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The Concept of Systematic Corruption in American History

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> What is really educational and beneficial to students of history is the clear view of the causes of events, and the consequent power of choosing the better policy in a particular case. Now in every practical undertaking by a state we must regard as the most powerful agent for success or failure the form of its constitution; for from this as from a fountainhead all conceptions and plans of action not only proceed, but attain their consummation.
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> —*The Histories of Polybius,* Book VI

Ever since Aristotle identified that the "true forms of government, therefore, are those in which the one, the few, or the many govern with a view to the common interests," political philosophers and practitioners have been concerned about corrupt governments: those perverted forms that "rule with a view to the private interest" (1996, book III, 1279[a], pp. 29–33). Aristotle, Polybius, Machiavelli and the sixteenth-century Italians, Harrington and the seventeenth- and eighteenth-century English writers who became known as Whigs or commonwealthmen, and Madison, Hamilton, and other American founders all grappled with the problem of corruption. Their search for an incorruptible form of true government required that they understand how corruption perverted government. Their ideas about corruption ranged from the moral and ethical values of princes and people to features of legal systems and political institutions. In the late seven-

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This paper originated in a series of conversations with Claudia Goldin, whom I gratefully acknowledge. Without her support and encouragement it never would have been written. Ed Glaeser challenged me to extend the paper further back in time, a license I took advantage of. Conversations with Naomi Lamoreaux, Lee Alston, Steve Webb, and William Novak, as well as the discussion of Morton Keller at the first preconference, while not specifically on the topic of this paper, were nonetheless extremely helpful, as were Professor Keller's comments at the final conference. At a critical time, Jeff Smith, Sally Snyder, and Barbara Gill forced me to be more precise about the concept of systematic corruption. The seminar in Early American History at the University of Maryland gave me a valuable opportunity to present the paper to historians, and their comments were invaluable. Seminars at the Mercatus Center at George Mason University, the economics departments at the University of Maryland, Stanford University, and the University of California at Irvine, the World Bank, and Universidad Carlos III provided stimulating discussion. This research was supported by National Science Foundation grants SBR-9709490, SES-0078849, and SES-0241699 Finally, the central idea in the paper developed in conjunction with my ongoing conversations with Barry Weingast and Doug North.

teenth and early eighteenth century a specific concept of corruption, which I call "systematic corruption," crystallized in Britain and spread to the American colonies and France. Having identified the disease, all three societies spent a century or more designing and implementing constitutional reforms to protect their political systems against systematic corruption. Balanced or mixed government was the cure. Modern economic development was the result.

The reawakening of interest among economists about the role that political institutions play in determining economic performance has stimulated a renewed interest in the quality of governance and corruption. While corruption did not disappear from twentieth-century American politics, it has ceased to be a major concern. Concerns over corruption disappeared from American politics because Americans figured out how to control it. This suggests that a longer view of American history may offer insights into how economic and political institutions curb corruption.

The original idea behind this volume was to examine only the Progressive Era, but Americans began grappling with corruption long before the 1890s. As it turns out, Progressive Era reformers and twenty-first-century economists think about corruption in a way that is, in one critical dimension, 180 degrees removed from the concept of corruption that prevailed until the mid-nineteenth century. The title of McCormick's essay, "The Discovery that Business Corrupts Politics," captures the essence of the modern concept of corruption, or, as Shleifer and Vishny define corruption, "the sale by government officials of government property for personal gain" (1993, p. 599).[1]

In contrast, eighteenth-century British—English, Scotch, Irish, and American—political thinkers worried much more that the king and his ministers were manipulating grants of economic privileges to secure political support for a corrupt and unconstitutional usurpation of government powers. The commonwealth indictment of corruption in British government accused the Executive of subordinating parliamentary independence by granting economic privilege in a way that eroded balanced government and, with it, checks on the crown.

Commonwealth thinking shaped American colonial political thought and prepared the colonists to interpret the actions of Crown and Parliament after 1763 as unconstitutional threats to their fundamental liberties as British citizens. Once independent, Americans worried continuously about their governments and how to design their political institutions to limit corruption.[2]

1. For other treatments of corruption see Klitgaard (1988); Rose-Ackerman (1978); and Clague (2003).

2. "In the process, the rhetoric of corruption emerged as the common grammar of politics, so overwhelming that it became difficult to discuss public questions in any other language. The age of Jefferson bequeathed to the United States an obsession with corruption that still deeply colors the way we think about politics" (Murrin 1994, p. 104).

What I define as systematic corruption is both a concrete form of political behavior and an idea. In polities plagued with systematic corruption, a group of politicians deliberately create rents by limiting entry into valuable economic activities, through grants of monopoly, restrictive corporate charters, tariffs, quotas, regulations, and the like. These rents bind the interests of the recipients to the politicians who create them. The purpose is to build a coalition that can dominate the government. Manipulating the economy for political ends is systematic corruption. Systematic corruption occurs when politics corrupts economics.

In contrast, venal corruption denotes the pursuit of private economic interests through the political process. Venal corruption occurs when economics corrupts politics. Classical thinkers worried about venal corruption, too. They talked at great length about the moral and ethical corruption of entire peoples and societies, as well as governments. They realized, however, that venal corruption is an inevitable result of human nature. So they focused their intellectual enterprise on designing and then protecting a form of government that could resist systematic corruption. By eliminating systematic corruption, they hoped to mitigate the problems of venal corruption as well.

The economic consequences of systematic corruption are enormous. Venal corruption, by comparison, is small potatoes in terms of social welfare and economic growth. Systematically corrupt governments are rent creating, not rent seeking, governments. The survival of a systematically corrupt government depends on limiting access to markets and resources in order to create rents that bind the interests of the ruling coalition together. Systematic corruption prevents development because it cripples markets. No matter what advice the International Monetary Fund or the World Bank gives to developing countries, it won't work if a country's government remains systematically corrupt.[3]

American history provides an important lesson for modern developing countries about how to eliminate systematic corruption. Not only did some American governments exhibit clear evidence of systematic corruption, but Americans consciously tried to eliminate systematic corruption through changes in their constitutions. The American lesson, however, is not just hard to learn, it is hard to understand in the first place. This is largely the result of changes in language. "Corruption" is an anachronism: it is a word with a meaning two centuries ago that it no longer has today. In the late eighteenth and early nineteenth centuries Americans were fixated on systematic corruption as the nation's primary political problem. They

3. North, Wallis, and Weingast, in "The Natural State," generalize the idea of systematically corrupt governments to include a broad class of political economy organizations that limit economic entry to create rents that are then used to solidify the political systems. Such "natural states" appear to have been dominant for the last 5,000 years of human history, and continue to exist in most countries of the world today.

feared systematic corruption and worried about venal corruption, but they *indiscriminately* used the same word to identify both.

Corruption is not the only word that poses a problem. British commonwealthmen and the American founders used language about the dangers of slavery, tyranny, conspiracy, and corruption that seem to us so highly exaggerated that it must have been purely rhetorical, or even propagandistic. The great contribution of Bernard Bailyn was to demonstrate that Whigs and American revolutionaries, in fact, believed exactly what they were saying.[4] Fears that corruption would lead to tyranny and slavery don't make sense to us today—after all, we know how the American Revolution turned out. But at the end of the eighteenth century, Americans were surrounded by countries ruled by tyrants and populated by citizens who did not possess a full measure of liberty and self-determination, the eighteenth-century definition of slavery.[5]

Paradoxically, British and American citizens believed they lived under the best system of constitutional government ever devised, one where a mixed and balanced constitution of government protected individual liberties and freedoms. Americans had a deep and abiding fear that if they were not vigilant in protecting their liberties today, their governments would become corrupt and quickly evolve into tyrannies tomorrow. In other words, they worried about what was going to happen next.

The final difficulty in understanding how Americans eliminated systematic corruption in their government is that they did not get it right on the first try. Every American constitution embodied some form of balanced government by 1787, but balanced government alone was not enough to withstand systematic corruption. Americans had more to learn than their British ancestors taught them. Systematic corruption was an inherently constitutional problem that required a constitutional solution. In the 1840s, the state finally understood that mandating open economic entry

4. "I began to see a new meaning in phrases that I, like most historians, had readily dismissed as mere rhetoric and propaganda: 'slavery,' 'corruption,' 'conspiracy'. . . . I began to suspect that they meant something very real to both the writers and their readers: that there 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" (Bailyn 1967, p. ix).

5. One of the clearest and most enlightening discussions of what British Whigs and Americans meant when they said "tyranny and slavery" is Quentin Skinner's short essay *Liberty before Liberalism.* "These writers are no less insistent, however, that a state or nation will be deprived of its liberty if it is merely subject or liable to having its actions determined by the will of anyone other than the representatives of the body politic as a whole. It may be that the community is not as a matter of fact governed tyrannically; its rulers may choose to follow the dictates of the law, so that the body politic may not in practice be deprived of any of its constitutional rights. Such a state will nevertheless be counted as living in slavery if its capacity for action is in any way dependent on the will of anyone other than the body of its own citizens" (Skinner 1998, p. 49).

undercut the ability of political factions to create rents and so to manipulate the economic system.[6]

The first section of this paper follows the concept of corruption as it developed in the philosophy of Aristotle, Polybius, Machiavelli, Harrington, through to the eighteenth-century British Whigs. Subsequent sections are devoted to Americans during the Revolution, in the 1790s, the 1830s, and finally the Progressive Era. The paper's fundamental conclusion is that the most basic economic institution in a modern, thriving, developed economy—unlimited free entry and competition unrestricted by government—developed as a solution to systematic corruption: a solution to the political problem of preventing narrow political groups from obtaining uncontested control of governments. The real lesson developing countries can learn from American history is how the United States eliminated systematic corruption. Eliminating systematic corruption required an economic solution to a political problem. Between the 1790s and 1840s, the United States developed a constitutional structure of state governments that mandated free economic entry and competition. It took seventy years, but the round of American state constitutional changes in the 1840s are the heart of what eliminated systematic corruption. American governments were so successful at eliminating systematic corruption that we no longer understand what the term corruption meant in the 1800s, nor do we worry about systematic corruption in our current political system.

