The early 19th century was filled with highly public and contentious debates over suffrage and electoral reform, that resulted in a number of legislative and constitutional changes between 1790 and 1850.⁶⁰ The connections between political organizations and voluntary organizations in discussed in the remainder of this section.

concern to the founder's, since it was through the creation of private interests that a democratic republic could be subverted.

⁵⁹I would very much like to know if there were state level parallels to the Alien and Sedition Acts.

⁶⁰These changes are documented in Keyssar, 2000, pp. 27-42, 127-129, and the appendixes.

Open corporate structures in municipal governments and the growing pressure for internal improvement investments in transportation and finance at the state level, and water, sewage, and roads at the local level, initially led to an extended effort to use the public service model of corporate promotion. In transportation the most significant efforts largely failed.⁶¹ In finance, the most significant efforts were enormously successful so successful that states began manipulating access to bank charters for fiscal and political purposes. Van Buren and the Albany Regency's manipulation of bank chartering is a clear example of the dangers of systematic corruption. But even as the New York innovators used control over bank chartering to build a political organization, they began arguing that persistent party competition was the way to sustain democracy.⁶² New York (and Michigan) would be the first state to move to open entry "free banking" in 1838, explicitly recognizing that allowing open economic entry was a way to neutralize the adverse political effect that chartering privileged economic corporations inevitably created.

States consciously began using economic institutions to sustain political competition and, thereby, secure their democratic republics from corruption. The realization that opening economic competition could be used to secure political competition reached fruition in a wave of constitutional changes in the 1840s. States corrected the founding error: allowing everyone access to economic organizations turned out to be the key to securing political competition.

⁶¹Attempts to build privately chartered canals, funded in part with public money, in New York, Pennsylvania, Maryland and Virginia failed. Goodrich 1960 and Larson 2000.

⁶²For the fiscal implications of bank chartering see Wallis, Sylla, and Legler. For manipulation of bank chartering in New York see Benson 1961, Gunn 1988, and Bodenhorn 2006. For the pro-party ideology of the New York Democratic-Republicans see Hofstadter 1969, Wallace 1969, and Leonard 2002.

These lessons are detailed in the next section.

In the early years, attempts to create organizations for political purposes naturally arose as citizens explored the limits and structures of their new republic. Most notable were the Democratic-Republican societies formed in 1793.⁶³ Based in cities, the societies met regularly to discuss resolutions and correspondence from other societies in other cities and then to disseminate their resolutions and discussion in the rapidly growing number of newspapers. “The societies’ publications combined and emphatic affirmation of the popular right to unrestricted speech and association with interventions in the perpetual debate over the United States position relative to France and Great Britain, one of the crucial faultlines of the decade.” (Koschnik 2007, pp. 16-17) The societies were associated with emerging Republican political movement in Philadelphia, organized quietly by Jefferson and Madison to oppose the Federalist policies of Washington and Hamilton. The societies immediately came in for criticism not only as parties, but given their explicit use of old revolutionary tactics of correspondence committees and call for public action, they drew fire as potentially revolutionary organizations. The Democratic-Republican societies raised a complicated and, for their time, insoluble problem. How could organized opposition to the policies of a democratically elected government that presumably reflected the will of the people legitimately criticize that will, and should the state condone and

⁶³The Democratic Society formed in May 1793 in Philadelphia was central to the movement because the national capital was in Philadelphia, the Philadelphia Society played an active role in publicizing its activities and coordinating other societies throughout the colonies, the importance of the Philadelphia newspapers in which the societies published their resolutions, and the geographic proximity to the societies in Western Pennsylvania which were implicated in the Whiskey Rebellion. I have called these Democratic-Republican societies following the standard nomenclature and have drawn on Koschnik 2007 and Elkins and McKittrick 1993 discussion of the 1790s and later to make connections between the voluntary associations and political parties. Also see Link 1942, Foner 1976, Handlin and Handlin 1961, and Brown, 1972, 1973, and 1976.

sanction such organizations? In the face of strong adverse reaction from the government and the possibility of association with the whiskey rebellion in western Pennsylvania, the Democratic Society of Philadelphia faded away. Ultimately the Democratic-Republican societies could not resolve the problem and “their claim to represent the people appeared as partisanship, and their existence suggested an insurrection in the making. Within eighteen months of the societies’ inception, an effective involvement in national politics had become impossible.” (Koschnik 2007, p. 23)

The Democratic-Republican societies raised a fundamental question about the shape of political and cultural life in the new nation. There was no grant of “freedom of association” in the national or state constitutions and there were strong, widely shared reasons for believing that some associations could be very dangerous.⁶⁴ Nonetheless there were powerful incentives to encourage the formation of state sanctioned private organizations to perform a wide variety of functions. As Novak describes, between 1789 and 1865, even the small state of Connecticut formally recognized over 3,000 special corporations through “private” legislative acts. The compilation of these acts consists of five bound volumes, arranged into 46 titles by the purpose of the acts and the organizations they created. The titles are given in table 2. While the table includes many headings describing economic organizations one type of organization is conspicuously missing: political parties or political organizations of any type.

What happened in Philadelphia after the demise of the Democratic Society holds out a potential explanation for both the vigorous growth of voluntary organizations and the lack of formal political parties at the local level. Chastened by the failure of the Democratic-Republican

⁶⁴On the freedom of association in constitutional history see Rice 1962, Horn 1956, and Novak 2001.

societies, politically active individuals began to channel their organizing activities into voluntary associations with an explicit public purpose. The Federalists in Philadelphia were particularly adept at the creation of volunteer militia companies, which then expanded into a network of literary, scholarly, and social associations.⁶⁵ These associations were formally recognized by the state through charters which granted them existence as legal persons, enjoyed rhetorical protection against claims that they were naked attempts to organize political power because of their dual purpose as social organizations, and enabled the coordination of political, economic, and other social activity within a fluid society in which entry into organizational forms was not limited by the state. Entry into a specific organization could be limited, but if anyone could form an organization as long as it was not overtly political those organizations could serve as the basic units of nascent political coalitions.

