

The Concept of Systematic Corruption in American Political and Economic History

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Friends:

This is an overlong manuscript, I'm sorry.

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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 fountain-head all conceptions and plans of action not only proceed, but attain their consummation. -- *The Histories of Polybius*, Book VI.

Corruption is a pervasive concept in western political thought. Aristotle defines the pure forms of government as those that “govern with a view to the common interest” and their corrupt forms “are as follows: – of kingship, tyranny; of aristocracy, oligarchy; and of constitutional government, democracy.”¹ Corruption played a central role in the political philosophy of Polybius, Machiavelli and the 16th century Italians, and Harrington and the 17th century English writers who, after the Glorious Revolution of 1688, were known as Whigs or Commonwealthmen. The Whigs were opposition thinkers, and their indictment of corruption in British government 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. “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.”²

¹Aristotle, *Politics*, Book III. 1279^a30 and 1279^b 4.

²Murrin, 1994, p. 104.

The reawakening of interest among economists in the role played by political institutions as a determinant of economic performance piqued a renewed interest in the quality of governance: of corruption. While corruption did not disappear from 20th century American politics, it is no longer a major concern. The history of the United States offers an opportunity to see how and why corruption might be contained in developing countries. The self-conscious, centuries long debate over corruption in western political thought in general and in American politics in particular, suggests that a longer view might offer insights into the process of institutional reform. This is a fascinating chapter in intellectual, political, and economic history and the way in which social scientists formulate feasible policy reforms; what Polybius called “the consequent power of choosing the better policy in a particular case.” For as it turns out, 20th century economists and society think about corruption in a way that is, in a critical dimension, 180 degrees removed from the concept of corruption that prevailed until the late nineteenth century.

The title of McCormack’s essay “The Discovery that Business Corrupts Politics” captures the essence of the modern concept of corruption. Economic interests corrupt politicians and bureaucrats by offering them options to promote their own interests at the expense of the public good. Shleifer and Vishny define corruption “as the sale by government officials of government property for personal gain.”³ The fear that economic interests, or in Olson’s more generic concept, that interest groups will capture or influence government policy is the essence of modern corruption. In contrast, eighteenth century British – English, Scotch, Irish, and

³Shleifer and Vishny, 1993, p. 599. For other treatments of corruption see Klitgaard , 1988; Rose-Ackerman, 1978; and Clague, 2003.

American – political thinkers worried much more that political interests would coopt economic groups to fundamentally erode the integrity of basic political rights and liberties. They feared that a group of government officials -- the king and his evil ministers, for example -- could use the grant of economic privileges to secure political support for a takeover of the government. Tyranny and slavery would follow.

“Corruption” is an anachronism: a word that means something different today than it did two centuries ago. To recapture the political and economic ideas of the founding fathers and early 19th century American politicians requires a examination of what corruption meant to them. The concept of systematic corruption, the idea that politics corrupts economies, is traced from Aristotle and Polybius, Machiavelli and Harrington, up through the 18th century British Whigs, Americans in the Revolution, in the 1790s, the 1830s, and finally the Progressive Era. Venal corruption, the use of government property for private ends, is always part of the story but not, until the twentieth century, the primary fear. 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 governments – developed historically not as a way to produce economic growth and enhance the wealth of nations, but as a solution to the political problem of constraining narrow political groups from obtaining uncontested control of governments. Eliminating systematic corruption required an economic solution to a political problem.

Three elements are important in reaching this conclusion. First, through the 1840s, systematic corruption threatened rights and liberties and was believed to lead directly to tyranny and slavery. Systematic corruption was an infra-marginal concept: the very existence of civil society was at stake. Desperate measures were justified in defense of liberty. What seems to

modern ears to be overblown rhetoric – the threat of tyranny and slavery -- was, in fact, precisely what the best educated and most knowledgeable people feared. Second, by the late 17th century, corruption was always viewed in constitutional terms. Corruption violated some aspect of the constitutional arrangement. As a result, the cures for corruption were constitutional. Americans responded repeatedly to perceived corruption by redesigning political and economic institutions at the constitutional level. The result of this continual tinkering is America’s contribution to the major political accomplishment of modern western economies: the concept of limited, constitutional government. Finally, the mechanism by which political groups exercise corrupt influences on the polity are, from 1700 onwards, always economic mechanisms. Political manipulation of economic interests involved in the growing government debt, the financial management of the debt, and the supply of the Army and Navy through private contractors that fueled fears of corruption in Britain. In the United States, political manipulation of efforts to promote economic development by chartering private business corporations focused political concerns about corruption and the consequences of majority rule in a democratic republic. The dual accomplishment of free incorporation and unlimited entry into the markets where those corporation compete is a fundamental “institution” of modern developed economies. Historically, that institution developed in the early 19th century United States as the solution to a political problem, not an economic problem. This paper attempts to trace how that happened.

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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.

— J.G.A. Pocock, “1776: The Revolution against Parliament”⁴

The work of Aristotle, Polybius, Machiavelli, and Harrington represent a larger body of western ideas about the evolution of governments. The purpose of this philosophy was to understand how good governments might be instituted in human society. In the 21st century, when we refer to governments as “corrupt,” we mean that individuals within those governments act in their own interests rather than in the interests of the citizens. Corrupt governments are defined by the individual choices of their political leaders and government employees. This notion of “venal” corruption is perfectly consistent with historical meaning and has strong classical roots. Aristotle wrote in *The Politics*: “The conclusion is evident: that governments which have a regard to the common interests are constituted in accordance with strict principles of justice, and are therefore true forms; but those which regard only the interests of the rulers are all defective and perverted forms.”⁵

But the classic thinkers also defined corruption in a more narrow and technical way.

⁴Pocock, “1776: The Revolution against Parliament,” *Virtue, Commerce and History*, p. 78.

⁵Aristotle, *Politics*, Book III, 1279^a, p. 71.

There was a profound difference between corruption of the individual and the political system. The concept of systematic corruption mattered so much because it was intimately tied to the concept of a constitution. Constitutions were originally thought of as literally the body politic, not as written documents or theoretical constructs.⁶ All physical bodies exhibit a cycle of growth, maturity, and decay: corruption. Corruption happened to constitutions, just as certainly 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 developed 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*, *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

⁶We speak of a persons with a hearty constitution or with a fragile constitutions. 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, *Ideological Origins*, 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, *A Dissertation upon Parties*, *Political Works*, p. 88.

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.⁷

In short, corruption was change. 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.”⁸ Any society with governments of the pure forms, inevitably cycled from kingship, through tyranny, aristocracy, oligarchy, democracy, and mob-rule. The mob being subdued by the noble and pure king, setting the cycle in motion again. For Polybius, corruption was explicitly systematic. It was the process by which one form of government evolved into another form. It was a force beyond the individual, an “undeviating law of nature” in unmixed governments. Corruption of the pure forms of government was inevitable, but he believed that it was possible to prevent corruption by resort to mixed and balanced governments that combined elements of all three pure types, which Polybius 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

⁷*Histories of Polybius*, p. 460.

⁸*Histories of Polybius*, p. 466.

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.⁹

Machiavelli took up Polybius. Here is Pocock's summary of Machiavelli's

understanding of corruption and the cyclical process of political change:

but older than any expression of this doctrine [balanced government] in English Constitutional terms ... was the Polybian doctrine of the mixed constitution, which the Renaissance had revived and Machiavelli transmitted to the many countries where he was read. According to this doctrine, each of the three pure forms of government, monarchy, aristocracy, and democracy, would if existing alone be destroyed by excess of its own qualities; it would be replaced by its own perverted form and that by one of the pure forms, itself doomed to excess and replacement; and so on in an unending cycle. Only a mixed or balanced constitution, combining the qualities of all three forms, could hope to escape the doom of degeneration through excess; but as excess was in this model the only cause of change in political systems, it was seriously contended that a perfectly balanced combination on monarchy, aristocracy, and democracy ought to last forever... But most admitted that even the most perfect equipoise could only be maintained through human care and attention, and since that was fallible, some theoretical attention had to be paid to the cause and cure of degeneration in the balanced constitution. In Machiavelli, the most influential of the Renaissance transmitters of Polybius, the technical term for this sort of degeneration is "corruption." It arises when the balance is disturbed, typically through the encroachment of one of its three constituents upon the others; and since, in Machiavellian thought, stability in the political system is a precondition of morality in the individual life, corruption is a moral as well as political phenomenon.¹⁰

Anything that disrupted the balance of the constitution was "technically" corruption, whether it resulted from morally corrupt individual behavior or not. Systematic corruption occurred

⁹*Histories of Polybius*, p. 466-7.