1.1 From Aristotle to the British Whigs

> The King's ministers were not attacked for sitting in Parliament, but they were attacked for allegedly filling Parliament with the recipients of government patronage. For what was universally acknowledged was that if the members of the legislatures became dependent on patronage, the legislature would cease to be independent and the balance of the constitution would become corrupt. 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.
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> —J. G. A. Pocock (1985, p. 78)[7]

Aristotle was the first western philosopher to talk about mixed government: "But they are nearer the truth who combine many forms: for the con-

6. Between 1776 and 1850, the national government wrote two constitutions, and the original thirteen states wrote their first constitutions and an additional sixteen new constitutions. For the importance of opening entry as a deterrent to corruption in the 1840s state constitution see Wallis (2005).

7. Pocock's work is fundamental for understanding the evolution of ideas about balanced government and corruption. The argument is completely developed in *The Machiavellian Mo-*

stitution is better which is made up of more numerous elements" (1996, book III, 1255[a] 4). Polybius explicitly tied corruption to the idea of constitutional balance and the changing distribution of power within governments. From then, the nature of both balanced government and corruption evolved together until, by 1776, corruption became synonymous with a failure to maintain balance in the constitutional structure of government.

Aristotle defined pure forms of government as those that "govern with a view to the common interest." The pure and corrupt forms "are as follows: —of kingship, tyranny; of aristocracy, oligarchy; and of constitutional government, democracy." (1996, book III, 1279[a] 30 and 1279[b] 4). Aristotle's task in the *Politics* was to understand how constitutions affected the behavior of governments, with the purpose of discerning how good governments might be instituted in human society. Constitutions were originally thought of as literally the body politic, not as written documents or theoretical constructs.[8] All physical bodies exhibit a cycle of growth, maturity, and decay: corruption. Corruption happened to constitutions, just as certainly as decay and death happened to individuals. The central question of political philosophy asked whether a political constitution could possibly be devised that did not inevitably end in corruption.

Polybius extended Aristotle's categories of pure and corrupt forms of government into an explicit cyclical theory of constitutional development:

> So then we enumerate six forms of government,—the three commonly spoken of which I have just mentioned, [the pure forms of kingship, aristocracy, and democracy] and three more allied forms, I mean *despotism,*

ment. The intellectual history developed in this and the following sections is based on the work of Pocock (1972, 1973, 1975, 1977, 1985, 1987), Bailyn, Wood, Skinner (1978a,b), and many others. This literature is truly remarkable. What no one seems to have seen, however, is how the concept of corruption developed in western political thought ties economic and political institutions together so closely and directly. That is the contribution of this paper.

8. We speak of a person with a hearty constitution or with a fragile constitution. Constitutions were like bodies. "Like their contemporaries in England and like their predecessors for centuries before, the colonists at the beginning of the Revolutionary controversy understood by the word 'constitution' not, as we would have it, a written document or even an unwritten but deliberately contrived design of government and specification of rights beyond the power of ordinary legislation to alter; they thought of it, rather as the constituted—that is, existing—arrangement of governmental institutions, laws, and customs together with the principles and goals that animated them. So John Adams wrote that a political constitution is like 'the constitution of the human body'; 'certain contextures of the nerves, fibres, and muscles, or certain qualities of the blood and juices' some of which 'may be properly called *stamina vitae,* or essentials and fundamentals of the constitution; parts without which life itself cannot be preserved a moment" (Bailyn 1967, p. 68, citing Adams *Works,* III, pp. 478–79).

"By constitution we mean, whenever we speak with propriety and exactness, that assemblage of laws, institutions, and customs, derived from certain fixed principles of reason, directed to certain fixed objects of public good, that compose the general system, according to which the community hath agreed to be governed" (Bolingbroke 1997, p. 88). Bolingbroke was a leading Tory politician in the early eighteenth century and an articulate proponent of Commonwealth ideas.

> *oligarchy* and *mob-rule.* The first of these arises without artificial aid and in the natural order of events. Next to this, and produced from it by the aid of art and adjustment, comes kingship; which degenerating into the evil form allied to it, by which I mean tyranny, both are once more destroyed and aristocracy produced. Again the latter being in the course of nature perverted to oligarchy, and the people passionately avenging the unjust acts of their rulers, democracy comes into existence; which again by its violence and contempt of law becomes sheer mob-rule. No clearer proof of the truth of what I say could be obtained than by a careful observation of the natural origin, genesis, and decadence of these several forms of government. For it is only by seeing distinctly how each of them is produced that a distinct view can also be obtained of its growth, zenith, and decadence, and the time, circumstance, and place in which each of these may be expected to recur. (Polybius 1962, book 6, 4, p. 460)

Polybius developed a theory of "the regular cycle of constitutional revolutions, in which and the natural order in which constitutions change, are transformed, and return again to their original stage" (book 6, 10, p. 466). Any society with governments of the pure forms inevitably cycled from kingship through tyranny, aristocracy, oligarchy, democracy, and mob-rule. The mob is subdued by the noble and pure king, setting the cycle in motion again. For Polybius, corruption was the process by which one form of government evolved into another form. It was a force beyond the individual, and so beyond individual moral or ethical behavior. Corruption was an "undeviating law of nature" in unmixed governments.

Polybius believed that it was possible to prevent corruption by resorting to mixed and balanced governments that combined elements of all three pure types, which he saw in the historical example of Lycurgus, who

> accordingly combined together all the excellences and distinctive features of the best constitutions, that no part should become unduly predominant, and be perverted into its kindred vice; and that, each power being checked by the others, no one part should turn the scale or decisively out balance the others; but that, by being accurately adjusted and in exact equilibrium, the whole might remain long steady like a ship sailing close to the wind. The royal power was prevented from growing insolent by fear of the people, which had also assigned to it an adequate share in the constitution. The people in their turn were restrained from a bold contempt of the kings by fear of the Gerusia: the members of which, being selected on grounds of merit, were certain to throw their influence on the side of justice in every question that arose; and thus the party placed at a disadvantage by its conservative tendency was always strengthened and supported by the weight and influence of the Gerusia. The result of this combination has been that the Lacedaemonians retained their freedom for the longest period of any people with which we are acquainted. (book 6, 10, pp. 466–67).

Machiavelli took up Polybius. Machiavelli was concerned with stability and the process of political change.[9] Anything that disrupted the balance of the constitution was technically corruption, whether it resulted from morally corrupt individual behavior or not. Corruption resulted from inherent tendencies in the structure of societies.

The very term *balance* suggests the modern concept of an equilibrium, but constitutional balance was not thought to be a stable or self-enforcing equilibrium. Small changes in the relative balance of power between the groups that made up the political and social order could disrupt the system. A balanced constitution could ward off corruption, but it had to be maintained by the eternal vigilance of fallible human care and attention. Maintaining a balance required politicians and philosophers to define exactly what constituted the balance, that is, to define exactly what behavior was unconstitutional or corrupt. This way of thinking produced two important consequences:

First, articulating the concept of corruption was fundamental to the evolution of constitutions as fundamental law, captured in a written document, and realized in the lives of men and women through custom, practice, conflict, and adjudication. Implementing the idea that societies should be governed by laws, not men, required that society at large agree on a way to identify when it was corrupted.

Second, the balanced constitution was a theoretical construct similar to a unique and universal maximum.[10] Any movement away from the balance was a movement toward tyranny and slavery. This was true whether the movement was toward tyranny of the one, the many, or the few. The balanced constitution was a perfect equipoise from which a slippery slope led downward in all directions. Any change in the balance was inherently corrupt. Systematic corruption was not about specific behaviors; it was not like moral and ethical corruption. It was change that destabilized the political order.

The conflict between the Stuart kings and the British Parliament generated a wealth of thinking about the nature of political constitutions, including Hobbes, Harrington, and Locke. A defining moment in the history of the English constitution occurred when, on June 21, 1642, shortly before the Civil War began, two of Charles I's advisors drafted and persuaded the king to issue a document, *His Majesty's Answer to the Nineteen Propositions of Both Houses of Parliament,* in which the king declared that England was a mixed government and not a condescending monarchy. The *Answer* was a critical turning point in constitutional history because in it the king

9. See Machiavelli (1996, book I, pp. 16–18) and Pocock (1973, p. 129; 1975, pp. 83–219).

10. Harrington concluded his "Epistle to the Reader," which opens *Oceana,* with a theoretical bent: "I dare promise you that if I have not made you a good flight, I have sprung you the best quarry; for though the discourses be full of crudities, the model hath had perfect concoction" (1992, p. 2).

admitted that England possessed a balanced government, not an absolute monarchy. It quickly became part of the English constitutional canon.[11] The *Answer* did not concede sovereignty to Parliament nor was it a concession of royal prerogatives. It cemented the constitutionality of the monarchy and enshrined the idea of balanced government.

If the *Answer* guaranteed a balanced constitution, it did very little to indicate exactly how the balance was to be defined, maintained, and allowed to change. During the interregnum, the writings of James Harrington helped define the constitutional balance and move it from a static to a dynamic basis. Harrington made two fundamental contributions. First, he delineated how the distribution of military power in a society was a function of the distribution of land tenure, and thus how every government rested on a particular set of property rights in land. Second, he showed how the constitutional balance within government must correspond to the balance of military power between social orders implied by the distribution of land tenure. Harrington's model contained two balances, one of government and one of military power. His genius was to see that these two balances must correspond. A constitutional system that gave more power to an element of society (king, aristocracy, the people) than the relevant share of land possessed by that element of the population was inevitably unstable. Either the constitution or the underlying balance of military power must change and, in classic Polybian terms, Harrington defined corruption as change: "corruption in this sense signifieth no more than that the corruption of one government (as in natural bodies) is the generation of another . . ." (1992, pp. 60–61). Harrington saw balanced government as a way to provide political stability and prevent the endless struggles of the one, the few, and the many to control the government, and the warfare, disruption, and occasional tyranny that ensued.