Note, however, that these organizations could not be cemented together by strong legal ties. There was no law of political parties to do that and the still virulent anti-party ideas as late as the 1820s mitigated against any formal state actions to make an overt party system more sustainable. Political parties would have to be built out of pebbles that were hard to manage, but there were ways to do it. Special economic privileges had not been banished from the arsenal of state legislatures and they could and would be used for partisan purposes.

V. Canals, Corporations, and Collapse

The lack of formal support for parties did not prevent politicians at the state and national level from forming coalitions to govern, nominate candidates, and campaign. Many coalitions

⁶⁵Koschnik 2007 documents the network of associations and individuals through several Philadelphia voluntary associations.

built around a charismatic individual, others were built more systematically around patronage and the distribution of public services. As Richard L. McCormick has emphasized, nineteenth century political parties can be thought of as machines for economic redistribution:

Throughout the party period, while these characteristic forms of voting continued, economic policy-making manifested distinctive patterns of its own. The government's most pervasive role was that of promoting development by distributing resources and privileges to individuals and groups. An understanding of distributive policies and their centrality in nineteenth century politics helps establish the complementary relationship between electoral behavior and government decision-making.⁶⁶

McCormick surely touched an important issue, but one that has to be considerably qualified, as Formisano (2001) has pointed out. First, as discussed earlier, the national government simply did too little to be seriously redistributive. Between 1790 and 1860, roughly two-thirds of all national government expenditures went for direct military expenditures or interest on the national debt. Little of that expenditure could be easily used for patronage. The remaining third was a small share of income. Certainly rivers and harbors appropriations and the post office offered considerable latitude for patronage, and both were used extensively by national politicians to consolidate their positions, but the allocation of these kind of expenditures had little or no effect on economic development or performance.⁶⁷ Second, although the states did pursue economic projects that were quite large, relative to their own budgets, their own economies, and the national government, state projects were often authorized in a way that commanded bi-partisan support rather than intense party conflict. Canals were rarely built

⁶⁶McCormick, 1979, p. 283 and McCormick 1986 throughout.

⁶⁷The presence of a post office was important, but the location of individual post offices which is what patronage is about, is of third or fourth order importance as long as a postal system exists. See Margo, NBER DAE paper.

because Whigs or Democrats got control of the state house.⁶⁸ We need to understand both why the national government did so little and why, though economic issues were important in state politics, many state projects were bi-partisan.

Elsewhere, I have sketched out a simple model of political economy to answer these questions.⁶⁹ It begin by noting that most economic improvements in finance or transportation generate geographically specific benefits. If a legislature operates according to majority rule and legislators represent the interests of their constituents, infrastructure projects will typically fail to generate majority support since most legislative districts will pay taxes and not receive any benefits. Simply raising existing taxes to pay for infrastructure typically won't work politically. Most taxpayers do not benefit from the higher taxes and oppose the legislation. For convenience, call this *normal taxation*.

One alternative is to finance investments using taxes that are proportional to the benefit an individual receives from the investment. If the total benefits of the project exceed the costs, and if taxes can be allocated among individuals (or districts) in proportion to the benefits received from the project, then a project financed with *benefit taxation* can receive majority support. Because the value of transportation improvements are usually capitalized in land values, an *ad valorem* property tax can serve as a kind of benefit tax.⁷⁰ So, obviously, can user

⁶⁸See Formisano, 2001, on consensus between the parties rather than competition.

⁶⁹Wallis 2005 and Wallis and Weingast 2005 present and utilize the model. Wallis 2003 which concerns Indiana in 1836 does not present the model but provides the detailed historical examination.

⁷⁰Wallis 2003 considers the effect of canal construction on property values in Indiana, Heckelman and Wallis 1997, Coffman and Eschelbach 1998, Craig, Palmquist, and Weiss 1998, and Haines and Margo 2006 all consider the effect of transportation improvement on land values in the early nineteenth century.

fees. Coordinating beneficiaries and taxpayers is one way to get a majority rule democracy to invest in geographically specific improvements.

Another set of alternatives can be grouped together in the category of *taxless finance*. This way of financing improvements does not involve raising current taxes but may involve taxpayers assuming a contingent liability in the future. The simplest form of taxless finance has already been discussed. A state creates a special corporation that receives privileges, like limited competition, to induce the corporation to provide a valuable public service, like supplying money, water, or transportation. A slightly more complicated form of taxless finance occurs when the state actually invests in the corporation. The state may borrow funds and buy stock in the corporation, in return the corporation agrees to pay dividends on the state stock holdings sufficient to service the bonds, so that tax payers do not incur higher taxes.⁷¹ Taxpayers do incur a contingent liability to service the debt if the corporation is incapable of generating sufficient profits. This method of finance was often used for bank investments, including the first and second Banks of the United States and almost all of the southern state investments in banks in the 1820s and 1830s.