¹⁰Pocock, *Politics, Language, and Time*, p. 129. "'Corruption' has had a similar semantic trajectory. In the writings of Machiavelli, who took the term from Polybius, *corruzione* stood for deterioration in the quality of government, no matter for what reason it may occur. The term was still used with this inclusive meaning in eighteenth-century England." Hirschman, *Passion and Interests*, p. 40.

because of inherent tendencies in the structure of societies.

The very term balance suggests the modern concept of an equilibrium, but this was not thought to be a stable of 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 the balance required politicians and philosophers to define exactly what constituted the balance, that is to define exactly what behavior was “unconstitutional” or corrupt. In the next section we will examine the first clear articulation of the balance in England in 1642 in Charles I’s *Answers to the Nineteen Propositions of Parliament*. But before doing that please note two consequences of this way of thinking:

First, articulating the concept of systematic 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 a society was corrupted.

Second, the balanced constitution was a theoretical construct similar to a unique and universal maximum.¹¹ Any movement away from the balance was a movement toward tyranny and slavery. This was true whether the movement was towards tyranny of the one, the many, or

¹¹Harrington 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.” *Commonwealth of Oceana*, p. 2.

the few; in 18th century England of tyranny of the King, the Lords, or the Commons; and in 19th century America of tyranny of the executive, legislative, or judicial branches. The balanced constitution was a perfect equipoise. From it a slippery slope led downwards in all directions.

Any movement away from the balance, specifically 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 about change that destabilized the political order. Harrington distinctly defined systematic corruption, as opposed to venal corruption, by distinguishing himself from his hero Machiavelli:

A people (saith Machiavel) that is corrupt is not capable of a commonwealth; but in showing what a corrupt people is, he hath either involved himself or me, nor can I otherwise come out of the labyrinth than by saying that, the balance altering, a people, as to the foregoing government, must of necessity be corrupt; but corruption in this sense signifieth no more than that the corruption of one government (as in natural bodies) is the generation of another [systematic corruption]; wherefore, if the balance alter from monarchy, the corruption of the people in this case is that which maketh them capable of a commonwealth. But whereas I am not ignorant that the corruption which he [Machiavelli] meaneth is in manners [venal corruption].¹²

Systematic corruption was the natural progression of one government to another. Only a balanced constitution could prevent the inevitable slide into tyranny and slavery. Systematic corruption threatened the fundamental rights and liberties of the entire society.

Walpole was supposed to be wielding two great instruments of corruption, of which the first was parliamentary patronage and the second the public credit.
— Pocock, *Hume and American Revolution: The Dying Thoughts of a North Briton*¹³

To corrupt and divide are the trite and wicked expedients, by which some ministers in all

¹²Harrington, *Commonwealth of Oceana*, p. 60-61.

¹³J.G.A. Pocock, *Virtue, Commerce, and History*, p. 129.

ages have affected to govern; but especially such as have been least capable of exerting the true arts of government.

— Bolingbroke, *A Dissertation Upon Parties*¹⁴

The ascension of the Scottish king James VI, to the English crown in 1603 as James I initiated a century of Stuart rule in England, but merely opened a new chapter in the long history of violent competition for control of the nation's government by political elites. "There was a tradition of conspiracy, riot, plot, and revolt among the ruling class that stretched back to the Normans. By 1688, violence in politics was an Englishman's birthright."¹⁵ The contest between the Stuarts and Parliament ultimately brought on civil war and regicide, but before the war started it also produced a defining moment in the history of the English constitution:

On 21 June, 1642, with about two months to go before the formal beginnings of civil war, two of Charles I's advisors – Viscount Falkland and Sir John Colepeper – drafted, and persuaded him to issue, a document in which the king, not parliament, took the step of declaring England a mixed government rather than a condescending monarchy. *His Majesty's Answer to the Nineteen Propositions of Both Houses of Parliament*, as has been emphatically and correctly asserted by Corrine C. Weston, is a crucial document in English political thought, and among other things one of a series of keys which opened the door to Machiavellian analysis. In essence, it asserts that the government of England is vested in three estates, the king, the lords, and the commons, and that the health and very survival of the system depend upon the maintenance of the balance between them. This drastic departure from the thesis of descending authority was both constitutionally incorrect and a disastrous tactical error in royalist polemic; but it was, in a very short time, so widely accepted and so diversely employed as to present us with a clear case of paradigmatic innovation – here, we must believe, was a new formulation of a kind for which many men had been searching for many reasons.¹⁶

The *Answer* was a critical turning point in the debate because in it the king admitted that England possessed a balanced government, not an absolute monarchy. It was an admission that

¹⁴Bolingbroke, *Political Writings*, p. 3.

¹⁵Plumb, *The Growth of Political Stability in England, 1675-1725*, p. 19.

¹⁶Pocock, *Machiavellian Moment*, p. 361

royalists immediately began pressing the king to retract. But the *Answer* quickly became part of the English constitutional canon.¹⁷ 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.

But 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 believed in mixed government. He was a devotee of Machiavelli. Harrington's fundamental contributions were, first, to delineate 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, to show 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, of government and military power. His genius was to see that these two balances must be the same. That is, 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, would inevitably be unstable. Harrington defined corruption in classic Polybian terms: "corruption in this sense signifieth no more than that the corruption of one government (as in natural bodies) is the generation of another..."

Harrington's analysis provided a neat explanation for the Civil War and the collapse of

¹⁷Text of the *Answer* is printed in Weston, *English Constitutionalism*, along with the *Political Catechism*, a popular document that interpreted the *Answer* in terms that would become a central part of Whig theory.

the Stuart monarchy. The changes in land tenure under Henry VII transferred control of land from large aristocratic land owners to the gentry. Power follows land, and the greater share of power exercised by the gentry appeared in the House of Commons. The rise of the Commons to challenge both the Lords and the King produced corruption in the existing constitutional system. Harrington called for a republican commonwealth, but not one without King or Lords. His commonwealth men would establish the correct balance of the English constitution, reestablishing order within the constitution laid out in the *Answers*.

After the restoration of Charles II in 1660, he and his brother, James II, continued to press the royal prerogative.¹⁸ The *Answers* and Harrington's *Oceana* defined a constitutional balance, but it was not yet in place. Conflict between King and Parliaments resulted in the deposition of James and the installation of William and Mary. Between 1660 and 1688, "commonwealthmen" or "True Whigs" or "Real Whigs" articulated a version of the balanced constitution and its associated corruptions. This group included Neville, Shaftesbury, Locke, Marvell, and Sidney.¹⁹ By 1675 they had developed a coherent position containing the basic

¹⁸"Charles, when he chose to exert himself, was extraordinarily clever. The role he played during the plot period and during the Exclusion parliaments was that of a wise and skilled politician. He generally succeeded through the flexibility and acumen of his approach to the problems as they came up from day to day. As the controversy degenerated into conspiracy and plot, he was able to get rid of the most influential of his opponents. Charles came nearer establishing despotism than any member of his family, or indeed any other English ruler." Robbins, *Eighteenth-Century Commonwealthman*, p. 27.

¹⁹These 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.

themes of opposition ideology, destined to be repeated for the next century.²⁰ Balanced government required independent actors in king, lords and commons. The creation of a standing army, as opposed to a militia, was the starting point of their critique of Stuart government.²¹ A professional standing army threatened the independence of Parliament by filling the Commons with professional soldiers and other office holders whose 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...” “There are the placemen, including military officers, whose allegiance is to their employer the Crown rather than to Parliament and whose sole business is to support the increase of government expenditure...”²²

²⁰The written sources can be found in Shaftesbury speech to the House of Lords in October; the anonymous tract *A Letter from a Person of Quality to his Friend in the Country*; and the publication of Marvell’s *Account of the Growth of Popery and Arbitrary Government in England* in 1677. I have drawn on Pocock “Machiavelli, Harrington, and English Political Ideologies” in this section, reprinted in *Politics, Language and Time*, pp. 104-147 (the source citations are on page 116). The argument is further developed in *The Machiavellian Moment*, pp. 406-422.

²¹ Since the influential position of the aristocracy depended on their provision on 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, *Politics, Language, and Time*, p. 118. As Pocock discusses, opposition to a standing army is a neo-Harrington position. Harrington himself believed that a paid standing army would eventually depose its king and lead to despotism, thus the standing army threatened the king. The author of *A Letter from a Person of Quality* was arguing before Parliament that the nobility was threatened by a standing army and growing executive influence.