The *Answers* and Harrington's *Oceana* defined a constitutional balance, but it was not yet in place. Between the restoration of Charles II in 1660 and the installation of William and Mary in 1688, "commonwealthmen" or "True Whigs" or "Real Whigs" articulated a version of the balanced constitution and its associated corruptions.[12] By 1675, they had developed

11. The text of the *Answer* is printed in Weston (1965), along with the *Political Catechism,* a popular document that interpreted the *Answer* in terms that would become a central part of Whig theory. The *Answer* is discussed in Pocock (1975, p. 361).

12. This group included Neville, Shaftesbury, Locke, Marvell, and Sidney. These men were contemporaries of Harrington, who died enfeebled and in poor health in 1677. The prominence of Harrington in this section is a matter of exposition. Harrington ultimately had the most influence, but he was only one of several important commonwealth thinkers. See Robbins (1959) for an in-depth treatment of the men and their ideas.

In the nineteenth century a "Whig" party developed, which was not identical with Whig theorists. Bolingbroke, for example, was a leading Whig thinker and a Tory politician. In the discussion that follows I use the term commonwealth thinkers or theorists to avoid confusion.

a coherent position containing the basic themes of opposition ideology.[13] Balanced government required that political actors, in Britain the king, the Lords, and the Commons, be truly independent of one another. If one branch of the government gained ascendancy over, or influence in, another branch the checks built into the system would be compromised. If, for example, the king gained control of the Commons, the Commons could no longer prevent the king from tyrannizing over the government.

The starting point of the commonwealth critique of the Stuart government was the creation of a standing army. This was not because a standing army was a direct physical threat to liberty. Instead, a professional standing army threatened the independence of Parliament, by filling the Commons with professional soldiers and other officeholders who careers and livelihood depended on the good will and patronage of the executive. "The standing army appears in this context as an instrument of corruption rather than of dictatorship. Army officers in Parliament are placemen, and they encourage the growth of a military establishment outside parliamentary control . . ." (Pocock 1973, p. 125).[14]

The critique widened after the new arrangements between King William and Parliament produced a complementary set of institutional changes in fiscal policy and government administration. They included the Bank of England, professionalization of tax collection and administration, and the development of new methods to fund the growing national debt.[15] Continuous warfare with France created a military-industrial complex in England. Between 1700 and 1800 government expenditures rose from 5 percent of income to 20 percent of income.[16] This unprecedented expansion of state power was equally the accomplishment of Parliament and the king, for Parliament controlled tax policy.

It was in the early eighteenth century that the concept of systematic corruption was articulated fully. Commonwealth theorists drew an explicit connection between royal manipulation of economic privileges and the securing of political power. The British had come through the civil wars of the seventeenth century with their belief in a balanced constitution intact and enhanced. They increasingly saw the House of Lords as a balance be-

13. I have drawn on Pocock's "Machiavelli, Harrington, and English Political Ideologies" in this section (1973, pp. 104–47). The argument is developed further in *The Machiavellian Moment* (1975, pp. 406–22).

14. Since the influential position of the aristocracy depended on their provision of military service, the country could have an independent nobility or a professional army, but not both. "For the power of *Peerage* and a *Standing Army* are like two buckets, the proportion that one goes down, the other exactly goes up . . ." From *A Letter from a Person of Quality to his Friend in the Country,* as quoted in Pocock (1973, p. 118).

15. On the Bank of England and the financial revolution generally see Dickson (1967); on the bureaucratization of tax collection see Brewer (1989); and for the national debt see North and Weingast (1989).

16. Mathias and O'Brian (1976) review the history of government revenues and expenditures in eighteenth-century Britain.

tween a competing monarchy and the House of Commons.[17] Independence of the three parts was required to maintain the balance. The commonwealthmen saw the economic innovations of the financial revolution as mechanisms by which the crown exerted influence in the Commons and subverted parliamentary independence. The king's tools were parliamentary patronage, the public credit, and political parties. If the king obtained enough influence in Parliament to suborn its independence, liberty would be lost and tyranny and slavery would follow.[18]

Rising defense expenditures increased the number of patronage positions in the Army, Navy, Treasury, Customs, and Excise at the disposal of the executive. By the time of the American Revolution, close to half of the House of Commons were placemen, pensioners, or represented electoral districts under the control of the king and his ministers.[19] The steadily growing public debt created a class of creditors with a direct interest in the financial stability of the government, many of them members of Parliament. The large profits to be made in marketing and servicing the debt went to the favored few financial houses, banks, and chartered trading companies, all of whom had connections in both the executive and Parliament. There was ample reason to doubt the independence of individual members of Parliament. And finally, the manipulations of politicians like Walpole created groups within the government whose interest "is that of men attached to the government; or to speak more properly, to the persons of those who govern; or, to speak more properly still, to the power profit, or protection they acquire by the favour of these persons, but enemies to the constitution" (Bolingbroke 1997, p. 85). The creation of a political party within Parliament that was headed by the king, organized by his ministers, financed by corporate privileges, and coordinated by the national debt, threatened the end of balanced government and the establishment of a unitary executive tyranny.[20]

17. This is the theme of Weston (1965).

18. "It is certain then, that if ever such men as call themselves friends of the government, but are real enemies of the constitution, prevail, they will make it a capital point of their wicked policy to keep up a standing army. . . . To destroy British liberty with an army of Britons, is not a measure so sure of success as some people may believe. To corrupt the Parliament is a slower, but might prove a more effectual method; and two or three hundred mercenaries in the two Houses, if they could be listed there, would be more fatal to the constitution, than ten times as many thousands in red and in blue out of them. Parliaments are the true guardians of liberty. For this principally they were instituted; and this is the principal article of that great and noble trust, which the collective body of the people of Britain reposes in the representative. But then no slavery can be so effectually brought and fixed upon us as parliamentary slavery. By the corruption of Parliament, and the absolute influence of a King, or his minister, on the two Houses, we return to that state, and are really governed by the arbitrary rule of one man" (Bolingbroke 1997, pp. 92, 93–94).

19. See the essays on "Parliamentary Patronage," pp. 46–56, and on "Placemen and Pensioners," pp. 118–26 in Namier and Brooke (1964).

20. The commonwealthmen opposed all political parties as a manifestation of corruption. To confuse matters, at the same time one of the parties that developed in Britain was the Whig Party, which is distinct from the Whig/Commonwealth thinkers. Bolingbroke, as noted, was a prominent Tory politician as well as a prominent Whig philosopher.

The British in the eighteenth century certainly enjoyed better government than they, and perhaps the world, had ever seen. Britons on both sides of the Atlantic extolled the virtues of the British constitution. John Toland called the British government "the most free and best constituted in the world." John Adams claimed, "no Government that ever existed was so essentially free." Even the Frenchman Montesquieu talked of "this beautiful system."[21] The Whigs believed in the perfect balance of the British constitution. In this light, it is easy to dismiss commonwealth claims of corruption as paranoia. To do so, however, overlooks that Whigs were not concerned about the current state of Britain. Commonwealthmen feared what would happen next. They had no historical yardstick to judge whether the changes that British society and government were undergoing in the eighteenth century were good or bad. Commonwealthmen believed, with the deepest conviction, that if executive influence in Parliament was allowed to go unchecked, then the next stage in British government would inevitably be tyranny and slavery.

The heart of the commonwealth attack on corruption criticized the government's relation to the economy. Adam Smith attacked the system of government-granted mercantilist privileges (Smith 1981). In *Cato's Letters,* Trenchard and Gordon (1995) challenged the use of chartered corporations to promote economic activity that potentially created economic rents (by limiting entry) that could be used by the Crown to cement economic interests to its cause (no. 3, 1720, 44–45).[22] "For as to that class of ravens, whose wealth has cost the nation its all, as they are manifest enemies to God and man, no man can call them his neighbours: They are rogues of prey, they are stock-jobbers, they are a conspiracy of stock-jobbers!"[23] The financial revolution brought with it numerous instances of special privileges granted by the government.[24] The combined charges of systematic corruption, suborning the independence of politicians and Parliament, and individual corruption, including the venality and greed of stock-jobbers and speculators, packed a powerful message.

21. Quotations from Wood (1969, p. 11).

22. "Companies and joint-stocks are always established for the encouragement and benefit of trade; though they always happen to mar and cramp trade" (Trenchard and Gordon [1720] 1995, *Cato's Letters,* no. 9, p. 69).

23. The title of *Letter* no. 6, December 10, 1720, conveys the sentiments of Trenchard and Gordon: *How easily the People are bubbled by Deceivers. Further Caution against deceitful Remedies for the publick sufferings from the wicked Execution of the South-Sea Scheme.*

24. As Dickson summarized: "Finally, it is worth noting that while few aspects of the Financial Revolution were of greater political and economic utility than the development of a market in securities in London, none united contemporary opinion more against it. It was denounced as inherently wicked and against the public interest. The phrase 'stock-jobbing', freely used to denote every kind of activity in the market, had clear overtones of self-interest and corruption. An anthology of comments by contemporaries would be remarkably uniform, indeed monotonous, in its tone, and uninformative about how the market actually worked" (1967, pp. 32–33).