In another form of taxless finance, a state may decide to operate the project itself, as Pennsylvania did with the Mainline canal. In order for such an investment project to be taxless, the state must borrow more money than necessary to finance construction, using the additional borrowed funds to pay interest on outstanding bonds. If the project comes through as anticipated, tolls or user fees sufficient to service the debt mean that taxpayers are not affected, but if the project fails to deliver, taxpayers must bear the cost of the contingent liability. In all of

⁷¹Specific examples of charters embodying these arrangements can be found in Mississippi and Louisiana in the 1820s and 1830s, cited in Wallis 2005.

these cases, taxpayers who do not directly benefit from the project, must nonetheless expect to benefit in the form of lower taxes if the project succeeds. Since all taxpayers expect to benefit, a taxless finance scheme can pass a majority rule legislature..

The final method of financing infrastructure is *something for everyone*. Each district gets a small allocation of funds or projects, and each district pays taxes through the normal system or through a well defined contribution. Often something for everyone schemes involve formulas for collecting taxes and for distributing benefits. At low levels of spending, something for everyone schemes meet both the majority and exit constraints.⁷²

Collect together the four schemes and three predictions follow. Normal taxation will rarely be used for infrastructure investment because most taxpayers are worse off. Something for everyone schemes can work, but only for small projects that can be widely dispersed. Both benefit taxation and taxless finance can potentially be used to finance large projects. Both schemes may be risky, *ex ante*, but benefit taxation at least opens the possibility of raising taxes to finance expenditures.

The national government is prohibited from levying property taxes by wealth, all direct taxes must be levied by population share (Article I, Section 2). So we expect to see the national government using something for everyone and taxless finance. Keeping with the small scale of national expenditures, that is exactly what happened. Between 1790 and 1860, of the \$60 million the national government spent on transportation improvements, two-thirds were spent on rivers and harbors improvements: small projects widely scattered among districts. The national

⁷²The current interstate highway system is a something for everyone scheme in which taxes are collected on user fees levied on gasoline and expenditures across the states are determined by a formula.

government did use taxless finance for the first and second Banks of the United States, and to finance the Union Pacific and Central Pacific railroads in the 1860s (Wallis and Weingast, 2005). States, on the other hand, could use both benefit taxation and taxless finance. Of the almost \$200 million in state debt outstanding in 1841, roughly one-quarter had been issued for projects using benefit taxation and three-quarters for projects using taxless finance (Wallis, 2005).

We are now in a position to answer questions about why the states and not the national government invested in internal improvements. The national government could not use benefit taxation because of the restriction on direct taxation. Using taxless finance required the creation of a privileged corporation, government borrowing, or both. As we have already seen, anti-charter fears made it extremely difficult for the national government to charter corporations for political reasons. The combination of strong geographic antagonisms and a fear of privileged corporations made it extremely difficult for the national government to engage in economic development projects.⁷³

The states were in a different position. First, they could use benefit taxation to solve the problem of geographic mismatch. New York, Ohio, Indiana, and Illinois all used *ad valorem* property taxation to coordinate the benefits of canal investments with the distribution of tax burdens when they began canal construction (Wallis 2003).

Second, states had more political room to create corporations as long as those corporations either served a clear public purpose or brought significant economic advantages to

⁷³This is the central argument of Larson's 2000 book on *Internal Improvements*, the national government could not overcome the combination of distinct geographic interests and the prejudice against the creation of privileged economic corporations.

the state taxpayers in the form of lower taxes.⁷⁴ Wallis, Sylla, and Legler (1994) look at revenues from banks in the early 19th century. They find that states that tax bank capital, like Massachusetts, encouraged bank entry and received between a third and a half of the revenues from bank sources. States that owned bank stock, like Pennsylvania which received a third of its revenues from bank charter fees and dividends on state investments, discouraged entry to raise bank profits and state revenues. Both states were deeply involved in the promotion of banking.

The final state advantage was the growing ability of state governments to confer valuable privileges, even if just in the form of charters for voluntary associations, that could be used to balance interests within a geographically diverse coalition. State governments steadily increased their capacity to provide government services. The proponents of an expansion of state services usually emphasized public utility and their opponents often raised the specter of systematic corruption. In many cases, however, big and important decisions about state programs were made under conditions of rough consensus rather than by narrow partisan majorities. This was particularly true of states where new projects involved the imposition of new taxes, as occurred in New York, Ohio, Indiana, and Illinois. It was less true in states where taxless finance schemes were used to finance banks.⁷⁵ As Ershkowitz and Shade (1971) show, while Democrats and Whigs were often deeply divided over granting corporate charters and banking matters, they

⁷⁴Because the national government received most of its revenue from import tariffs, it is not clear that their was reducing taxes would, on net, produce greater political support for the national legislature. Lowering or raising tariffs was fraught with political complexity in the early 19th century.

⁷⁵This is an assertion that I need to document. For New York, see Benson 1961, Gunn 1988, Miller 1962; for Ohio see Scheiber 1969; for Indiana see Esarey 1912 and 1918, Wallis 2003, and Fatout 1972; for Illinois see Krenkel 1958; for Alabama see Brantley 1961; for Mississippi see Brough; for Arkansas see Worley 1950 ; for Louisiana see Green 1972.

were much closer on issues of internal improvement.

States became significantly more important and active promoters of economic development through investments in finance and transportation in the 1820s and 1830s. Rising state involvement clearly reflects the ability of states to solve the political coordination problem that the national government could not solve. The cobbling together of diverse factions, that may or may not have united under a party banner, had advanced far enough in the states to begin large scale investments. It is important not to underestimate the tie between national policy difference and state decisions. At the national level in the 1830s, the Democrats were anti-bank and the Whigs were pro-bank, but those distinctions did not translate easily into positions in the states. In some states, the Democrats were not only pro-banking in general, they were running the banks! The national competition between Democrats and Whig was personal and vicious, it was two groups accusing the other of following policies that would lead to tyranny and slavery if the other were elected. It was not a competition closely tied to policies, and certainly not to policies that shaped party positions at the state level.⁷⁶ State politics remained factional and fragmented. There were cases of stable party machines developing, the Albany Regency in New York and the ___ Families in Arkansas⁷⁷ are good examples, but by no means everywhere.