²²Both quotations from Pocock *Politics, Language, and Time*, first quote p. 125; second quote from pages 123-4 citing Marvell’s *Account of the Growth of Popery and Arbitrary Government in England*.

The Glorious Revolution of 1688 and the new arrangements between King William and Parliament produced a complementary set of institutional changes in fiscal policy and administration that recognized, in Harrington's terms, an increased role for the Commons. They included the Bank of England, professionalization of tax collection and administration, and the development of new methods to fund the growing national debt.²³ This lowered the cost of government borrowing and gave Britain an important edge in the wars with France. Continuous warfare created a military-industrial complex in England. Between 1700 and 1800 government expenditures rose from 5 percent of income to 20 percent of income.²⁴ This unprecedented expansion of state power was equally the accomplishment of Parliament and the King, for Parliament controlled tax policy.

The growth of the military-industrial and the military-financial complex required a more durable and continuous method of coordinating decisions between the executive (the Crown and his ministers) and Parliament. Influence in the new world of finance and industry did not stem from one's position on the land. Millions of pounds were at stake in letting government contracts, marketing and servicing government debt, and obtaining these plums required connections in Parliament and the administration. The King necessarily forged alliances with powerful political groups within Parliament, employed Prime Ministers like Walpole to manipulate the system, reward his followers with patronage and influence, and held the new

²³On the Bank of England and the financial revolution generally see Dickson *Financial Revolution*; on the bureaucratization of tax collection see Brewer *Sinews of Power*; and for the national debt see North and Weingast, "Commitment."

²⁴Mathias and O'Brian review the history of government revenues and expenditures in 18th century Britain.

system together with the funds and support of the new financial and industrial elites. The British Empire flourished, taxes increased steadily, the army and navy multiplied, and the commonwealthmen continued to question whether this whole system was constitutional.

Standing armies continued to be a rhetorical focal point, but ongoing warfare made the existence of a standing army moot. The main opposition complaints were parliamentary patronage, the public credit, and political parties. These concerns extended the argument that through patronage and influence the King obtained enough influence in Parliament to suborn its independence.²⁵ As government expenditures rose from 5 to 10 to 20 percent of national output, the executive had a growing number of patronage positions at its disposal in the Army, Navy, Treasury, Customs, and Excise. By the time of the American Revolution Namier estimates that ___ of ___ members of the House of Commons were placemen, pensioners, or represented electoral districts under control of the King and his ministers. The steadily growing public debt created a class 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

²⁵“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, *A Dissertation on Parties, Political Writings*, pp. 92, 93-4.

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.”²⁶ The creation of a political party within Parliament 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.

What is hard for modern readers to see is that Whig claims of corruption were not about the current state of Britain, but instead were fears about the future of British government. 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 that “No Government that ever existed was so essentially free.” Even the Frenchman Montesquieu talked of “this beautiful system.”²⁷ But they read Harrington and they knew that the stability of the system required careful adjustment of the balance social estates within the government and the distribution of land without. They read Polybius and they knew that a unitary government, no matter how pure, inevitably evolved into its corrupt form. A monarchy, no matter how virtuous, would become a tyranny. Finally, they knew from all that they read that corruption was change. They believed in the perfect balance of the British constitution, but they

²⁶Bolingbroke, *A Dissertation upon Parties, Political Works*, p. 85.

²⁷Quotations from Wood, *Creation of the American Republic*, p. 11.

had no historical yardstick to judge whether the change that British society and government was undergoing in the 18th century was 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 government's relation to the economy, particularly the new commercial and financial economy, was the focus of the corruption charges. The use of chartered corporations to promote economic activity potentially created economic rents (by limiting entry) that could be used by the Crown to cement economic interests to his cause. Adam Smith attacked the system of government granted mercantilist privileges. Trenchard and Gordon in *Cato's Letters* charged "Companies and joint-stocks are always established for the encouragement and benefit of trade; though they always happen to mar and cramp trade."²⁸ Commonwealthmen were not concerned that monopolies, corporations, and government regulations created rents and slowed the rate of income growth (Smith's *Wealth of Nations* was the first purely economic analysis of British policy.) They worried instead that mercantilist economic policy was a way for the government to create rents that were then the gift of the executive to dispose of, and the disposition of rents were being used to create dependencies on royal favor in other branches of the government.²⁹

Corporations were also an easy to attack as examples of venal corruption. *Cato's Letters* opening issues attacked the directors of the South Sea Company, whose venture into refunding

²⁸*Cato's Letters*, No. 9. December 31, 1720; p. 69.

²⁹The possibility that private interests would use the public debt for their own purposes soon arose. "Thus the method of funding and the trade of stock-jobbing began. Thus were great companies created, the pretended servants, but in many cases the real masters of every administration." Dickson, *Financial Revolution*, p. 18: Quoting Bolingbroke *Some Thoughts on the present State of the Nation*, in *Works*, iii, 151.

the national debt led to a spectacular crash.

What progress we have lately made in England, towards such a blessed state of confusion and misery, by the credulity of the people, throwing their all upon the mercy of base-spirited, hard-hearted villains, mischievously trusted with a power to undo them, is too manifest from the woeful condition that we are in. The ruin is general, and every man has the miserable consolation to see his neighbour undone: 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! A name which carries along with it such a detestable and deadly image, that it exceed all human invention to aggravate it; nor can nature, with all her variety and stores, furnish out any thing to illustrate is deformities; nay, it gains visible advantage by the worst comparisons you can make: Your terror lessons, when you liken them to crocodiles and cannibals, who feed, for hunger, on human bodies.³⁰

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.³¹

Even as the financial revolution stabilized and supported the government, enabled Britain to dominate in the military struggle with France for colonial dominion, and as the scope and size of British trade (financed by the commercial revolution) dramatically expanded the market for British goods the new financial organizations came under increasing public criticism as an instrument of corruption in the government itself. The combined charges of systematic

³⁰*Cato's Letters*, No. 3, November 19, 1720, pp. 44-5. 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.*

³¹Dickson, *Financial Revolution*, pp. 32-33.

corruption, suborning the independence of politicians and Parliament, and individual corruption, the venality and greed of stock-jobbers and speculators, packed a powerful message.

By mid-18th century commonwealthmen decried the corrupting evils of executive patronage, the public credit, and parties. Commonwealth ideals were important elements of the political conversation in the 18th century; the term “conscience Whigs” conveys the main contribution of commonwealth thought. They defined, with clear bright lines, what was constitutional and what was unconstitutional. 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 Britain, 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. The 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.”

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 arrest 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, *The Ancient Constitution and the Feudal Law*.³²

We have reached the point where British and American paths divide. The “republican synthesis” in American history provides a convincing explanation for why Americans revolted and what “made their revolution so unusual, for they revolted not against the English constitution but on behalf of it.”³³ 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 colonists in these prerevolutionary years watched England in bewilderment as what had long been predicted by “her senators and historians” seemed actually to be happening -- the English constitution, formerly “the noblest Improvement of human reason,” was at last succumbing to the forces of tyranny, “shaken to its very basis.” England, the Americans said over and over again, “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.” By the 1770's the metaphors describing England's course were all despairing: the nation was fast streaming toward a cataract, hanging on the edge of a precipice; the brightest lamp of liberty in all the world was dimming. Internal decay was the most common image. A poison had entered the nation and was turning the people and the government into “one mass of corruption.” On the eve of the Revolution the belief that England was “sunk in corruption” and “tottering on the brink of destruction” had become entrenched in the minds of disaffected Englishmen on both sides of the Atlantic.

These widely voiced fears for the fate of the English constitution, “the mighty ruin of a once noble fabrick,” were not simply the bombastic expressions of revolutionary-minded men. They represented the rational and scientific conclusions of considered social analysis. For all of its rhetorical exaggeration, the ideology of Whig radicalism, embraced by Americans of varying political persuasions and at every social level, was

³² The Patrick Henry quote is from his “Liberty or Death” speech. The Pocock quote is from page 310.

³³ Wood, *Creation of the American Republic*, p. 10. The republican synthesis literature is neatly summarized and discussed in Shalhope 1972 and 1982.

grounded in the best, most enlightened knowledge of the eighteenth century; it was this grounding that gave the Whig ideology much of its persuasive force. When the American Whigs described the English nation and government as eaten away by “corruption,” they were in fact using a technical term of political science, rooted in the writings of classical antiquity, made famous by Machiavelli, developed by the classical republicans of seventeenth-century England, and carried into the eighteenth-century by nearly everyone who laid claim to knowing anything about politics.”³⁴

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.³⁵ 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.³⁶

³⁴Wood, *Creation*, p. 32.