By the mid-eighteenth century commonwealthmen decried the corrupting evils of executive patronage, the public credit, and political parties. Commonwealth ideals were important elements of the political conversation in the eighteenth century. They defined, with clear, bright lines, what was and was not constitutional. Britain, of course, was in the midst of a phenomenal rise to world power, and most Britons were happily apathetic about the supposed corruption of their government. In Briton, the commonwealthmen "were not in any sense of the word an organized opposition. . . . Without leaders and organization the reformers failed. When they achieved these they still failed to attract sufficient public support and interest. A part of their failure must be attributed to their detestation of party. . . . The Real Whigs were not a coherent party. They professed almost as many creeds in politics as in religion." Yet "In America the academic ideas of the Whigs of the British Isles were fruitful and found practical expression."[25]

1.2 Corruption, Revolution, and Constitutions

> Sir, we have done everything that could be done to avert the storm which is now coming on. We have petitioned; we have remonstrated; we have supplicated; we have prostrated ourselves before the throne, and have implored its interposition to attest the tyrannical hands of the ministry and Parliament.
>
> The battle, sir, is not to the strong alone; it is to the vigilant, the active, the brave. Besides, sir, we have no election. If we were base enough to desire it, it is now too late to retire from the contest. There is no retreat but in submission and slavery! Our chains are forged. Their clanking may be heard on the plains of Boston! The war is inevitable—and let it come!
>
> —Patrick Henry, *Address to the Virginia Provincial Convention,* March 23, 1775

> The notion of a legislative power exercised conjointly by kings, lords and commons is a notion of legislative sovereignty undeveloped in classical republican theory; its presence in the *Answer* is a reminder that the notion of "separation of powers," though invented largely in England, could not be effective there and could be realized in the United States only after rejection of parliamentary government.
>
> —J. G. A. Pocock (1987, p. 310)

We have reached the point where British and American paths divide. The "republican synthesis" in American history provides a convincing ex-

25. Robbins (1959) quotes from pages 381, 382, and 385.

planation for why Americans revolted and what "made their revolution so unusual, for they revolted not against the English constitution but on behalf of it" (Wood 1969, p. 10).[26] The desire to preserve the existing constitution made the American revolution one motivated by fear rather than hope. The widespread perception of English corruption, on both sides of the Atlantic, inexorably drove the Americans to independence once a wedge opened between Parliament and the colonies in 1763. The fear in the American colonies was that England, "once the land of liberty—the school of patriots—the nurse of heroes, has become the land of slavery—the school of parricides and the nurse of tyrants."[27] At its root, the fear driving the American Revolution was Polybian. The influence of the executive in Parliament had unbalanced the constitution. What inevitably followed monarchy, no matter how pure the intentions of those who produced the monarchy, was tyranny. As Patrick Henry declared: "Our chains are forged. Their clanking may be heard on the plains of Boston!"

Any government organized along commonwealth lines should immediately have put in place a constitution with balanced government. In May of 1776, the Continental Congress asked the states to write their own constitutions. By July 3, New Jersey had drafted a new constitution which, among its many features, distinctly articulated the separation of powers:

> XX. That the legislative department of this government may, as much as possible, be, preserved from all suspicion of corruption, none of the Judges of the Supreme or other Courts, Sheriffs, or any other person or persons possessed of any post of profit under the government, other than Justices of the Peace, shall be entitled to a seat in the Assembly: but that, on his being elected, and taking his seat, his office or post shall be considered as vacant.[28]

The Constitution of Maryland, ratified in November 1776, stipulated in Section 6 of the Declaration of Rights: "That the legislative, executive and judicial powers of government, ought to be forever separate and distinct from each other." Separation of powers was the most visible way that Americans addressed systematic political corruption, but the entire structure of early state constitutions, with their articulated branches, attempted to systematize balanced government.

The powers assumed by the states in their constitutions were not powers

26. Wood (1969, p. 10). The republican synthesis literature is neatly summarized and discussed in Shalhope (1972, 1982).

27. The quotation is from a letter from Charles Lee to Robert Morris, January 3, 1776, as quoted by Wood (1969, p. 32).

28. New Jersey, Constitution of 1776, Article 20. The New Jersey Constitution of 1844, Article 3, Section 1, read: "1. The powers of the government shall be divided into three distinct departments—the legislative, executive and judicial; and no person or persons belonging to, or constituting one of these departments, shall exercise any of the powers properly belonging to either of the others, except as herein expressly provided" (Wallis, *NBER/Maryland State Constitution Project*).

necessarily denied to the national government. But once states defined their powers they could not be taken by the national government without substantial political cost. The second national constitution, written in 1787, gave the national government broad and generous powers. But only in the areas of military and international affairs, public lands, international trade and commercial policy, and (to a lesser and immediately disputed extent) financial and monetary policy, did the national government possess well-defined *exclusive* powers. Even in these areas, with the exception of military defense and international relations, the national government subsequently found it extremely difficult for political reasons to exercise its constitutional powers.[29] National government action inevitably raised the specter of systematic corruption.

The ability of states to legislate, regulate, or promote almost any aspect of economic and social behavior meant that the states, and not the national government, became the focal point of economic policies. Americans were embarking on two new experiments in government: written constitutions and widespread government support of private organizations. The first experiment is a central part of American history. The second experiment, successful as it was, is so taken for granted that we rarely recognize how important government support of private organizations was for American social and economic development. As de Tocqueville famously noted: "Americans of all ages, all stations in life, and all types of dispositions are forever forming associations. There are not only commercial and industrial associations in which all take part, but others of a thousand different types—religious, moral, serious, futile, very general and very limited, immensely large and very minutes. . . . In every case, at the head of any new undertaking, where in France you would find the government or in England some territorial magnate, in the United States you are sure to find an association" (1966, p. 513).

The American colonists brought the ancient English constitution with them, but not a king or an aristocracy, two of the critical elements in the constitutional balance. This led to a more egalitarian society, a deep belief in the right of individuals to assemble, and more vigorous private sector organizations. In Europe, the right to form voluntary organizations was not universal; one found governments and territorial magnates at the head of organizations because they possessed the sometimes implicit, but often explicit, privilege to form organizations. The ability to form corporations was limited to the social and economic elite. Limited entry created the economic rents that made royal grants of privilege to the monied interests so valuable. In America, the freedom to assemble, the ability to form religious, political, economic, and social organizations did not go undisputed after the revolution. Deciding how much public support should be given to

29. This point is developed further in Wallis (2005b) and Wallis and Weingast (2005).

private organizations was important and, at least in the economic and political world, very contentious.

America's balanced state constitutions recognized the Harringtonian imperative of balancing power within the government in the same proportion as land ownership was balanced in the population. "Power results from the real property of society."[30] The equality of land ownership posed new and vexing problems for American politicians, problems without English antecedents. The distribution of land did not mirror the distribution of social prestige or the presumed distribution of leadership talents within the "natural elite." Freedom of assembly, freedom of speech, and freedom of petition were fundamental rights. How far did these rights extend into the politically competent, independent, landowning citizenry? Who had the right to vote, to incorporate a business, or form a political party? Britain's financial revolution did not represent a move toward an economy or society with more open entry; it restricted entry. Adam Smith and the classical economists built their criticism of government policy on mercantilist limitations on access to economic organization. Kings and ministers used limited access to create economic rents, then used the spoils from the rents to purchase political influence, and thus eroded the independence of Parliament and corrupted the entire political system. Corporations and stock-jobbers represented the very essence of both systematic and venal corruption. How was the United States to deal with the identical problem?

1.3 Corruption and the First Crisis of National Politics

> "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 (1978, p. 128)

Straightening out the nation's finances instigated the first battle over corruption in the new republic. Hamilton's proposed financial policies—refunding national and state debts, a national bank, a moderate revenue tariff, and excise taxes—all stimulated opposition and debate when Congress considered them in the first Congress, which ended in March of 1791. Each of Hamilton's measures raised fears of corruption in classic commonwealth terms, but all of them passed. The debate over the meaning of

30. Joseph Galloway to the Continental Congress, as quoted by Jensen (1940, p. 66), quoting John Adam's Notes on Debates, *Works of John Adams,* 2:372.

the new financial system in the summer of 1791, however, produced a conflagration of fears about systematic corruption, and led to the creation of an opposition party in the United States. All of the policy measures at issue were economic, and the critical element in the debate was the effect of the economic policies on politics.

We have already seen how the financial revolution in England created a funded national debt, a bureaucracy of excise and tariff collectors, a national bank, and an interlocking set of financial intermediaries and chartered corporations that marketed and traded in government debt. As the bureaucracy expanded, so did opportunities for executive patronage. The ability to tie the interests of the financial community to the policies of the government through the medium of the national debt and corporate charters allowed the Crown to extend its influence and undermine the independence of Parliament. The danger of the English system of finance was to fundamental liberties; it was systematic corruption, and the identification of financial interests with the Crown was the mechanism of corruption.

Hamilton's arguments for America's new financial system had ominous overtones. 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."[31] Hamilton proposed precisely the type of arrangement with the monied interest that commonwealthmen feared in Britain. A typical response to Hamilton's proposals came from the Virginia legislature's memorial to Congress on December 16, 1790:

> That it is with great concern they find themselves compelled, from a sense of duty, to call the attention of Congress to an act of their last session, entitled "An act making provision for the debt of the United States," which the General Assembly conceives neither policy, justice, nor the constitution, warrants. Republican policy, in the opinion of your memorialists, could scarcely have suggested those clauses in the aforesaid act, which limit the right of the United States, in their redemption of the public debt. On the contrary, they discern a striking resemblance between this system and that which was introduced into England at the Revolution—a system which has perpetuated upon that nation an enormous debt, and has, moreover, insinuated into the hands of the Executive an unbounded influence, which, pervading every branch of the Government, bears down all opposition, and daily threatens the destruction of every thing that appertains to English liberty. The same causes produce the same effects.

31. "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.

> In an agricultural country like this, therefore, to erect and concentrate and perpetuate a large moneyed interest, is a measure which your memorialists apprehend must, in the course of human events, produce one or other of two evils: the prostration of agriculture at the feet of commerce, or a change in the present form of Federal Government, fatal to the existence of American liberty. (*American State Papers, Finance,* vol. I, p. 90)

The Virginians questioned whether "Republican policy," that is, commonwealth ideas, could have suggested such a financial program and drew a direct connection between Hamilton's plan and English executive corruption, which has "insinuated into the hands of the Executive an unbounded influence." In typical commonwealth style, the memorial raises the alarm that Hamilton's plans threaten the "existence of American liberty."

As Banning noted (1978), it would have been difficult to consciously design a financial program that provoked commonwealth fears of executive influence more directly than Hamilton's. The debate about the implications of the financial plan after it was passed in 1791 opened a division within the national government.[32] 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 Prime Minister. 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 parties in national politics. The way in which the conflict was resolved placed corruption in governmental promotion of economic development at the center of American politics for the next seventy years. It took a long time for Americans to figure out how to write their constitutions. The conflict of the 1790s brought to prominence several contradictions in the American experiment with republican government.