Whether rising state involvement would turn out to be a good idea or bad idea would

⁷⁶Holt, 1978, has a great set of examples of where the Whigs take different sides on the same issues in different parts of the country, and the Democrats do the same.

⁷⁷In New York Martin Van Buren and his political allies, the Regency, used the granting of bank charters and other public patronage to build the most sophisticated political organization in the country. The Regency and their political skills served as the base for Jackson's rise to national prominence and the Democratic party's development. For the specifics of banking in New York see Bodenhorn 2006 and Benson 1961. For Arkansas see Wallis 2008 and Worley 1950.

depend on whether the contingent liabilities embedded in the taxless finance schemes of the 1820s and 1830s ever came due. Unfortunately, the contingent liabilities did come due after 1839.⁷⁸ In 1841 and 1842, eight states and the Territory of Florida defaulted on their interest payments and five states repudiated all or part of their debts. In the aftermath of the crisis, states considered how they got into the situation in the first place. Obviously, the states that did not borrow did not face a crisis. Why had states been willing to borrow so much? Interestingly, only one state, Indiana, decided to prohibit future state borrowing altogether. Most states did not want to forego the chance to pursue valuable investments in finance, transportation, or other public utilities in the future.

States did, however, see that systematic corruption may have been part of the problem. In general, states blamed their bad decisions in the 1820s and 1830s on taxless finance. They remembered how in their democracies, both voters and legislators had been incapable of resisting offers from project promoters to give privileged corporations special advantages, including preferred access to state credit, in return for which taxpayers would receive valuable services at little or no cost. States moved decisively to eliminate taxless finance in the 1840s by revising their constitutions. Eleven existing states wrote new constitutions between 1842 and 1852, Table 3. The three major constitutional changes implemented in the new constitutions were designed to eliminate taxless finance.

First, states amended their constitutions to impose procedural debt restrictions. The

⁷⁸Whether states thought that their fiscal crises after 1839 were caused by forces internal or external to the United States, or by corruption or incompetence in their own governments, certainly mattered to how they responded in 1841 and 1842 when they chose to default, repudiate, or continue servicing their debts. I do not think those issues played a significant role in the constitutional reforms that followed after 1842.

procedural restrictions required that all state borrowing be preceded by a bond referendum. The referendum asked voters to approve the higher taxes necessary to service the bonds. Without voter approval, bonds could not be issued. Procedural debt restrictions did not limit the amount of debt a state could incur, but they directly eliminated taxless finance by requiring that voters agree to raise taxes immediately before any bonds could be issued. Ten states passed debt restrictions.

Second, states eliminated the pressure to create special corporate privileges by enacting constitutional provisions requiring legislatures to pass general incorporation laws. These laws allowed unlimited entry into corporate status via an administrative procedure. Eight states passed mandatory general incorporation laws.

Third, most states forbade state and local investment in private corporations. Governments could not acquire an ownership stake in a private venture. State and local government could operate their own canal, for example, but they could not invest in a private canal. It was still possible for a government to subsidize canal construction, but it could not be an owner in a private company with a residual claim to profits. Eight other states prohibited state governments from investing any state funds in private corporations.

The point of these reforms was not to eliminate state and local government investments in finance and transportation. State governments could borrow for as long and as much as they wanted to, but every time they borrowed they had to go to the voters and raise taxes immediately before any bonds could be issued. States could build canals and railroads, but they could no longer take an equity position in a private company to build a canal or railroad. They could contract with private companies to provide services, but states could not become partner with

private entities through stock ownership. The reforms were not designed to limit the creation of corporations. General incorporation acts made it much easier to get a charter. The reforms were designed to reduce or eliminate the private economic rents that were created when the political system limited entry and to change the process by which states decided to borrow money to bring some of the costs of debt service immediately to the attention of voters.

VI. Generality, Politics, and Economic Development.

The constitutional changes noted in Table 3, were initiated in the 1840s were neither spread uniformly across the country nor do they exhaust the range of constitutional changes put in place in that decade. What happened in the 1830s and 1840s was part of a learning process that would eventually spread throughout most of the states in the 1870s and 1880s. From one perspective the changes put in place in the 1840s were intended to limit the discretionary power of legislatures, and the changes certainly did that. But the changes also profoundly altered the pressures placed on legislatures from the interaction of economic and political interests. By imposing constitutional restrictions that required legislatures to act through general legislation, represented by the general incorporation act, the constitutional reforms intended to short circuit the process of systematic corruption by limiting the ability of political groups to manipulate economic interests. Lets begin with geography and timing, then return to the issue of generality and its effect on the dynamic nature of the economy and the economy's relationship to politics.

The most striking geographic feature of Table 3 is the lack of Southern and New England states that implement either procedural debt restrictions or mandate general incorporation. The two reforms were adopted in the band of states running between New York, Maryland, and

Illinois (excluding only Delaware and including Rhode Island and Louisiana). Many things distinguished these states from the South and New England, but a prominent one in the financing of internal improvements in the 1820s, 1830s, and 1840s was the use of state wide property taxation. In New York, Ohio, Indiana, and Illinois the adoption of benefit taxation was explicit at the beginning of their canal systems. In Pennsylvania and Maryland, the adoption of a state property tax came in the wake of the state defaults in the 1840s. These states were forced to face the accommodation of conflicting geographic interests. Perhaps early adoption in these states is not surprising, since the effect of a procedural restriction was to tie new debt issue closely to property taxation, by requiring all voters to approve the tax increases necessary to fund new bond issues in a bond referendum.