³⁵The call was repeated in the Declaration of Independence: “Therefore, ' ' Resolved, That it be recommended to the respective assemblies and conventions of the united colonies, where no government sufficient to the exigencies of their affairs has been hitherto established, to adopt such government as shall, in the opinion of the representatives of the people, best conduce to the happiness and safety of their constituents in particular, and America in general.' ”

³⁶New Jersey, Constitution of 1776, Article 20. The New Jersey Constitution of 1844 read: Article 3, Section 1: “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

The Constitution of Maryland ratified in November, 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 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.³⁷ National government action inevitably raised the specter of corruption.

The ability of states to legislate, regulate, or promote almost any aspect of economic and social behavior meant that 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

either of the others, except as herein expressly provided.”

³⁷This point is developed further in Wallis, 2004B, and Wallis and Weingast, 2004.

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 Toqueville 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 minute... 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.”³⁸

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 a universal right; and one found governments and territorial magnates at the head of organizations because they possessed the sometimes implicit, but often explicit ability 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 interest so valuable. In America, freedom to assemble, the ability to form religious, political, economic, and social organization did not go undisputed after the revolution. Deciding how much public support should be given to private organization was important and, at least in the economic and political world, very contentious.

³⁸*Democracy in America*, p. 513.

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."³⁹ 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, land owning 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. 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 systematic and venal corruption. How was the United States to deal with the identical problem?

"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."

³⁹Joseph Galloway to the Continental Congress, as quoted by Jensen *The Articles of Confederation*, p. 66, quoting John Adam's Notes on Debates, *Works of John Adams*, 2:372.

— Lance Banning, *Jeffersonian Persuasion*⁴⁰

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.⁴¹ The debate that ensued in the summer of 1791 over what the new financial system meant, however, produced a conflagration of fears over corruption and led to the creation of an opposition party in the United States.⁴² All of the policy measures at issue were economic. The important element in the debate, however, 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, allowed the Crown to extend its influence and undermine the independence of

⁴⁰Banning, *Jeffersonian Persuasion*, p. 128.

⁴¹ “Americans who paused for bearings in the spring of 1791 could be pleased with the success of the federal experiment that most of them had undertaken with considerable trepidation. The constitution was by then a working instrument of government, accepted on all sides as a starting point for future debates. The nation's finances were at last in order, its economic future bright. There had been no lack of controversy during the first three sessions... These seemed to have been weathered rather well.” Banning, *Jeffersonian Persuasion*, p. 149.

⁴²“By the end of the summer of 1791, the political mood of the country had undergone a radical change.” Banning, *Jeffersonian Republic*, p. 159.

Parliament. Although stock jobbers and financial parvenus were reviled for their personal venality, the danger of the English system of finance was to fundamental liberties, it was systematic corruption. The identification of financial interest 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."⁴³

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.

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

⁴³"Report on the Public Credit" *American State Papers, Finance*, Vol I, p. 15. See Ferguson, *Power of the Purse*, for an analysis of how constitutional issues and the public debt interacted in Hamilton's thinking.

the existence of American liberty.⁴⁴

The Virginians questioned whether “Republican policy,” i.e. commonwealth ideas, could have suggested such a financial program, draws 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 whig style, the memorial raises the alarm that Hamilton’s plans threaten the “existence of American liberty.”

James Madison, then a representative from Virginia, raised similar concerns in Congress about balance within the national government and specifically about the dangers of granting corporate charters:

Mr. M. then enlarged on the exact balance or equipoise contemplated by the Constitution, to be observed and maintained between the several branches of Government; and showed, that except this idea was preserved, the advantages of different independent branches would be lost, and their separate deliberations and determinations be entirely useless....

The power of granting; charters, he observed, is a great and important power, and ought not to be exercised unless we find ourselves expressly authorized to grant them. Here he dilated on the great and extensive influence that incorporated societies had on public affairs in Europe. They are powerful machines which have always been found competent to effect objects on principles in a great measure independent of the people.⁴⁵

As Banning noted, it would have been difficult to consciously design a financial program that provoked commonwealth fears of executive influence more directly than Hamilton’s.

Nonetheless, Congress passed all the plan’s elements. Opponents then questioned whether the Bank charter was constitutional. Washington polled his cabinet on the issue. Attorney General Randolph and Secretary of State Jefferson opposed the bank, arguing that the Constitution did not

⁴⁴*American State Papers, Finance*, Vol. I, p. 90.

⁴⁵*Annals of Congress*, 1st Congress, 3rd Session, pp, 2008-2009.

explicitly enumerate the power of the government to create a corporation. Treasury Secretary Hamilton argued, in his letter to the president, that the power to create a corporation was inherent in the powers of a sovereign government:

The latter [Randolph], expressly admits, that if there is anything in the bill which is not warranted by the Constitution, it is the clause of incorporation.

Now it appears to the Secretary of the Treasury [Hamilton] that this *general principle* is *inherent* in the very *definition* of government, and *essential* to every step of the progress to be made by that of the United States, namely: That every power vested in a government is in its nature *sovereign*, and includes by *force* of the *term*, a right to employ all the *means* requisite and fairly applicable to the attainment of the *ends* of such power, and which are not precluded by restrictions and exceptions specified in the Constitution, or not immoral, or not contrary to the *essential ends* of political society.⁴⁶

Hamilton's arguments carried the day and Washington signed the charter bill into law.

Although Hamilton's proposals were controversial, they all passed. The debate that flared up in the summer of 1791, however, between Jefferson and Madison on one side and Hamilton on the Adamses on the other, revealed several inherent contradictions in the system devised by the founders. Public acrimony between the participants set in motion the formation of distinct Federalist and Republican parties in national politics. And, finally, the way in which the conflict was resolved placed corruption in government promotion of economic development at the center of American politics for the next half century. First some history, then the contradictions.

In 1790, John Adams published *Discourses on Davilla*. The book praised the British constitution and argued for caution in extending democracy too far. Thomas Paine *Rights of Man* appeared in London February 1791. It was an attack on the corruption of balanced

⁴⁶Hamilton's letter to Washington on the Constitutionality of a National Bank, McKee, p. 101, emphasis in the original.

government as developed by Hume and in Burke's *Reflections on the Revolution in France*. Paine argued that the only uncorrupt government would be a single legislature elected by the people; the very antithesis of balanced government.⁴⁷ Jefferson, passing an original copy of *The Rights of Man* to a Philadelphia printer, included praise for Paine in his note accompanying the volume. The printer, without Jefferson's consent, included an excerpt of Jefferson's comments in the preface to the Philadelphia edition: "I am extremely pleased to find it [*Rights*] will be reprinted here, and that something is at length going to be publicly said against the political heresies which have sprung up amongst us. I have no doubt our citizens will rally a second time round the standard of Common Sense."⁴⁸ The heresy's of Jefferson's comment were Adams and his *Discourses*. As he wrote to Madison "I had in view certainly the doctrines of Davila. I tell the writer freely that he is a heretic, but certainly never meant to step into a public newspaper with that in my mouth. I have just reason therefore to think he will be displeased."⁴⁹ Madison's reply "Mr. Adams can least of all complain. Under a mock defence of the Republican Constitutions of this Country, he attacked them with all the force he possessed..."⁵⁰

John Quincy Adams, then 24, came to his father's defense in a series of letters published under the pseudonym *Publicola*, letters widely attributed to the senior Adams. "...like his father,

⁴⁷Paine wrote: "A mixed government is an imperfect everything, cementing and soldering the discordant parts together by corruption to act as a whole.... The parts cover each other till responsibility is lost, and the corruption which moves the machine contrives at the same time its own escape." "The Rights of Man" in *The Complete Writings of Thomas Paine*, Foner, ed. p. 339, as quoted in Banning, *Jeffersonian Persuasion*, p. 158.

⁴⁸As quoted in Malone, *Jefferson and the Rights of Man*, p. 359.

⁴⁹Jefferson to Madison, May 9, 1791; Smith, *Republic of Letters*, p. 687-8.

⁵⁰Madison to Jefferson, May 12, 1791; Smith, *Republic of Letters*, p. 688.