Popular sovereignty versus tyranny of the majority. In the ratification debates, both the Federalists and the Anti-Federalists argued for popular sovereignty as a critical element in the new American system. Sovereignty, lodged with the people, could be delegated to representatives through election. Yet ultimately sovereignty remained in the hands of the voters. But to those steeped in commonwealth theory, tyranny of the many was just as much of a threat as tyranny of the one or the few. The exercise of popular sovereignty necessarily involved the risk of tyranny of the majority, a risk that Madison and Hamilton both appreciated. Madison hoped the ex-

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

tended republic would mitigate the risk, as he argued famously in Federalist #10. The greatest danger from majority rule lay in the possibility that a demagogue would arise, unify a majority of the voters behind him, and lead the government into despotism. Such a leader might override the checks and balances built into system by sweeping a majority through all the branches of government. Madison's hopes didn't last a decade: by the early 1790s the Federalists controlled all three branches of the national government.[33]

Political parties versus corruption. The Constitution itself offered a way for Jefferson and Madison to oppose the Federalists: the formation of an opposition party. The logic of the winner-take-all electoral process for President, as well as other offices, seemed to guarantee that two competing parties would eventually emerge.[34] Despite the strict separation of executive and legislative functions in the Constitution, the President and Congress still had to find a way to come to an agreement about how government was to be carried out, a coordination eventually accomplished through political parties. But the formation of an overt opposition party carried with it an explicit danger. The incumbent Federalists, with Washington at their head, could plausibly claim that their administration was nonpartisan. Parties and factions were inherently and systematically corrupt. For the Republicans to contest for control of the government as an organized party exposed them to the charge of per se corruption in the 1790s.[35]

Rather than stressing the need for competing parties, Madison and the Republicans emphasized the need for one government with the right policies. They claimed that they stood on the side of the angels in a debate over republican versus monarchical government and pure versus corrupt methods of governing.[36] Tarring Adams and the Federalists with being closet

33. "The success of the Federalist Party in gaining control of all three branches of the national government called into question the fundamental premise of the Madisonian federalism of 1787–8: that durable factious majorities would be far less likely to coalesce at the national level of politics" (Ferejohn, Rakove, and Riley 2001, p. 3).

34. "Yet even amid the presumed 'paranoia' of the 1790s, with insidious motives being ascribed all around, both Federalists and Republicans opted to seek advantage not through a strategy of exit but rather by exploiting potential opportunities within the Constitution itself. Both parties quickly discovered a strong incentive to convert the untested mechanism of presidential election into an occasion for political innovation. In 1787 no one had expected the presidency to emerge as the crucial focus for national political competition, but by 1796, and even more so by 1800, it was evident that control of the executive was essential to control of the government" (Ferejohn, Rakove, and Riley 2001, p. 7).

35. In particular see Hofstadter (1969, pp. 80–86) and the third chapter, "The Jeffersonians in Opposition." Madison, in a series of articles published in the *National Gazette,* attempted to provide an intellectual justification for parties. He drew on the classic distinction between the few and the many, arguing that the Republicans represented the many.

36. "A final aspect of these essays is worth remark, since it represents a strain in Republican thought which we encounter again and again: it is the effort to reduce the issue between the two sides to a dispute over the merits of republican government. Today this seems a false question; the issues of funding, assumption, the bank, taxation, and foreign policy seem real

monarchists played well to some voters, but it was the fear of executive influence in the legislature, wielded by Prime Minister Hamilton through the coordinating mechanism of the Bank of the United States and the national debt that posed the greatest threat. It was a threat that resonated with a century of British political writing and decades of American paranoia over corruption in the Britain. The negative political implications of the Republicans' existence as an organized political party were minimized by stressing the rightness of their cause. "The situation of the public good, in the hands of two parties nearly poised as to numbers, must be extremely perilous. Truth is a thing, not of divisibility into conflicting parts, but of unity. Hence both sides cannot be right. Every patriot deprecates a disunion, which is only to be obviated by a national preference for one of these parties."[37] If the Republicans were truly right, then their cause was not a partisan one but a righteous one, and when the country came to see the wisdom of their position there would no longer be a need for competing parties.

Corruption versus promotion of economic development. By building their case against Hamilton and the Federalists along traditional commonwealth lines, the Republicans gained the moral force of a century of British and American thinking about corruption in government. At the same time, they boxed themselves into a fundamental dilemma. The Republicans were just as pro-growth and development as the Federalists. Their arguments against the Federalists were political, not economic. They were not arguing that Hamilton's plan wouldn't work in economic terms, but that Hamilton was taking the first step down the slippery slope to executive tyranny. How then did the Republicans propose to promote economic development?

The only model available at the end of the eighteenth century was one that had been used by European governments to promote economic development for centuries: by creating public service corporations. Those corporations were given public privileges in order to induce them to provide public services. Their public privileges generated private rents by limiting entry. Drew McCoy's book, *Elusive Republic,* makes abundantly clear that

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and substantial enough without superimposing on them an artificial quarrel over a question of monarchy and hereditary power which all but the tiniest handful of Americans agreed. But the exaggerated passions of both sides can be understood if we remember that most politically conscious Americans were acutely aware of being involved in a political experiment in republicanism that was attended by difficulties of the most acute kind and that might face many hidden and unpredictable pitfalls. Both sides were nervous about the stability of republicanism in an extensive federal union pervaded by many differences of sensibility and interest" (Hofstadter 1969, pp. 34–50). In this passage Hofstadter articulates the notion than any movement away from the perfect balance is a move down a slippery slope "back towards monarchy and the hereditary principle." My only qualification to Hofstadter is his overemphasis on the fear of monarchy relative to the fears of systematic corruption represented by the funding system.

37. John Taylor, *A Definition of Parties* (1794, p. 2); cited in Hofstadter (1968, p. 100).

the central tenets of Jefferson's and Madison's economic vision required the construction of a financial and transportation infrastructure to bring the agrarian west into viable production. At the same time, foreign economic policy had to ensure growing external markets for American products abroad, so that yeomen farmers did not produce themselves into poverty.[38] There was no institutional vehicle to promote financial and transportation improvements but the corporation. If the Republicans condemned the corporation as an instrument of corruption at the national level, they left themselves without a way of promoting the very economic development that they sought and that voters demanded.

None of these contradictions were resolved in the first forty years of the country's history—all three were resolved in the 1830s and 1840s.

1.4 Corruption Everywhere: Jacksonian Democracy and the Whig Response

The Republicans' ability to govern by apparent consensus from 1800 to 1824 papered over the threat of a tyrannous majority by governing as a virtuous majority. Geographic, if not partisan, divisions soon appeared in Congress. The inability of the federal government to overcome the problem of internal geographic competition produced inaction at the federal level.[39] Responsibility for promoting development fell squarely on the states. The resurgence of national party politics in the 1820s and 1830s was a result of the fight between the Democrats and Whigs over economic issues and, fundamentally, over systematic corruption. Again, the national government failed to provide active leadership and, in the 1840s, it was state governments that finally solved the paradox of promoting economic development while avoiding systematic corruption.

State governments expanded their involvement in banking and transportation from 1790 onward.[40] It is tempting to attribute the rise of state promotion to an absence of federal promotion, but it seems clear that state activity was a continuation of the development of government capacity at the state level that began in 1776, with the call for new state constitutions. States began chartering banks, turnpike companies, bridge companies, fire companies, and all manner of religious, charitable, educational, and mu-

38. In particular see McCoy (1980) chapter 3, "Commerce and the Independent Republic," pp. 76–104. The opening chapters to McCoy lay out the Whig origins of Republican thought as clearly as Banning (1978). The essential role of corruption in McCoy's analysis is captured in the title to Chapter One: "Social Progress and Decay in Eighteenth Century Thought."

39. Wallis and Weingast (2005) investigate the causes of federal inaction.

40. The history of government promotion of transportation improvements, federal, state, and local, is Goodrich (1950, 1960). Larson (2001) supplements Goodrich's study of the politics of federal internal improvements. The history of banking is enormous. State banking is the subject of two recent books by Bodenhorn (2000, 2003).

nicipal corporations in the 1790s.[41] By 1836, when the national charter for the Second Bank of the United States expired, there were over 600 state-chartered banks. In the meantime, the federal government had chartered the First and Second Banks of the United States and a few small banks in the District of Columbia.[42] Between 1790 and 1860, state and local governments spent $450 million, financing the Erie Canal, the Baltimore and Ohio Railroad, and hundreds of other successful projects—as well as hundreds of failures. Over the same period, the federal government spent $60 million on transportation improvements, mostly small rivers and harbor projects. In 1841, aggregate state debts stood at $198 million, larger than the national debt had ever been.

Corporate charters were, of course, grants of special privileges to small groups of citizens. Initially, every charter required an act of the state legislature, and all corporations were, in the language of the time, special. Charters always raised the specter of corruption, and strong anticharter sentiments were usually expressed whenever a charter was contemplated (Larson 2001, p. 119). At the same time, there was widespread public sentiment for promoting economic development, and the corporation was seen as the vehicle for state promotion. As a result, corporate chartering policy often contained contradictory elements.

> Although anticharter arguments were frequently stated as if they applied to all corporations without exception, in practice opposition usually settled on some corporations only. Even the Pennsylvania legislators who campaigned against the BNA and the reincorporation of Philadelphia [the city] apparently raised no objections to the charters granted "every day," as one legislator put it in 1786, to "half a dozen or 20 people for some purpose or another." Similarly, in 1792 James Sullivan carefully distinguished the incorporation of a bank from that "to build a bridge, or to cut a canal," which he found unobjectionable. Banks were probably assailed more often than any other kind of corporation. But consider the position of a delegate to the Massachusetts constitutional convention of 1853 who launched a rhetorically powerful attack on corporations "of a business character." Among corporations "for other purposes," which were apparently exempted from his criticisms, he included railroads, insurance companies and banks!" (Maier 1992, pp. 73–74)

The right to assemble, the right to organize, was explicitly recognized by early American states. Their charter policies reflected public support of

41. In the decade of the 1800s, New York averaged eighteen incorporations per year, Ohio one, Maryland two, Pennsylvania six, and New Jersey, four. In the 1830s, New York averaged fifty-seven, Ohio forty-three, Maryland eighteen, Pennsylvania thirty-eight, and New Jersey eighteen (Evans 1948). There is a substantial historical and legal literature on American corporations: Davis (1961), Dodd (1954), Hurst (1970), Handlin and Handlin (1969), Seavoy (1982), Maier (1992, 1993), Lamoreaux (2004), and Dunlavy (2004).