Southern states, in contrast, had borrowed largely to finance banks and had done so through explicit taxless finance schemes that imposed the burden of debt service on the banks themselves, rather than on the taxpayers. When southern banks failed after 1839, voters and taxpayers in Florida, Mississippi, Louisiana, and Arkansas refused to tax themselves to satisfy the bond holders and repudiated all or part of their state debts. For the time being these southern states resolved not to get back into the internal improvement business.⁷⁹ Table 4 tracks the adoption of debt restrictions through the remainder of the 19th century. Procedural debt restrictions would be adopted in southern states during reconstruction. By the 1880s most states outside of New England had closely tied debt issue to property taxation through procedural debt restrictions.

⁷⁹The exception was Louisiana, which borrowed to finance railroads in the 1850s and was the one southern state to adopt procedural debt restrictions and general incorporation in the 1840s and again in the 1850s.

Table 5 shows the dates when states adopted mandatory general incorporation provisions in their constitutions. The table is organized into existing states and new states. Every state that entered the Union after Iowa in 1846 mandated general incorporation. Southern states, again with the exception of Louisiana, also adopted mandatory incorporation provisions in their constitutions between the mid-1860s and the 1890s.

The absence of New England states from tables 4 and 5 is notable. As late as 1940, Massachusetts, Connecticut, New Hampshire, and Rhode Island did not have constitutional provisions mandating general incorporation, although by that time all four states had adopted legislation providing for general incorporation (Massachusetts in 1851, I don't have the dates on the others yet). The New England states are different to the extent that they did not incorporate provisions about general incorporation in their constitutions, but chose to do so via legislation, as they had begun doing in the late 18th century.

Why did states begin adopting mandatory general incorporation laws in the 1840s? The passage of constitutional provisions requiring general incorporation acts can be traced most clearly in New York. New York passed its first general incorporation act, for churches, in 1784. The state adopted a general act for the incorporation of manufacturing companies in 1811, the first law providing for the general incorporation of private business enterprises. In 1827, the Revised Statutes of the state created a general regulatory statute that governed the features that corporation charters could possess, including liability rules, capital limitations, corporation officers, and by laws. The Revised Statutes limited the ability of the state to create special corporations with special features, but a general regulatory statute could not prevent the state legislature from limiting entry. The Albany Regency under Van Buren deliberately limited

access to charters for banks in order to garner political support. It was a classic case of systematic corruption.⁸⁰ When the Whigs gained control of the legislature after the election of 1837, they passed the most famous general incorporation act of all, the Free Banking Act, in 1838.

But it was not until 1846 that the New York constitution was modified to mandate general incorporation. The arguments for general incorporation revolved around the issue of entry, rather than the powers and privileges given to corporations. At issue was removing from the legislature discretionary power to limit entry into a particular line of business to one or a few firms. William Leggett, a New York newspaper columnist and Loco Foco supporter, wrote extensively about general incorporation:

Nothing can be more absurd than to suppose that the advocacy of these sentiments [supporting general incorporation] implies opposition to any of the great undertakings for which special legislative authority and immunities are usually sought. We are opposed only to a violation of the great democratic principle of our government; that principle which stands at the head of the Declaration of Independence; and that which most of the states have repeated, with equal explicitness, in their separate constitutions. A general partnership law, making the peculiar advantages of a corporation available to any set of men who might chose to associate, for any lawful purpose whatsoever, would wholly obviate the objections which we urge. Such a law would confer no exclusive of special privileges; such a law would be in strict accordance with the great maxim of man's political equality; such a law would embrace the whole community in its bound, leaving capital to flow in its natural channels, and enterprise to regulate its own pursuits.⁸¹

Advocates of mandatory general incorporation hammered away at the political costs of special legislation. E. P. Hurlbut, a New York lawyer, wrote in 1845, that general incorporation would annihilate “the lobby, or third house, that embodiment of selfishness and gross corruption. The

⁸⁰The literature on banking and the Albany Regency is extensive. See Benson, *Concept, Seavoy, Origins*, and Bodenhorn, “Bank Chartering.”

⁸¹Leggett, *Democratick Editorials*, p. 342. The column appeared in the *Plaindealer*, December 3, 1836.

halls of legislation would be cleansed, and the representatives of the people would breathe a purer and freer atmosphere. All 'logrolling'... would cease."⁸² As Leggett emphasized, economic benefits would flow from general incorporation, but it was the political arguments that carried the day.

Legislatures typically granted charters with truly special corporate privileges only when there was a "great undertaking" with a public purpose involved.⁸³ The creation of special corporate privileges to serve the greater public good was a form of taxless finance that was extremely tempting to voters and legislatures. There was little to distinguish a group of promoters who came to the state legislature with a canal or railroad project funded with state bonds to be repaid with tolls and dividends, than from a group of bankers or railroad promoters who wanted a special charter in return for providing their public service. Both were offering to provide a public good without cost to the state treasury. Because neither type of project involved raising current taxes and both types involved creating privileges for a limited group within the community, citizens and politicians came to suspect that allowing legislatures to consider taxless finance proposals amounted to courting corruption.

General incorporation acts eliminated the ability of the legislature to create special economic interests in any area of the economy where firms could organize without legislative approval.⁸⁴ This underlay the logic of Hurlbut's claim that general incorporation would

⁸²Hurlbut, *Essays on Human Rights*, p. 11- 15. As quoted in Gunn, p. 231.