John Quincy Adams was essentially concerned to advocate a set of institutional arrangements that would guarantee a people's liberty against a preference for empty declarations that could sacrifice real liberty for speculative definitions."⁵¹ The Adamses found themselves defending the hereditary and unwritten British constitution against the enlightened wave of new French ideas. The response to *Publicola* was swift and vehement, and accused the Adams of supporting monarchy. *Publicola*'s purpose "must be to encourage and support the idea of change of the government of these states from a republican to an aristocratic system."⁵² Newspaper editorials appeared that challenged the Adamses' praise of the British constitution and began calling into question the entire Federalist program:

The great danger to be apprehended at present to our government is that the democratical part, that is the people, will lose their due and proper influence in the government. The sources of this danger are various: ...the influence made and increasingly in favor of the executive, the monarchical part, by the multiplicity of officers;... the vast accumulation of property occasioned by the funding system, etc. in the hands of those who have been called the natural aristocracy.⁵³

The *Publicola* letters marked a turning point in American political debate. "From the revival of old suspicions of Federalist motives, it was a short step to a more general consideration of conspiracy and corruption in American affairs."⁵⁴ The debate escalated over the year that followed. Jefferson and Madison's succeeded in placing Philip Freneau as editor of the *National Gazette*, which quickly became the Republican newspaper and published a series of

⁵¹Banning, *Jeffersonian Persuasion*, p. 156.

⁵²Banning, *Jefferson Persuasion*, p. 157, quoting "Agricola" no 1. *American Daily Advertiser*, June 5, 1791.

⁵³Banning, *Jeffersonian Persuasion*, p. 159, quoting "The Watchman," no. 2, *Boston Independent Chronicle*, Sept. 8, 1791.

⁵⁴Banning, *Jeffersonian Persuasion*, p. 158.

essays by Madison and others challenging Hamilton. Hamilton responded in kind in the *Gazette of the United States*, the Federalist standard bearer, attacking Jefferson. The political warfare continued to the election of Jefferson in 1800.

The *Publicola* episode illustrate three fundamental contradictions in the American system:

1) *Popular Sovereignty vs. Tyranny of the Majority*. Both the Federalists and the Anti-Federalist argued for popular sovereignty as a critical element in the new American system. In particular, popular sovereignty solved the vexing problem of dividing sovereignty, of *imperio in imperium*, in at least a formal logical way. 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 trained in the ways of commonwealth theory, tyranny of the many was just as much a problem 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 extended republic would mitigate the risk, as he argued famously in Federalist #10. Madison's hopes didn't last a decade: "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...."⁵⁵ 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 over ride

⁵⁵"Editor's Introduction," Ferejohn, Rakove, and Riley, ed. *Constitutional Culture and Democratic Rule*, p. 3.

the checks and balances built into system by sweeping a majority through all the branches of government.

2) *Political Parties vs. Corruption.* The Constitution itself offered a way for Jefferson and Madison to oppose the Federalists: the formation of a opposition party. The logic of the winner take all electoral process for President, as well as other offices, seemed to guarantee that eventually two competing parties would emerge.⁵⁶ And 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 parties. But the formation of an overt political party challenge the incumbent Federalists, who could plausibly argue that their administration was non-partisan, carried with it an explicit danger. Parties and factions were inherently, systematically corrupt. For a party to contest for control of the government in an organized way was *per se* corrupt in the 1790s. Madison, in a series of articles published in the *National Gazette*, provided an intellectual justification for parties.⁵⁷ Madison drew on the classic distinction between the few and the many, arguing that the Republicans represented the many.

⁵⁶“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, *Constitutional Culture*, p. 7.

⁵⁷In particular see Hofstadter, *The Idea of a Party System*, p.80-86, as well as the entire third chapter “The Jeffersonians in Opposition.” His citation is to Madisons *Writings*, pp. 86. 87. 104-5, 106-23.

But a much stronger argument was to obviate the need for parties at all. Madison and the entire Republican party claimed that they stood on the side of the angels in a debate over republican vs. monarchical government and pure vs. corrupt methods of governing.⁵⁸ Tarring Adams and the Federalists with being closet 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 the decades of American paranoia over corruption in the Britain. The negative political implications of the Republicans existence as an organized political party could be 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

⁵⁸“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 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, *Idea of a Party System*, p.p. 84-5. 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.

disunion, which is only to be obviated by a national preference for one of these parties.”⁵⁹ 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.

3) *Corruption vs. Promotion of Economic Development*. By building their case against Hamilton and the Federalists along traditional Whig lines, the Republicans gained the moral force of a century of British/American thinking about corruption in government. At the same time, they boxed themselves into a fundamental dilemma. The Republicans were just as much a pro-growth and development party 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 it was the first step down the slippery slope to executive tyranny. How then did the Republicans propose to promote economic development?

There was really only one model available at the end of the 18th century. Governments promoted economic development for centuries, Britain and elsewhere, 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. Corporation charters, in general, limited entry. Drew McCoy’s book, *Elusive Republic*, makes abundantly clear that the central tenets of Jefferson 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 insure growing external markets for American

⁵⁹John Taylor, *A Definition of Parties*, (1794), p. 2; cited in Hofstadter, *Idea of a Party System*, p. 100.

products abroad, so that yeomen farmers did not produce themselves into poverty.⁶⁰ There was no institutional vehicle to promote financial and transportation improvements but the corporation. If the Republicans were to condemn 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 of them resolved themselves in the 1830s and 1840s.

Perhaps party competition between the Federalists and Republicans could have culminated in a resolution of the contradictions of American democracy in the early 1800s. But John Adams and the Federalists fatally wounded their cause when they passed the Alien and Sedition Acts in 1798. The acts gave concrete expression of the worst Whig fears, that tyrannous executive government threatened individual liberties.⁶¹ The Federalists completed their political suicide when they divided over support of the War of 1812, but by then the Republicans had firm control of the national political agenda. The triumph of Jefferson over Adams in 1800 and the Republican's ability to form a consensus national government obviated

⁶⁰In particular see McCoy, 1980, chapter Three, "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. 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."

⁶¹ The Alien and Sedition Acts provoked a response from Madison and Jefferson that pointed towards the way that they would address the contradiction between corruption and promotion of economic development. The Virginia and Kentucky resolves called for state rather than federal action. This did nothing to resolve the paradox, it merely transferred it to the state governments.

the need to form a partisan political party, and so put off the paradox of corruption and political parties at the national level until 1824. The ability of the Republican to govern by apparent consensus 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.⁶²

This section begins with a review of state and federal activity in finance and transportation, then considers the bank war, and concludes with an explanation of how states solved the paradox of corruption and the promotion of economic development.

I. State governments expanded their involvement in banking and transportation from 1790 onward.⁶³ It is tempting to attribute the rise of state promotion to the 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 municipal corporations in

⁶²Wallis and Weingast, 2004, investigate the causes of federal inaction.

⁶³The history of government promotion of transportation improvements, federal, state, and local, is Goodrich (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 and 2003); the compilations of bank history by McCulloch (1888), Knox (1900) and Redlich (1968); and Hammond's (1957) more discursive history

the 1790s.⁶⁴ Northeastern states acquired bank investments as early as the 1790s, Louisiana and Ohio invested in banks in the 1820s, and bank investment spread into the south and west in the 1830s. In 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.⁶⁵

The War of 1812 interrupted state transportation investments, but after the war was over New York embarked on the Erie canal, followed in the 1820s by Ohio, Pennsylvania, and Maryland. Between 1790 and 1860, state and local governments spent \$450 million, financing the Erie Canal, the Baltimore and Ohio railroad, hundreds of other successful projects as well as hundreds of failures. In 1841, aggregate state debts, bonds issued to finance investments in banks, canals, and railroads, stood at \$198 million, larger than the national debt had ever been. Over the same period, the federal government spent \$54 million on transportation improvements, mostly small rivers and harbor projects.

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

⁶⁴In the decade of the 1800s, New York averaged 18 incorporations per year, Ohio 1, Maryland 2, Pennsylvania 6, and New Jersey 4. In the 1830s, New York averaged 57, Ohio 43, Maryland 18, Pennsylvania 38, and New Jersey 18. Evans (1948). There is a substantial historical and legal literature on American corporations: Davis (1961), Dodd (1936 and 1954), Hurst (1970), Handlin and Handlin (1945), Seavoy (1982), Maier (1992 and 1993), Lamoreaux (2004), and Dunlavy (2004).

⁶⁵For state involvement in banking in the early 19th century see Wallis, Sylla, and Legler, 1994; Sylla, Legler, and Wallis, 1987; and Bodenhorn, 2000 and 2003.

anti-charter sentiments were usually expressed whenever a charter was contemplated.⁶⁶ At the same time, there was wide spread 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!”⁶⁷

The right to assemble, the right to organize, was explicitly recognized by early American states. Their charter policies reflected public support of private organization. In itself, this made a significant, if unmeasurable, to the development of the American economy and the rate of economic growth.