42. For state involvement in banking in the early nineteenth century see Wallis, Sylla, and Legler (1994); Sylla, Legler, and Wallis (1987); and Bodenhorn (2000, 2003).

private organization. In itself, this made a significant, if unmeasured, contribution to the development of the American economy.[43]

But granting corporate charters was not without its costs, real and potential. In New York the Albany Regency, headed by Martin Van Buren, used bank charters to dominate state politics.[44] The Regency granted bank charters only to their political allies. In return, the bankers provided financial support to the Regency, enabling the Regency to maintain control of state government. It was a classic case of systematic corruption: a group of politicians using economic privileges to secure their control of the political system. New York was not unique. Unlike New York, however, most states that created rents by limiting entry chose to take their share of the rents in the form of tax revenues, not political influence.[45]

The presidential election of 1824 offered a chance to change the course of federal policy. The election was contested by William Crawford, John Quincy Adams, Henry Clay, and Andrew Jackson. Corruption was the theme of Jackson's campaign:

> 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.[46]

Jackson won a plurality of the popular vote and the electoral vote. When the election went to the House, however, Clay threw his support behind Adams. Adams was elected, and subsequently appointed Clay Secretary of State. Jackson decried the "corrupt bargain": "so you see, the *Judas* of the West [Clay] has closed the contract and will receive thirty pieces of silver. His end will be the same. Was there ever witnessed such a bare faced corruption in any country before?"[47] Jackson's campaign for the 1828 election began in 1824, and its theme was corruption.

43. See Handlin and Handlin (1969) for a clear statement of how corporation policy in Massachusetts was used to support private organizations.

44. See Bodenhorn, this volume, Seavoy (1982), and Benson (1961) for the political uses of bank chartering in New York.

45. Wallis, Sylla, and Legler (1994) present a simple model of "fiscal interest" that explains why some states chose to limit entry into banking in return for higher dividends on the bank stock they owned. Pennsylvania consciously limited entry into banking. New Jersey created a monopoly railroad, the Camden and Amboy, from which the state received substantial dividends (Cadman 1949). In Arkansas, two politically powerful families used a state bank for the same purposes as the Albany Regency (Worley 1950).

46. Eaton (1824, pp. 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).

47. Jackson to Lewis, February 20, 1825; as quoted in Remini (1967, p. 98).

Jackson's election in 1828 brought the three contradictions of American democracy into clear focus—tyranny of the majority, political parties, and the connection between economic development and systematic corruption. General Jackson was the military hero who, to his enemies, offered the perfect image of a demagogue and the dark side of democracy. The Democratic party built to elect Jackson did not disappear after 1828; competitive party politics became a permanent part of American politics and raised the specter of corruption, faction, and party. Finally, the opposition party that emerged during Jackson's first term, what became the Whig party headed by Henry Clay, chose to contest Jackson in the arena of economic policy. The first defining question for Whigs and Democrats was whether the national government should renew the charter of the Second Bank of the United States. The question boiled down to whether a national bank was an instrument of systematic corruption.

The economic and political history of the Bank War is well known.[48] The debate between Jackson and his opponents was carried out in terms of systematic corruption. Jackson's veto message railed against the special privileges conveyed to the Bank, laid out Jackson's position on the battle between the aristocratic wealthy and the masses of the population, and articulated the abuse of privilege as an evil of government.[49] But he did not begin speaking of systematic corruption until the Bank War broke into open conflict with his plans to remove the federal deposits. On September 18, 1833, Jackson had Secretary Taney read a statement to the Cabinet that Jackson and Taney had prepared on why the deposits should be removed:

> The Bank of the United States is in itself a Government which has gradually increased its strength from the day of its establishment. The question between it and the people has become one of power—a question which its adherents do not scruple to avow must ultimately be decided in favor of the Bank. . . . The mass of people have more to fear from com-

48. See Remini (1967) and Temin (1969). The debate in economic history over the effects of the Bank War, Jackson's other economic policies, and the causes of the macroeconomic rages on. For a summary of the literature, and a strong argument that Jackson's domestic economic policies contributed to the Panic of 1837, see Rousseau (2002).

49. "It is to be regretted that the rich and powerful too often bend the acts of government to their selfish purposes. Distinctions in society will always exist under every just government . . . but when the laws undertake to add to these natural and just advantages artificial distinctions, to grant titles, gratuities, and exclusive privileges, to make the rich richer and the potent more powerful, the humble members of society—the farmers, mechanics, and laborers—who have neither the time nor the means of securing like favors to themselves, have a right to complain of the injustice of their government. There are no necessary evils in government. Its evils exist only in its abuses.

If we can not at once, in justice to interest vested under improvident legislation, make our government what it ought to be, we can at least take a stand against all new grants of monopolies exclusive privileges, against any prostitution of our Government to the advancement of the few at the expense of the many, and in favor of compromise and gradual reform in our code of laws and system of political economy." Jackson's Veto Message, July 10, 1832 (Richardson 1897, pp. 1153–54).

> binations of the wealthy and professional classes—from an aristocracy which thro' the influence of riches and talents, insidiously employed, sometimes succeeds in preventing political institutions, however well adjusted, from securing the freedom of the citizen, and in establishing the most odious and oppressive government under the forms of a free institution.[50]

Jackson recalled the classic phrases of systematic corruption. The Bank itself was a government: a small group (in this case Biddle and Clay) were using the powers of government to create a powerful economic interest, and gains from monopoly rents thus created were being used to subvert the process of government and threaten the liberties of all citizens by establishing an odious and oppressive government.

His opponents replied in kind. In the election of 1832, they styled themselves National Republicans, and by late 1833 the Whig party was born. 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![51]

Clay did not accuse Jackson of venal corruption. Clay and the Whigs charged Jackson with executive usurpation, of systematically corrupting the political process. Following commonwealth theory, tyranny and slavery would inevitably follow.

During the early 1830s, when permanent two-party political competition developed, both parties accused the other of systematic corruption. It

50. From "Paper read to the Cabinet" in the Jackson Papers, L. C.; as quoted in Remini (1967, p. 119).

51. Henry Clay's speech on the "Removal of Deposits," December 30, 1833. *Register of Debates,* 21st Cong., 1st sess., p. 94.

was the most salient issue for American voters. The contest between Clay and Jackson, and the longer struggle between Whigs and Democrats, was fought over classic commonwealth concerns: executive usurpation, the monied conspiracy, corporations, and the appropriate role of government in promoting economic development. The major issues between Democrats and Whigs were economic, but the foundation for the debate over economic policy was a larger debate over systematic corruption.

Jackson's administration resolved two of the paradoxes of American democracy. First, from Jackson onward, demagogues were accepted, as long as they were elected President.[52] Jackson permanently increased the power of the Executive branch. He claimed that the President most effectively represented the collective will of the entire people, as shown in the only nationwide election. Second, political parties became an accepted part of the political system. Suspicion of partisan motivation and the dangers of faction and party remain to the present day, of course.[53] But the national government could not resolve the third paradox—corruption and the promotion of economic development. Jackson's solution to corruption in banking was to not have a bank. He extended the existing federal policy of inaction. Except in the earliest days of the Washington administration, the national government, Congress and executive, were unable to design or execute a program of active government promotion of economic development.

Promotion of economic development was left to the states. By the end of Jackson's second term, states throughout the country were deeply involved in investing in and promoting banks and transportation systems. The investment boom of the 1830s was ended by the depression that began in 1839. By 1842, eight states and the territory of Florida were in default. The crisis in public finance naturally brought investigations into its causes. Venal corruption caused fiscal problems in a few states: Mississippi, Florida, and Arkansas. Most states, however, blamed faulty institutions: they blamed corruption on how democracy was working out in practice.[54]

American state governments were the first governments of their kind in

52. Sprague colorfully expanded on the dangers of Jackson. "The people love their constitution, their liberties, and themselves. They are always politically honest. . . . But they are not infallible . . . oftentimes a military chieftain, having wrought real or fancied deliverance by successful battles—fervent gratitude, unbounded admiration, the best feelings of our nature, rush towards him. . . . In the paroxysm of their devotion, they are ready at his shrine to sacrifice their rights, their liberties, their children, and themselves." Senate Debate, 23rd Cong., 1st sess., on the Removal of the Deposits, January 29, 1834, *Register of Debates,* pp. 386–87.

53. Hofstader (1968) is particularly illuminating on the rise of parties and the role played by Martin Van Buren in the process of rationalizing the need for parties in a democracy.

54. See Wallis, Sylla, and Grinath (2004) for a description of the default crisis and a discussion of its causes. We explicitly consider the role played by naivete and corruption and find that most states were neither. For examples of corruption, both systematic and venal, in American states between 1790 and 1860 and its effect on financial system development, see Wallis (forthcoming).

history. Governed by written constitutions, they operated within the framework of a national government that provided military defense and international relations, a basic legal system, and very little else. States believed that republican government was good. They wanted to promote economic growth, but they worried incessantly that the corporations and privileges they created for that purpose benefitted a favored few to the detriment of the many and undermined the integrity of their governments. States were forced to solve the paradox of corruption and the promotion of economic development. Their solution was elegantly simple: let everybody have a corporate charter who wants one.

Their history endowed American state governments and their citizens with the idea that some problems of government were not caused by bad men, but by bad governments. They were Aristotelian and Polybian in their understanding that the constitution of a government, the *stamina vitae,* created incentives for the actors, politicians, and citizens to pursue particular ends. They were the first modern people to possess extensive experience with written constitutions.[55] The early nineteenth century was an era of continual political debate about the structure of government.