⁸³Many legislative acts chartering special corporations simply duplicated existing charters or, as in New York after 1827, enacted charters that fit pre-existing charter forms. In these states and cases, the only thing special about the charter was that the state legislature had passed it.

⁸⁴Not all states banned special incorporation completely. Some municipal and transportation charters need to contain unique provisions in order to regulate eminent domain (in

eliminate lobbying, since that type of legislative benefit could no longer be created and disbursed. Hurlbut's focus on eliminating the incentives for economic interests to lobby the legislature sounds different than Jackson's contemporaneous complaint that Biddle, Clay, and the Bank of the United States were a political faction attempting to subvert democracy through the manipulation of economic privilege, but they reflect the same underlying logic.

Governments that could create special economic privileges could manipulate those privileges for political purposes. The privileges could be eliminated by preventing the government from creating them or, as Hurlbut recognized, by making the privileges available to everyone. What enabled the political system to manipulate the privilege of forming a corporation was not something inherent in the nature of a corporation, but in the restricting the privilege to a small number of people.

In the language of American legislative history, the distinction is embodied in the move from special legislation to general legislation. Beginning in the 1840s states began constraining legislatures only to pass general legislation that applied to all citizens (or corporations, towns, schools, and churches) equally, and prohibited legislatures from passing special legislation for specific purposes. The Indiana constitution of 1851 was the first to make bans on special legislation widespread. Article 4, section 22 prohibited the legislature from passing special legislation in 16 areas.⁸⁵ Just as general incorporation and debt restrictions spread throughout the

the case of transportation companies) or to accommodate local demands.

⁸⁵SEC. 22. The General Assembly shall not pass local or special laws, in any of the following enumerated cases, that is to say:
 Regulating the jurisdiction and duties of justices of the peace and of constables;
 For the punishment of crimes and misdemeanors;
 Regulating the practice in courts of justice;
 Providing for changing the venue in civil and criminal cases;

country over the remainder of the century, so did restrictions on special legislation, as shown in Table 6.

The movement toward general legislation is usually thought of as part of a general movement to limit legislative discretion. The three most important were shifting powers from legislatures to governors, increasing the veto power of governors, and moving from judges appointed by legislatures (or by governors with the consent of legislatures) to direct popular election of the judiciary. [I do not yet have a time series of adoptions for these last three changes.] I suspect that the time pattern of adoption of these measures is similar to the debt restrictions, general incorporation restrictions, and general law restrictions, but I am not yet certain.

As with the debt restrictions, however, we must be careful about how we interpret the restrictions on special legislation. The restrictions were not simple limits on legislature power. Just as what we call debt restrictions did not limit the amount of debt that could be issued but

Granting divorces;
 Changing the names of persons;
 For laying out, opening and working on, highways, and for the election or appointment of supervisors;
 Vacating roads, town plats, streets, alleys and public squares,
 Summoning and empanneling grand and petit juries, and providing for their compensation;
 Regulating county and township business;
 Regulating the election of county and township officers, and their compensation;
 For the assessment and collection of taxes for State, county, township or road purposes;
 Providing for supporting common schools, and for the preservation of school funds;
 In relation to fees or salaries;
 In relation to interest on money;
 Providing for opening and conducting elections of State, county or township officers, and designating the places of voting;
 Providing for the sale of real estate belonging to minors, or other persons laboring under legal disabilities, by executors, administrators, guardians or trustees.

restricted the procedures that states had to follow to issue debt, restrictions on special legislation placed no limits on the things the legislature could do substantively but only on the way state legislatures had to do them. The central thrust of mandates for general legislation was the elimination of legislative ability to create special interest, particularly special economic interests.

I have placed particular emphasis in this paper on the role of organizations and the ability of states to create organizations for several reasons. The founding fathers preoccupation with and fears of faction, with organized interests, posed the question of how America came to be the first country with mass political parties and general incorporation laws. Fifty years after the founding, these fears were ameliorated not by eliminating organizations but by guaranteeing that the privilege of forming an organization would be extended to every citizen. Tables 3, 4, 5, and 6 show clearly that the move to restrict the ability of state governments to create special privileges originated first with economic organizations and the issuing of debt, and then moved into more general prohibitions of special legislation in a wider range of areas. It would take another half century or more before these prohibitions were embodied in state constitutions throughout the country, excepting New England where open access to organizational forms seems to have been so secure that constitutional protection was never thought necessary.

It is impossible to understate the importance of these institutional reforms to the performance of the economy. In various guises, the principle of general legislation appears as “rule of law” or “secure property rights” throughout the entire corpus of economic thinking, from development economics, to macroeconomics, to economic history. More specifically, the right to form an organization that the state will support through unbiased enforcement of laws is often taken to be a given in areas of economics, and other social sciences, that deal with the

behavior of organizations. Yet we know, looking across the world today, that a major difference between developed and developing societies is precisely their ability to support organizations. Rich and variegated civil societies are a feature of all developed countries and very few developing ones. Subsequent to the adoption of the mandatory general incorporation clause in 1846, New York enacted “more than thirty general incorporation statutes between 1846 and 1857.”⁸⁶

VII. Lessons, Conclusions, and Speculations

Since 1959, when Lipset first set out the modernization hypothesis economists, political scientists, and historians have wrestled with the establishing finer details of social behavior and institutions structure the pattern Lipset noticed. Societies that develop economically also develop politically.