⁶⁶“Even as they celebrated peace and prosperity, Americans worried reflexively that some other class, party, or region was gaining advantage behind the smiling mask of public amenity. Still guided by a Manichean notion of politics that comprehended opposition as subversion or intrigue, American voters and their representatives readily peered behind the curtain, searching for the agents of corruption that their ideology led to them to suspect. Often they found what they were seeking, and the ubiquitous evidence of narrow selfish interest that tainted every appeal to principle seemed to validate the cynical view. As a result, public works seldom were seen as simply roads or river improvements, and policy initiatives easily stood condemned as stalking horses for interested factions and their sinister designs.” Larson, 2001, p. 119.

⁶⁷Maier (1992), pp. 73-4.

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.⁶⁸ 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 through by limiting entry chose to take their share of the rents in the form of tax revenues, not political influence.⁶⁹

II. The election of 1824 offered a chance to change the course of federal policy. The Congressional Caucus nominated William Crawford, but the election was contested as well by John Quincy Adams, Henry Clay, and Andrew Jackson. The theme of Jackson's campaign was corruption:

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 by and bye to go forth and dictate to the people as is

⁶⁸See Bodenhorn, this volume, Seavoy (1982), and Benson (1961) for the political uses of bank chartering in New York.

⁶⁹Wallis, 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 (1949 and 1950).

right.⁷⁰

Jackson won a plurality of the popular vote and the electoral vote. When the election went to the House, Clay threw his support behind Adams. Adams was elected and 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?”⁷¹ Jackson’s campaign for the 1828 election began in 1824, and its theme was corruption.

John Quincy Adams came out strongly for internal improvements in 1825. His administration spent more on internal improvements than any before him, but Congress refused to authorize a general system of federally sponsored transportation projects.⁷² Jackson’s election in 1828 did not necessarily signal the end of hope for a more active federal government, but it did bring back into clear focus the three contradictions of American democracy. General

⁷⁰Eaton, 1824, p. p. 3-4, as quoted in Larson, 2001, p. 154. The quote is from *Letters of Wyoming*, campaign pamphlets that began appearing in 1823, written by John Eaton, later Jackson’s Secretary of War. “Eaton was constructing for Jackson our 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

⁷¹Jackson to Lewis, February 20, 1825; as quoted in Remini, 1981, p. 98.

⁷²“The forces that buoyed the Jackson movement, wrecked the Adams administration, and spoiled the national system of internal improvements reflected two great fears that stalked the American experiment from the firsts days of the Revolution. One was the enduring fear of monarchy and class rule, and while it seems implausible to us, men and women in a world still governed by royalty saw real danger from an evil they had escaped not so long ago. The second fear was of the oft-denounced tendency of men in office to abuse their power, building up networks of support for their continuance by handing out favors, benefits, and offices to unscrupulous armies of placemen. As democratization proceeded it was the people themselves who plagued the government for favors, yet they continued to respond to the rhetoric of old that decried the tendency of “ministries’ to subvert the people’s virtue.” Larson, 2001, p. 150.

Jackson was the epitome of the man on horseback 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 and initially financed by Nicolas Biddle, chose to contest Jackson in the arena of economic policy. The defining question for Whigs and Democrats was whether the national government should renew the charter of the Second Bank of the United States.

The economic and political history of the Bank War is well known.⁷³ The debate between Jackson and his opponents, chief among them Henry Clay, were carried out in terms of systematic corruption. Jackson's veto message railed against the special privileges conveyed to the Bank. The veto message laid out Jackson's position on the Bank, on the battle between the aristocratic wealthy and the masses of the population, and on the abuse of privilege as an evil of government.⁷⁴ But he did not begin speaking of systematic corruption until the Bank War broke

⁷³See Remini's *Bank War* and Temin's *Jacksonian Economy*. 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, 2003.

⁷⁴ 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

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 the Jackson and Taney had prepared on the 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 combinations 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.”⁷⁵

Jackson recalled the classic phrases of systematic corruption. The Bank itself was a government: a small group (in this case Biddle and Clay) 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.

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

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. 1153-4.

⁷⁵From "Paper read to the Cabinet" in the Jackson Papers, L.C.; as quoted in Remini, 1967, *Bank War*, p. 119.

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!⁷⁶

Jackson's actions gave Whigs the opportunity to accuse Jackson of executive usurpation. Clay's rhetoric seems outlandish to us, but it was the language of the commonwealthman. The American Whigs charged Jackson with executive usurpation, of corrupting the political process, tyranny and slavery would follow.

Senator Sprague was equally direct. Jackson claimed that he, and he alone, represented the will of the people. Jackson interpreted his victory in the 1832 elections as a referendum on his bank policy. Sprague demurred:

We are told and it is constantly reiterated in our ears, that in all these assumptions and claims of prerogative, the President is sustained by the people.... But they [the people] are not infallible...

Let it then be distinctly understood, that these two tremendous powers, the Executive and the people, cannot meet, and in their coming together, crush the legislature, the judiciary, and the Senate between them, and still leave a constitutional republic. It was such a meeting that crushed the Senate and the liberties of ancient Rome, and placed the bloodstained Caesar upon the throne. It was such a meeting that extinguished the legislative assembly, and annihilated the hopes of republican France, and elevated Bonaparte to imperial power. We have been admonished, warned, if not threatened here, in this debate, that if we bow not to Executive will, we shall be driven from this Hall by

⁷⁶Henry Clay's speech on the "Removal of Deposits," December 30, 1833. *Register of Debates*, 21st Congress, 1st Session, p. 94.

ruffian force, as Cromwell expelled the Rump Parliament!⁷⁷

At the end of the debate over the removal of the deposits, the Senate censured Jackson. Jackson's protested the censure, and in his protest message to the Senate he made clear why he felt the Bank was dangerous:

The Bank of the United States, a great moneyed monopoly, had attempted to obtain a renewal of its charter by controlling the elections of the people and the actions of the Government. The use of its corporate funds and power in that attempt was fully disclosed, and it was made known to the President that the corporations was putting in train the same course of measures, with the view of making another vigorous effort, through an interference in the elections of the people, to control public opinion and force the Government to yield to its demands. This, with its corruption of the press, its violation of its charter, its exclusion of the Government directors from its proceedings, its neglect of duty and arrogant pretensions, made it, in the opinion of the President, incompatible with the public interest and the safety of our institutions that it should be no longer employed as the fiscal agent of the Treasury.⁷⁸

The contest between Clay and Jackson, and the longer struggle between the Whigs and the Democrats was fought over classic commonwealth concerns: executive usurpation, the moneyed 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. Both sides of the Bank War debate painted the other side as systematically corrupt.

Jackson's administration resolved two of the paradoxes of American democracy, but not the third. First, from Jackson onward, demagogues were accepted, as long as they were elected

⁷⁷Senate Debate, 23 Congress, 1st Session, on the Removal of the Deposits, *Register of Debates*, pp. 386-87. January 29, 1834.

⁷⁸Protest. April 15, 1834, Richardson, 1897, p. 1306.

President.⁷⁹ Jackson permanently increased the power of the Executive branch within the national government. He based his claim for expanded powers on the will of the people as shown in the only nation wide election. Second, political parties became an accepted part of the political system. Suspicion of partisan motivation, of the dangers of faction and party remain to the present day of course.⁸⁰ But the national government could not resolve the third paradox -- corruption and the promotion of economic development – except by inaction. Jackson solution to corruption in banking was to not have a bank. Perhaps this should not be a surprising outcome. Except in the earliest days of the Washington administration during Hamilton’s tenure as Treasury Secretary, the national government, Congress and Executive, and were unable to design or execute a program of active government promotion of economic development.

III. Promoting economic development was left to the states. By the end of Jackson’s second

⁷⁹Sprague colorfully expanded on the danger of Jackson as a “man on horseback.” “The people love their constitution, their liberties, and themselves. They are always politically honest, for political honesty desires the greatest good of the greatest number; they are the greatest number, and must desire their own greatest good. But they are not infallible. I should be false to all history, false to human nature, false to holy writ, if I could so flatter the people as to tell them that they were exempt from that great besetting sin, a proneness to idolatry. It is of the nature of man to worship the work of his own hands, to bow down to idols which they have set up. Feeble, fallible mortals like themselves are canonized and deified. And 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: the excited imagination invests him with a glorious halo, circling around him as the splendid perfections and dazzling attributes of heroes and patriots; -and then the strongest facts, the clearest evidence, and the most cogent reasoning, which expose his errors or ambition, excite only indignation and resentment towards their authors, as impious and sacrilegious revilers of the idol of their hearts. 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 Congress, 1st Session, on the Removal of the Deposits, *Register of Debates*, pp. 386-87. January 29, 1834.