States were the first governments with extensive experience in chartering corporations. The first and most important connections between governments and corporations were fiscal. This was true in Britain, with the mercantilist privileges that Adam Smith complained about. It was true in the American states from the beginning. If governments were going to sell monopoly privileges and corporate charters for revenue, then inevitably each charter required a price, a negotiation, a bargain.[56] This was a feature of any system of government where charters created limited entry into a line of business. Democratic governments could create and sell corporate privileges. Taxpayers liked receiving government services paid for by charter fees, taxes on capital, or dividends on stock. But by its very nature the cre-

55. By the 1830s most of the original states had experience with two or more state constitutional conventions and the state ratifying conventions for the national constitution. Only North Carolina and Massachusetts stayed with their first constitution through the Civil War. By 1860, states had written the following number of constitutions: Connecticut, two; Delaware, three; Georgia, three; Maryland, two; New Hampshire, three; New Jersey, two; New York, three; Pennsylvania, three; South Carolina, three; Vermont, two; Virginia, three. Of the new states: Kentucky, two; Tennessee, two; Maine was part of Massachusetts until 1820, when it wrote a new constitution. In addition to the new constitutions, there were several constitutional conventions that produced constitutions that were not ratified by the voters.

56. Andrew Jackson's first complaint in his veto of the proposed charter renewal for the Second Bank of the United States was that the government wasn't getting a good enough deal: "Every monopoly and all exclusive privileges are granted at the expense of the public, which ought to receive a fair equivalent. . . . If our Government must sell monopolies, it would seem to be its duty to take nothing less than their full value, and if gratuities must be made once in fifteen of twenty years let them not be bestowed on the subjects of a foreign government nor upon a designated and favored class of men in our own country." Veto Message, July 10, 1833 (Richardson 1897, pp. 1140–41).

ation of corporate privileges created the opportunity for political groups to create economic privileges that could be used to distort the political process. The commonwealthmen claimed that this happened in Britain with the national debt, it happened in New York with the sale of bank charters to the political friends of the Albany Regency, it was a systematic feature of any government that sold corporate privilege. State governments came to understand that if they remained in the market for selling corporate charters, if they remained willing to consider developers' proposals that promised tax-free provisions of railroads and banks, inevitably some politicians, even well-meaning politicians, would make some serious mistakes. Voters could easily be induced to vote for expenditures that promised large returns without levying taxes. States also came to understand that allowing entry reduced the rents associated with corporate privileges, without eliminating the wider social benefits of creating corporations.

The states' solution to the paradox of corruption and economic development was as simple as it was ingenious. First, 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. Second, states passed constitutional provisions requiring that all state borrowing required a bond referendum: mandating that the higher taxes necessary to service the bonds be approved by the voters before the bonds were issued. Third, most states forbade state and local investment in private corporations. Between 1841 and 1852, twelve states wrote new constitutions. Eleven of the twelve contained procedural debt restrictions and eight mandated general incorporation acts. In banking, general incorporation acts produced free banking (the first free banking acts were in Michigan and New York in 1837 and 1838). Nine states prohibited incorporation by special legislative acts altogether, prohibiting state legislatures from creating corporations with special privileges.[57]

The point of these reforms was not to eliminate state and local government investments in finance and transportation. Governments could borrow as long as they were willing to raise taxes. 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. The reforms intended to reduce the political manipulation of the economic system, not by making such manipulations illegal or unconstitutional, but by reducing the payoff to political machinations. Institutions supporting unlimited entry, free competition,

57. The history of these constitutional changes is presented in Wallis (2005). The general relationship between public finance and corporations is discussed in Wallis (2003). For a history of incorporation laws see Evans (1948), and for a larger discussion of the nineteenth-century corporation see Hurst (1970).

and competitive markets were put in place by American states in the 1830s and 1840s. They were the solution to a political problem, not an economic problem. The effect of the reforms, however, was to put in place a critical institutional underpinning of modern economies. It was the uniquely American solution to the paradox of systematic corruption and the promotion of economic development.

1.5 Venal Corruption and Progressive Era Reforms

> Almost any history textbook that covers the Progressive era and was written at least twenty years ago tells how early-twentieth-century Americans discovered how big business interests were corrupting politics in quest of special privileges and how an outraged people acted to reform the perceived evils.
> —McCormick (1981, p. 247)

By the Progressive Era, the fear of systematic corruption, the corruption of economics by politics, had faded. Venal corruption remained, of course, and, as the title of McCormick's essay suggests, there was a growing concern with the "discovery that business corrupts politics." The Civil War, the rise of an integrated national economy, and the development of a thriving manufacturing sector all could have unbalanced and corrupted America's governments. But they did not produce tyranny or dictatorship, and by the 1890s Americans had become more confident in the inherent balance and resilience of their system of government. Corruption no longer seemed to be an inframarginal threat; the system was no longer at risk. When progressive reformers complained about the evils of big business's influence on politics, they no longer warned that slavery and tyranny were just around the corner. Their confidence in the American system was reflected in the constitutional changes made during the era: at the national level the direct election of senators by popular vote and women's suffrage, and at the state and local level the spread of initiatives, referendums, and recalls, and the rise of home rule. Progressive Era constitutional reforms all emphasized an increased role for popular participation in the political process, reforms that were unthinkable a century before.

Benjamin Parke DeWitt, progressive reformer and historian, wrote in his history of the Progressive movement in 1915:

> In this widespread political agitation that at first sight seems so incoherent and chaotic, there may be distinguished upon examination and analysis three tendencies. The first of these tendencies is found in the insistence by the best men in all political parties that special, minority, and corrupt influence in government—national, state, and city—be removed; the second tendency is found in the demand that the structure or machinery of government, which as hitherto been admirably adapted to

> control by the few, be so changed and modified that it will be more difficult for the few, and easier for the many, to control; and, finally, the third tendency is found in the rapidly growing conviction that the functions of government at present are too restricted and that they must be increased and extended to relieve social and economic distress. These three tendencies with varying emphasis are seen to-day in the platform and program of every political party; they are manifested in the political changes and reforms that are advocated and made in the nation, state, and the cities; and because of the universality and definiteness, they may be said to constitute the real progressive movement. (DeWitt 1915, pp. 4–5)

The first Progressive tendency—that special, minority, and corrupt influence in government be removed—could have been written in Rome in 200 BC, Florence in 1500, London in 1720, Philadelphia in 1787, Albany or Indianapolis in the 1840s, or today for that matter. The venal will always be with us, and venal corruption can only be prevented by eternal vigilance. The third tendency, a call for government policies to relieve social and economic distress, translated into new social programs like workmen's compensation and mother's pensions in the 1900s and 1910s, but reached its full measure in the New Deal.[58]

The second tendency, to make changes in the structure and machinery of government, constituted the heart of the Progressive reform agenda. DeWitt's language indicates the distance that Progressives had come from Commonwealthmen. The structure of machinery of government "be so changed and modified that it will be more difficult for the few, and easier for the many, to control." A century earlier such a suggestion would have been a call for unbalanced government—in short, a call for corruption. The Progressive movement was an anticorruption reform movement, nonetheless it promoted policies the founding fathers would have regarded as systematically corrupt.

The Progressive movement produced reforms in three distinct constitutional areas. First, the Progressives altered the relationship between corporations and governments through active regulation and changes in chartering. Second, they expanded direct participation in government; at the national level through women's suffrage and the direct election of senators, and at the state and local level through the initiative, referendum, and recall to bring direct democracy into the policy process. Third, they altered the relationship between state and local governments through home rule amendments and the local charter movement. These reforms shared several elements. They allowed both public and private sector organizations more flexibility to choose the form of their internal organization. They in-

58. See Wallis, Fishback, and Kantor, this volume, for a discussion of social welfare in the New Deal and the end of corruption in relief administration.

creased the acceptable range of interaction between government and the economy, allowing governments to interfere and regulate business, or to withdraw their regulation. Finally, the entire process was to be monitored by more democracy, by putting more power in the hands of the many. The Progressives believed in balanced government. But it was the checks and balances of the national and state constitutions, not the balance of social orders and classes reflecting the interests of the one, the few, and the many.

State chartering policy links the Progressive and Jacksonian eras. The widespread adoption of general incorporation acts in the 1840s liberalized access to corporate charters and the number of corporations in America exploded, relative to both early American history and contemporary European economies.[59] But general incorporation acts liberalized entry while putting more severe restrictions on the structure of corporations. All corporations created under a general act shared common features. In states that banned special incorporation altogether, a corporation that wanted to change its internal voting rules, shareholder rights, or its management structure was severely constrained.[60] For example, corporations were typically prohibited from owning stock in corporations domiciled in other states. All this began to change in New Jersey in the late 1880s.[61]

In a series of acts between 1888 and 1896, New Jersey created liberal general incorporation. These acts allowed corporations to merge and hold stock in other corporations, to operate outside of the state, and to define their internal governance structure within much wider bounds. Corporations flocked to New Jersey, swelling the state's revenues and opening up new opportunities for corporate structure throughout the country. What followed was the great merger movement. Between 1895 and 1904 there was a rapid consolidation of the nation's largest manufacturing firms. Over half of the consolidations involving more than $1 million in capital took place in New Jersey (Grandy 1989, pp. 678 and 681–83).[62] New York and Delaware soon followed New Jersey's lead, liberalizing their incorporation laws and trying to lure businesses into their states.

Attributing the Progressive Era to the merger movement would be silly, although there is a remarkable coincidence of timing. "Yet, given the long-term forces involved, it is notable how suddenly the main elements of the

59. For a comparison on corporate chartering in France and the United States, see Lamoreaux and Rosenthal (2004). Their point that the options open to structure firms in France was much more flexible than the options open to firms in the United States is a key argument in this section.

60. For a discussion of general incorporation acts see Dunlavy (2004), Million (1990), and Mark (2000). The actual structure of corporations under general acts is an area of which legal and economic historians are almost completely ignorant. Dunlavy's paper and her current project examining a large sample of corporate charters is beginning to shed light on this critical area.