This paper has set out a way to think about the process of modernization in American history. First, the founders were not only wrong about parties and corporations. They turned out to be wrong to fear a close connection between economics and politics in general, and particularly between economic and political organizations. A healthy republic and, even more, a healthy republican democracy required political competition, not rule by a virtuous elite. The founders feared that political competition would lead to civil war, it almost always had in history why not in the United States? They were wrong. To work well, democracy required open political competition and that, in turn, required economic competition. Economic competition

⁸⁶Gunn, *Decline of Authority*, p. 232. Gunn’s entire chapter on general incorporation laws, pp. 222-245, is relevant to this issue, as is Seavoy’s entire book, *Origins of the Modern Business Corporation*.

required open entry. The severe limits on political and economic entry that the founders probably would have been willing to live with, were something the American people were not content to bear.

But entry and competition in and of themselves were not self-sustaining. Political competition in a world with limited economic entry, particularly a world where the political winners get to pick the economic winners, produces systematic corruption. Electoral competition counts for little if people's underlying economic interests are being manipulated by the political system. The founders saw the danger of systematic corruption, they didn't see the solution.

Nobody did. No one alive in 1800 had any experience with a competitive, yes modern, society where political and economic competition sustained each other. Most Americans feared the growth of economic organizations, many Americans still do today. But by establishing open economic entry in the 1840s as the solution to the political problem of constraining powerful political factions, American states were able to create the economic conditions in which organized political party competition would not only be sustainable but would produce reasonably good political policies. Not policies that were the best, but policies that were continually subjected to competition and that produced institutional flexibility over time as new organizations emerged to challenge existing interests.

Why were institutional change that led to equality and democracy sustained in the United States? Why is it so hard to do in most societies? This paper gives a very definite answer to both questions. Equality, either of status or opportunity, was not an initial condition in a country that enslaved twenty percent of its population and denied effective political participation to over

half its population. Americans feared the effects of organized political interests so much that they refused to sanction legal political organizations until after the Civil War, although they tolerated the presence of parties in their midst almost from the beginning. But political interests were forced to work through other organizations. The deep fears that economic organizations would become the tools of political interests created resistance to privileged corporations. At the same time popular demands for canals, banks, and other internal improvements forced states to create them anyway. States opened access to social and economic organizations in order to protect the democratic process, not because they were trying to stimulate economic development. If states had to create corporations, they eventually figured out that it was best for the polity to create many of them, indeed to allow any citizen who wanted to get a charter. The initial movement toward general access to organizations and prohibitions and special organizations spread into law and legislation more generally. By the end of the 19th century, the idea that laws should apply equally to everyone in an unbiased manner was not just an idea, it was an institutional reality. It was a reality that did not exist in 1800. By allowing economic, social, and eventually political organizations to form at will the social dynamics necessary to sustain a competitive and representative polity were created.

Equality is not a self-implementing idea. Developing societies today desire it just as much as Americans do, but they continue to struggle to see how economic and political institutions can develop that make equal and impersonal application of the laws a sustainable outcome. It cannot be done with political change alone, nor can it be done with economic change alone. In the United States, the political system used economic changes to cement political development. Open access to economic organizations was an economic solution to a

political problem. We can't see this process at work at the national level, because until 1933, the process wasn't working at the national level. National governments in the United States did very little of central importance besides conquer the continent, defend the borders, and ensure the free movement of people and goods. Time and history corrected the founder's errors about parties and corporations, it is time we stopped fixating on the national government. Until we do, we will never learn the lessons that American history holds out for the entire world.

Table 1
Dimensions on which corporation charters vary.

Special	General	Whether a charter is passed by legislature or by administrative procedure.
Open	Close	Whether membership in the corporation is open to a wide range of individuals, e.g. shareholders or restricted to specific to certain individuals and is self-perpetuating, e.g. a board that appoints replacement members.
Internal	External	Aspects of the corporation that refer to internal relationships, e.g. election of Boards, voting schemes for shareholders, etc. versus aspects of the corporation that refer to non-corporate entities, e.g. limited liability, restrictions on entry, etc.
Shared	Unique	Whether features of the corporation are shared by other corporations or unique to it.
Flexible	Fixed	Flexible attributes are subject to change by the corporation through by-laws without approval of the state, Fixed attributes can only be changed with approval of the state.
Entry	Exit	The process by which a charter is obtained (entry) and the process by which a corporation is dissolved (exit).

Note that with the exception of the general/special distinction, these are all continuous dimensions not bivariate states of the world. All of the dimensions can be, and were, combined in many ways.

Table 2
Voluntary Associations

1. Academies	24. Manufacturing Companies
2. Agricultural Societies	25. Masonic Lodges
3. Aqueducts	26. Markets
4. Banks	27. Mechanics Societies
5. Boroughs	28. Medical Institutions
6. Bridges	29. Mining Companies
7. Burial Grounds	30. Monument Societies
8. Canals	31. Musical Societies
9. Charitable Associations	32. Powder House Companies
10. Churches	33. Railroad Companies
11. Cities	34. Religious Associations
12. Colleges	35. Saving Societies
13. Companies Navigation	36. Schools
14. Ecclesiastical Societies	37. School Districts
15. Ferries	38. School Societies
16. Fire Companies	39. Scientific Associations
17. Fishing Companies	40. Sewer Companies
18. Governors Guard	41. Steam Boat Companies
19. Highways	42. Theft Detecting Societies
20. Highway Districts	43. Towns
21. Hotel Companies	44. Turnpike Companies
22. Insurance Companies	45. Villages
23. Library Companies	46. Work House

Source: Novak, 2001, p. 175. “Taken from *Resolves and Private Laws of the State of Connecticut, 1789–1865*. 5 vols. (New Haven, 1837–1871). Also known as “private” acts, these statutes were often published separately to distinguish them from the more “public” acts of general legislation. Here the public private distinction is deployed to designate the specific versus general (applying to some versus applying to all) character of the legislation rather than the presence or absence of the state. The presence of the state is only too apparent in all these statutes.”