⁸⁰Hoftstader’s, *The Idea of a Party System*, is particularly illuminating on the rise of parties and the role played by Martin Van Buren in the process.

term, states throughout the country were deeply involved in investing in and promoting banks and transportation systems. In the mid-1830s state investment exploded, increasing by \$100 million between 1836 and 1841 alone (GNP was roughly \$1.5 billion). An economic depression began in earnest in 1839. The collapse of the boom in western land and a rapid deflation brought the state investment boom to an end. By 1842, eight states and the territory of Florida were in default on their bonded debts, and three additional states narrowly avoided default. The crisis in public finance naturally brought investigations into its causes. In a few states venal corruption caused fiscal problems: Mississippi, Florida, and Arkansas. Most states placed the blame on faulty institutions: they blamed it on the way democracy was working out in practice.⁸¹

American state governments were the first governments of their kind in 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. By the 1830s, all but a few of the states adopted universal white male suffrage. They chartered and constituted local governments. They built roads, schools, and hospitals; constructed judicial systems and codified laws; and laid the foundation for a financial and transportation infrastructure to link themselves together. States kept track of titles to land, enforced property rights, and solved most of the knotty problems of how governments and markets should interface on a day to day basis. They believed that republican government was good. They wanted to promote economic growth, but they worried incessantly that the corporations and privileges they created to promote growth benefitted a favored few to the

⁸¹See 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.

detriment of the many. State governments 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. Here is how they figured out the answer.

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. 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.⁸² The early nineteenth century was an era of continual political debate about the structure of government.

They were the first governments with extensive experience in chartering corporations. By the 1830s the states had chartered thousands of corporations; ranging from local library

⁸²Of the original thirteen states, only North Carolina and Massachusetts, stayed with their first constitution through the Civil War. Connecticut began with its original colonial charter and wrote a new constitution in 1818; Delaware 1776, 1792, and 1831; Georgia 1777, 1789, and 1798 ; Maryland, 1776 and 1851; Massachusetts wrote its first and only constitution in 1780 after an earlier attempt failed at ratification, and held a constitutional convention in 1820-21 that produced a constitution that also failed ratification; New Hampshire 1776, 1784, and 1792 (and I believe a constitutional convention in the 1820s that failed ratification); New Jersey, 1776 and 1844; New York 1777, 1821, and 1846; Pennsylvania 1776, 1790, and 1839; South Carolina 1776, 1778, and 1790; Vermont, 1777 and 1786; Virginia 1776, 1830, and 1850. Of the first new states: Kentucky 1792 and 1799; Tennessee 1790 and 1834; 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.

societies to the Camden and Amboy Railroad.⁸³ States had learned that corporations could bite the hand that created them, as in the Charles River Bridge Company. They had extensive experience with the fiscal potential of corporations. States learned that entrepreneurs were willing to pay for corporate charters, and that charters limiting competition brought larger fees. States learned that they could earn comfortable dividends from the ownership of stock, particularly if the state protected their dividends by limiting the competition of the firms that they owned. They also learned, sometimes at their own expense, that many corporate ventures looked better on paper than they did in reality.

Do not forget that the first and most important connections between governments and corporations were fiscal. This was true in Britain and the mercantilist privileges that Adam Smith complained about. It was true in the American states from the beginning. 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 or 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."⁸⁴

⁸³The Camden and Amboy possessed a monopoly on the through railroad route between New York and Philadelphia. British experience with corporations encompassed large public corporations like the Virginia Company, Hudson Bay Company, and the Bank of England; municipal corporations; and public utilities, but it had nothing like the variety or number of corporations that the United States possessed by the 1830s.

⁸⁴Veto Message, July 10, 1833, Richardson, 1897, pp. 1140-1141.

If governments were going to sell monopoly privileges, if they were going to sell corporate charters, then inevitably each charter required a price, a negotiation, a bargain. This was a systemic 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 loved receiving government services paid for by charter fees, taxes on capital, or dividends on stock. But by its very nature the creation of corporate privileges created the opportunity for political groups to create economic privileges that could be used to distort the political process. 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.⁸⁵ 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, that inevitably some politicians, even well meaning politicians, were going to make some serious mistakes. Voters could easily be induced to vote for expenditures that promised large returns without levying taxes.

The solution the paradox of corruption and economic development was as simple as it was ingenious. First, eliminated the pressure to create special corporate privileges by enacted constitutional provisions requiring legislatures to pass general incorporation laws allowing

⁸⁵ Moreover, in the 1830s American states learned that it was easy to slip across the line from chartering corporations to investing in them. By 1840, states throughout the country had invested in private banking and transportation companies, in most cases by issuing state bonds. Taxpayers were promised that their taxes would be lower, that investments would return profits to the state above and beyond the interest on state bonds. Land developers proposed canals and railroads that would pay for themselves in higher land values.

unlimited entry into corporate status. A corporate charter could be obtained by anyone by meeting the stated requirements and paying the requisite fee to a state administrator. Second, states forced development promoters to raise taxes at the beginning of their projects. States passed constitutional provisions requiring that all state borrowing required a bond referendum: 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 mandated general incorporation acts, Virginia was the only exception. 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.⁸⁶

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.⁸⁷ 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

⁸⁶The history of these constitutional changes is presented in Wallis, 2004A. The general relationship between public finance and corporations is discussed in Wallis, 2003. For a history of incorporation laws see Evans, 1948, for and a larger discussion of the 19th century corporation see Hurst, 1970.

⁸⁷One impact of the restrictions was to move more borrowing to local governments.

making such manipulations illegal or unconstitutional, but by reducing the payoff to political machinations. Institutions supporting unlimited entry, free competition, 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.

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.

Richard L. McCormick, “The Discovery that Business Corrupts Politics”⁸⁸

The title of McCormick’s essay suggests that corruption in the Progressive era was no longer the kind of systematic corruption this essay has focused on: the corruption of the economic system by politicians. A fundamental shift occurred over the last half of the nineteenth century, American’s faith that their system worked was strengthened by a civil war, the rise of an integrated national economy, and the development of a thriving manufacturing sector. Their faith was strengthened because none of these developments, all of which could have unbalanced and corrupted America’s governments, did not do so. Corruption stopped being an infra-marginal 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 suggested 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

⁸⁸McCormack, 1981, p. 247.

election of Senators by popular vote and women's suffrage, and at the state and local level by the spread of initiative, referendums, and recalls and the rise of home rule.

The link between the progressive era and the Jacksonian era is state chartering policy. The widespread adoption of general incorporation act liberalized access to corporate charters, and the number of corporations in America exploded, relative to both early American history and contemporary European economies.⁸⁹ But general incorporation acts liberalized entry while, at the same time, 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.⁹⁰ For example, corporations were typically prohibited from owning stock in corporations domiciled in other states. In the 1870s, in New Jersey, this all began to change.

The New Jersey charter of the Camden and Amboy railroad granted the railroad a monopoly of northeast-southwest rail traffic in the state – a monopoly on the direct through route from New York to Philadelphia.⁹¹ For most of the period from 1840 to 1875, the state relied on dividends on its Camden and Amboy stock and transit fees paid by the railroad for the bulk of

⁸⁹For 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 the following section.

⁹⁰For a discussion of general 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.

⁹¹For the history of New Jersey see Cadman, 1949. For the specifics of New Jersey's changing corporation policy, see Grandy, 1989.

state revenue. In the early 1870s the Pennsylvania Railroad was able to purchase controlling interest in the Camden and Amboy. The New Jersey constitution of 1844 mandated general incorporation acts, but did not forbid the granting of special legislative charters. The Camden and Amboy charter was very special. In 1875, the state amended the constitution: “No county, city borough, town, township or village shall hereafter give any money or property, or loan its money or credit, to or in aid of any individual, association or corporation, or become security for, or be directly or indirectly the owner of any stock or bonds of any association or corporation.” The state legislature “... shall not pass private, local or special laws ... Granting to any corporation, association or individual any exclusive privilege, immunity or franchise whatever. Granting to any corporation, association or individual the right to lay down railroad tracks.”⁹²

Losing its railroad revenue put New Jersey in fiscal jam. The state responded by raising the state property tax, and by considering changes in its incorporation laws. 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 create define their internal structure within much wider bounds. Corporations flocked to New Jersey, swelling the states revenues, and opening up new opportunities for corporate structure throughout the United States.⁹³ 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

⁹²The first amendment was to Article 1, section 19 and the second amendment was to Article 9, section 7.