61. For the history of New Jersey corporations, see Cadman (1949). For the specifics of New Jersey's changing corporation policy, see Grandy (1989).

62. For a general history of the merger wave see Lamoreaux (1985) and Nelson (1959).

new political order went into place. The first fifteen years of the twentieth century witnessed most of the changes; more precisely, the brief period from 1904 to 1908 saw a remarkably compressed political transformation. During these years the regulatory revolution peaked; new and powerful agencies of government came into being everywhere" (McCormick 1981, p. 252). When a small number of unprecedentedly large corporations sprang into being during the merger wave, the national and state governments responded to the public perception that corruption was again a problem in American politics. But they responded much differently in the first decades of the twentieth century than they did in the nineteenth century.

Giving more control to the many was the mechanism by which "special, minority, and corrupt influence in government—national, state, and city—[could] be removed" (DeWitt 1915). The constitutional machinery of the progressive constitutional reforms were electoral and democratic. At the national level, the direct election of senators by popular majorities and suffrage for women were the key progressive accomplishments. At the state level, the adoption of the initiative, referendum, and recall gave voters direct control over legislation and officials. Initiative, referendum, and recall were adopted at the local level as well, but the critical change was the widespread adoption of home rule provisions and new methods of chartering local governments. These transferred control of local governments from state to local governments, providing voters with the ability to directly shape local government policies to suit the ends of local majorities.

Battling venal corruption and regulating the excesses of the plutocrats charged the Progressive movement with a populist morality and a renewed faith in majoritarian democracy. It is striking how much of the Progressive rhetoric, perhaps in combination with the symbols of the temperance movement, focuses on bad men rather than on bad institutions. The medicine prescribed by progressives to cure corruption would have seemed insane to a founding father. Systematic corruption flowed from the ability of politicians to use the economic system to further their political ends. Electoral excess, tyranny of the majority, and mob rule were serious threats that had to be balanced by the creation of other centers of power in the political system. Progressive reforms celebrated popular sovereignty, the concept that the voters were the ultimate judges of government policy. Deciding whether politicians and policies were venally corrupt could be left to popular choice. The many would decide whether the few had violated their mandate to govern on behalf of the common good. Majorities really would rule.

How could this happen? One constant element in earlier discussions of systematic corruption in America and Britain was that it inevitably leads to tyranny and slavery. Such language is not to be found in the Progressive Era. Between 1840 and 1890 American crossed a divide. On the early side

of the divide governments could never be trusted. Politicians would always, if the chance presented itself, use the powers of government to manipulate the economic system in order to consolidate their control of the political system. Consolidation of political control upset the delicate balance of government and, with Polybian certainty, led to tyranny and slavery. Balance in government could never be assumed. Small changes in the distribution of power could quickly lead to imbalance. The defense of liberty required eternal vigilance. On the later side of the divide, balance in government is no longer fragile. Tyranny and slavery are still possibilities, but highly improbable ones. By allowing, indeed mandating, more competition and entry into the economic and political system, Madison's extended republic, as modified by the states, had produced a stable balance within government.

In classic commonwealth political theory, increasing government regulation raised as many red flags as did special corporate charters. Regulation created the opportunity for creating rents, and rent creation created the possibility for political manipulation of the economy. One could see James I or Charles II supporting Progressive policies, not Whig commonwealthmen. If, on the other hand, political and economic competition limit rent creation and dissipation, they also make it safer for the government to regulate in positive and negative ways. Competition and entry create their own balanced equilibrium.

This could only have happened if Americans came to trust their government more than they ever had in the colonial, revolutionary, or early national periods.[63] Progressive Era reforms increased political entry by widening the scope of popular democratic political institutions: direct election of senators, women's suffrage, the initiative, the referendum, the recall, and home rule. At the same time, Progressive Era policy reforms created much wider opportunities for rent-seeking by politicians and economic actors, trusting, apparently, that voters could monitor the new powers given to their representatives. The threat of systematic corruption, so prevalent for three centuries in British and American political and economic thinking, had receded to the point of disappearance from the political debates of the Progressive Era.

1.6 The End of Systematic Corruption

One way to think about developing countries is that they are poor because their government officials are venally corrupt. If only the right people and policies could be put in place, economic growth would ensue. A more pessimistic and realistic view is that developing countries are systematically

63. This "trust" is historically relative; Americans retain a profound ability to mistrust government.

corrupt. They are plagued by governments that systematically manipulate the economy to produce economic rents to further the political interests of the people and parties in power. This is not a matter of bad people causing problems. This is a fundamental flaw in the constitutional structure, the *stamina vitae,* of these societies.

The United States came by its fear of systematic corruption legitimately. It was born in a constitutional crisis rooted in Whig paranoia about the threat to fundamental liberties of all Britons embodied in the executive usurpation of Parliamentary independence. The emerging institutions of modern financial capitalism—a national debt, a central bank, a stock market, and a host of financial intermediaries—were not the causes of corruption. The institutions of modern financial capitalism were the instruments of systematic corruption, tools in the hands of the Crown and its evil ministers. British corruption threatened fundamental liberties. The storm warnings of tyranny and slavery were flying in 1776. Today, of course, we see the eighteenth century as the dawning of a new era of personal and economic liberty that produced modern economies and societies. Early Americans could not afford to be complacent.

The founding fathers seized the first chance to write their own constitutions in 1776, crafting a series of state constitutions implementing precepts of balanced government. They didn't get it right the first time. Between 1776 and 1852 the original thirteen states wrote twenty-nine constitutions and the national government wrote two. Congress implemented Hamilton's financial plan in 1791, deliberately modeled on the British financial system: a national debt, a central bank, and assumption of state debts. Within a year, national politics fragmented over the charge that Hamilton and the Federalists were establishing a Prime Ministry with Hamilton at the center of a web of influence and interest. The national government remained gridlocked for decades over how, and whether, economic development should be promoted. When the national government's experiment in central banking came to an end with Jackson's veto of the charter of the Bank of the United States in 1832, the issue was still systematic corruption. Clay claimed that "we shall die—ignobly die—base, mean, and abject slaves; the scorn and contempt of mankind; unpitied, unwept, unmourned!" if Jackson went unchecked.

Meanwhile, in the 1790s states began chartering banks, churches, and all varieties of corporations. By the 1820s states were building canals, experimenting with railroads, borrowing money, and investing their own funds in corporations. By the 1830s there were over 600 state-chartered banks, and state debt for internal improvement investment was double the national debt accumulated during the Revolution and the War of 1812. State activism did not go unchallenged. Corporations were still regarded as potential vehicles for corruption. Bank chartering under New York's Albany Regency was a classic example of systematic corruption: a political faction

using the creation of economic privilege to secure its control of the political system. The central theme in Jackson's rise to prominence was an attack on corruption, an attack on government-created privilege. Of course, most American governments were not thoroughly systematically corrupt, but there were warning signs everywhere, New York included. Americans did not fear that their governments were corrupt: they worried that their governments would become corrupt if they did not take measures to protect and strengthen the institutions that supported balanced government.

When the internal improvement boom collapsed after 1839, states carefully reexamined the policies that had led them to issue $200 million in state bonds. States again turned to their constitutions and implemented a series of reforms that mandated general incorporation acts guaranteeing free entry into corporate privileges, modified the procedures by which state and local governments borrowed money, and prohibited government investment in private corporations. With few exceptions, the constitutional reforms were not bans on state promotion of economic development. They did not prevent governments from chartering banks, building canals or railroads, or, in the Progressive Era, building municipal water systems, sewer systems, and school systems. Constitutional reforms were explicitly designed to cut away the roots of systematic corruption, by limiting the government's ability to create economic rents through limiting entry and granting special economic privileges.

Republican and Federalists in the 1790s, Whigs and Democrats in the 1840s, were just as concerned with venal corruption as the Progressives in the first decade of the twentieth century. But venal corruption was not the most dangerous problem facing America before the Civil War. Tyranny and slavery were all around the world of the early nineteenth century. France went from absolute monarchy, to revolution, to dictatorship, and back to monarchy. Spain's New World empire collapsed in a wave of revolutions, many inspired by the United State's example. New World revolutionary governments often adopted constitutions explicitly modeled on the United States, checks and balances and separation of powers included. But tyranny, not liberty, was typically the fruit of revolution in Latin and South America. Americans feared that any movement away from balanced government would bring, with Polybian certainty, an erosion of republican government and the rise of tyranny and slavery.

By 1890, however, not only was the American experiment in limited government a demonstrable success, but the country's institutions had persisted through a bloody civil war, with liberty intact and chattel slavery ended. Fear of tyranny and slavery was justifiably receding. A modern industrial economy and the world's largest integrated market posed a new set of problems for governments. After tentative first steps at economic regulation in the 1870s and 1880s, the national government effloresced in the first half of the twentieth century, as the papers in this volume show so

clearly. Giving the national government control over food and drugs would have seemed insane to the founding fathers, Federalist and Republican. Such regulation opened up vistas of rent creation beyond the imagination of James I or Charles II.

Yet, for all the fear of corruption that filled the rhetoric of Progressive reformers, the corruption documented so ably in this volume is distinctly venal corruption. The Progressives were not afraid that a faction within government would use the creation of economic privileges to seize control of the government. They were concerned that economic interests were using their growing size to wrest concessions from governments. They worried about the efficiency of American government, about the quality of representation, of equity, access, and fairness. They worried that economics corrupted politics. They did not worry about politics corrupting economics.

The landmark accomplishment of the western democracies in the nineteenth and twentieth centuries has been the creation of stable, limited government. No society with a systematically corrupt political system has limited government. The economic system is always at risk, entry is limited, competition is fettered, and economic policies are shaped by politicians to maintain their political control of the government. Crony capitalism is not a manifestation of venal corruption—it is a symptom of systematic corruption. Developing countries do not have markets that work well, because the open access and competition necessary to make impersonal markets work cannot flourish when entry is limited to create the privileges that hold the political system together. What lessons does the United States have to teach about corruption? The fundamental lesson is how to construct a government that does not depend on manipulation of the economy for its continued existence.

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