Table 3
States That Wrote New Constitutions
Or Amended Constitutions between 1842 and 1852,
And whether the changes affected Debt, Corporations, and Taxation.

Wrote New Constitutions		Debt	Corporations	Taxation
Rhode Island	1842	Y	Y	Y
New Jersey	1844	Y	Y	Y
Louisiana	1845	Y	Y	Y
	1851	Y	Y	Y
New York	1846	Y	Y	
Illinois	1848	Y	Y	Y
Kentucky	1850	Y	Y	
Michigan	1850	Y	Y	Y
Virginia	1850			Y
Indiana	1851	Y	Y	Y
Maryland	1851	Y	Y	Y
Ohio	1851	Y	Y	Y
Wrote First Constitution				
Iowa	1847	Y	Y	
	1857	Y	Y	
California	1849	Y	Y	Y
Wisconsin	1848	Y	Y	Y
Florida	1838		Y	Y
Amended Constitutions				
Arkansas	1846			
Pennsylvania	1857	Y		
Michigan	1843			

Source: Wallis, 2005.

A “Y” means that the state adopted some provisions regarding debt, corporations, or taxation. See appendix tables to Wallis 2005 for specific features of the constitutions.

Table 4
State Debt Limit Adoption Dates

State	State Debt Measure	State Debt Limit	Local Provisions
New Jersey	1844		1875
Texas	1845, 1876	1876	1876
Louisiana	1845, 1879	1879	1879
New York	1846		1846, 1874, 1884
Maine	1848	1848	1868, 1878
Wisconsin	1848		1848, 1874
Illinois	1848, 1870		1870
California	1849, 1879		1879
Michigan	1850		1850
Kentucky	1850		
Ohio	1851		1851
Indiana	1851	1851	1851, 1881
Maryland	1851, 1867		1867
Iowa	1857		1885(?)
Oregon	1857		1857
Minnesota	1857		1879
Pennsylvania	1858, 1873		1873
Kansas	1859		
Nevada	1864		1864
Nebraska	1866, 1875	1866, 1875	1875
South Carolina	1868, 1873, 1884		1868, 1884
Florida	1868, 1875		1868, 1875
Tennessee	1870		1870
Virginia	1870		
West Virginia	1872	1872	1872
Missouri	1875		1875
Mississippi	1875		1875
Alabama	1875	1875	1875
North Carolina	1876		1876
Colorado	1876	1876	1876
Georgia	1877	1877	1877
Idaho	1889		1889
Wyoming	1889		1889
Montana	1889		1889
Washington	1889		1889
North Dakota	1889		1889
South Dakota	1889		1889
Utah	1895		1895
Delaware			
Vermont			
Connecticut			1877
New Hampshire			1877
Massachusetts			
Arkansas			1874
Rhode Island			

Source: Wallis and Weingast, 2008

Table 5

Dates of Constitutional Provisions Requiring Incorporation under General Laws

Existing States		New States	
State	Year	State	Year
Louisiana	1845	Iowa	1846
New York	1846	Wisconsin	1848
Illinois	1848	California	1849
Michigan	1850	Minnesota	1858
Maryland	1851	Oregon	1859
Ohio	1851	Kansas	1861
Indiana	1851	West Virginia	1863
Missouri	1865	Nevada	1864
Alabama	1867	Nebraska	1867
North Carolina	1868	Colorado	1876
Arkansas	1868	North Dakota	1889
Tennessee	1870	South Dakota	1889
Pennsylvania	1874	Montana	1889
New Jersey	1875	Washington	1889
Maine	1875	Idaho	1890
Texas	1876	Wyoming	1890
Georgia	1877	Utah	1896
Mississippi	1890	Oklahoma	1907
Kentucky	1891	New Mexico	1912
South Carolina	1895	Arizona	1912
Delaware	1897		
Florida	1900		
Virginia	1902		
Vermont	1913		

As of 1940, only four states did not have constitutional restrictions: Massachusetts, Connecticut, New Hampshire, and Rhode Island.

Source: Evans, p. 11, Table 5.

Table 6
Date When States Adopts General Framework for Laws

State	Full	Partial	Early Adoptions
New York	1894(?)	1846	
Indiana	1851		
Iowa	1857	1846	
Nevada	1864		
Maryland	1864	1851	
Florida	1868	1839	1869
Texas	1869		
Illinois	1870	1848	1872
West Virginia	1872		
Pennsylvania	1874		
New Jersey	1875	1844	
Colorado	1876		
Louisiana	1879	1845	
California	1879	1849	
Minnesota	1881		
Washington	1889		
North Dakota	1889		
Wyoming	1889		
Montana	1889		
Idaho	1889		
South Dakota	1889		
Mississippi	1890		
Kentucky	1891		
Utah	1895		
South Carolina	1896		
Alabama	1901	1861	
Oklahoma	1907		
New Mexico	1911		
Arizona	1912		
Georgia		1865	
Michigan		1835	1909
Kansas		1859	
Maine		1875	
North Carolina		1835	1916
Delaware		1831	
Arkansas		1868	1951
Rhode Island		1951	

Source: Jessica Hennessey (thank you)

Note, states that are not included in the table are states for which we do not yet have constitutions or have not yet made a determination about general legislation.

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