⁹³“By the end of the merger wave, revenue from incorporation fees and franchise taxes represented more than 60 percent of State Fund revenues. The state budget moved solidly into the black by 1890 and stayed there into the next century. By 1902 New Jersey had eliminated its bonded debt and had abolished its state property tax.” Grandy, 1989, pp. 681-3.

of the consolidations involving more than \$1 million in capital took place in New Jersey.⁹⁴ New York and Delaware soon followed New Jersey's lead, liberalizing their incorporation laws and trying to lure businesses into their states. Delaware remains a haven for large corporation to this day.

Attributing the Progressive era to the merge 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 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."⁹⁵ When a small number of unprecedentedly large corporations sprang into being during the merger wave, states, and to a lesser extent the national government, 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 had before.

Benjamin Parke DeWitt, progressive reformer and historian, wrote in his *Progressive Movement: A Non-partisan, Comprehensive Discussion of Current Tendencies in American Politics* in 1915:

In this widespread political agitation that at first sight seems so incoherent and chaotic,

⁹⁴"New Jersey charters represented more than 60 percent of firm disappearances and almost 80 percent of the capitalization of these combinations. Half of John Moody's 318 "industrial trusts" bore New Jersey charters – including *all* of his seven "greater industrial trusts." Grandy, 1989, p. 678. See Lamoreaux, 1985, and Nelson, 1959, for more detailed history of the merger movement.

⁹⁵McCormick, 1981, p. 252.

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 an 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, pp. 4-5).

The first progressive tendency -- that special, minority, and corrupt influence in government be removed -- could have been written in London in 1720, Philadelphia in 1787, Albany or Indianapolis in the 1840s, or today for that matter. The venal are 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.⁹⁶

The second tendency, changes in the "structure and machinery of government," while not unique to the Progressive movement, constituted the heart of the Progressive reform agenda. It aimed directly at limiting systematic corruption by changing the structure and machinery of government. Part II, III, and IV of DeWitt's history delineate the Progressive strategy.

Part II is the "Progressive Movement in the Nation:" composed of "Measures of Corporation Control," "Measures of Government Control," and "Measures of Relief."

⁹⁶See Wallis, Fishback, and Kantor for a discussion of social welfare in the New Deal and the end of corruption in relief administration.

Part III is “The Progressive Movement in the States:” composed of “Measures of Control over the Nomination and Election of Officials,” “Measures of Post-Electoral Control: the Initiative, Referendum and Recall,” “Measures to Prevent and Relieve Social and Economic Distress.”

Part IV is “The Progressive Movement in the City:” composed of “Municipal Home Rule,” “The Charter Movement,” “The Efficiency Movement,” and “The Social Movement,”

The progressive movement went forward in three distinct areas. First, they altered the relationship between corporations and governments through active regulation and changes in chartering. Second, they pressed for a series of electoral reforms including the initiative, referendum, and recall that brought 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.

Battling venal corruption and regulating the excesses of the plutocrats charged the progressive movement with a populist morality. 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 accomplishment. 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 (some of these innovations, like city managers, reduced voter control over local government). 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.⁹⁷

The medicine prescribed by progressives to cure systematic corruption would have seemed insane to a founding father. The original American problem with 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. All of the constitutional progressive reforms strengthened direct popular participation in political decision making. Of course, the progressives did not dismantle the checks and balances that set interests against one another in the Madisonian system, nor did they dismantle the constitutional reforms that required popular approval of state and local debt issue and therefore spending. Progressive reforms celebrated popular sovereignty, the concept that the voters were the ultimate judge of government policy. Whether politicians and policies were corrupt would be left to popular choice. The many would decide whether the few had violated their mandate to govern on behalf of the common good. Constitutional reforms in the early 20th century would institutionalize popular control, majorities really would rule.

How could this happen? The key piece of evidence is something that did not occur, a dog that did not bark. The constant element in discussion of corruption in America and Britain is that corruption inevitably leads to tyranny and slavery. Patrick Henry could hear the chains clinking on the plains of Boston in 1775, Henry Clay feared that we would “all die – ignobly die – base, mean, and abject slaves” if Andrew Jackson was allowed to get away with removing

⁹⁷ In 1902, local government revenues and expenditures were over 60 percent of total government revenues and expenditures in the United States. Control of local government meant control over most of the functions of government.

federal deposits from the Bank of the United States. Such language is not to be found in the progressive era, at least not in the writing and thinking of the progressives themselves.

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 in the economic and political system, Madison's extended republic, as modified by the states, had produced a stable balance within government. Competition and entry create their own equilibriums.

Some of the contradictions of the Progressive era dissolve when viewed from this perspective. In classical Whig political economy, increasing government regulation raised as many red flags as did special corporate charters. Regulation created the opportunity for creating rents; rent creation created the possibility for political manipulation of the economy. If political and economic competition limit rent creation and dissipation, they also make it safer for the government to regulate in positive and negative ways. For example, how could New Jersey, New York, and Delaware's liberal incorporation policy be squared with more vigorous enforcement of anti-trust laws? One seemed to increase corporate power and the other to reduce it. Allowing corporations to structure the internal governance structures without external

regulation, and allowing them to operate across state lines, produced the biggest corporations the world had ever seen. Anti-trust law seemed to put a tool in the hands of government to regulate bigness, but it was a blunt and awkward tool. It was a tool that seemed custom designed to allow political manipulation of the anti-trust laws for political and economic advantage. One could see James I or II promoting these changes in government, not Whig commonwealthmen.

Progressive era seemed to give more power to everybody: to the government, to regulators, to voters, to labor, to management. Fishback and Kantor's (2000) impressive accomplishment is to show how worker's compensation systems evolved in such a way to benefit labor, management, and the insurance industry, at the same time providing progressive state governments with a triumph of social reform. Sorting out who gained and who lost from a particular piece of legislation is an ineffective way to understand progressive era reforms. The idea was that everyone could gain, although the political rhetoric of the times was much more inflammatory.

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. This trust is historically relative; Americans have a profound ability to mistrust government. 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. Apparently it worked. Simultaneous with the strengthening of popular democratic institutions and widening the powers of government, voter

participation began seriously to decline.

The threat of systematic corruption, so prevalent for three centuries in British and American political and economic thinking, had begun to recede. Some voters and citizens would continue to exercise eternal vigilance in defense of liberty. Many citizens retired from active political participation, trusting in the mechanisms of balanced government to protect their rights and insure the efficient operation of the political system.

At the beginning of the twenty-first century, economists and policy makers are struggling to improve the quality of governance in developing economies. The quality of institutions, the trust that people put in their governments and the institutions around them, appear to be powerful determinants of the performance of economies over time. Whether good institutions cause growth or whether growth causes good institutions is, of course, a vexing question. How we answer it will guide policy makers decisions about the placement and direction of resources. This essay examines the role played by an idea – systematic corruption – in the development of British and American economic and political institutions over the three centuries from Jamestown to World War I. Americans in those centuries fixated on corruption. They feared that the growth of a military-financial-industrial complex in 18th century Britain had corrupted British government and that their fundamental liberties had been eroded. Those fears led them to seek independence in 1776. They worried that plans restore the federal credit and promote economic development put forward by Alexander Hamilton in the 1790s would corrupt the new political system. They worried that the growth of private corporations and large government investments in financial and transportation infrastructure would corrupt the political system in

the 1830s. Every time, they worried that their fundamental liberties were at stake, that tyranny and slavery were just around the corner. At least, that is what they said.

How much does this teach us about corruption in the modern developing world? It depends on the questions we ask. Perhaps the biggest contribution a historical study of systematic corruption offers to modern economists is a better understanding of the sources of change in economic institutions. In a country with bad government, one where property rights are not enforced, courts are unreliable, and public officials are corrupt, the main obstacle to growth is not the lack of human and physical capital. It is the presence of bad government: governments that steal, lie, and cheat; governments that manipulate the economy for their own ends; governments that are corrupt. In these countries the first step to economic development is political reform.

Seventeenth century Britain had plenty of experience with bad government. During the Civil wars of the 1640s, as British thinkers tried to articulate how they believed good government in Britain should be constituted, some drew on continental political thinkers, particularly Machiavelli and his classical forefathers Aristotle and Polybius. They articulated the idea of balanced government, enshrined in Charles I's *Answer to the Nineteen Propositions of Both Houses of Parliament*. A balanced government possessed three independent parts: King, Lords, and Commons. Corruption occurred when anything upset the balance. In the eighteenth century, executive influence in Parliament, financed by the new financial and industrial corporations and organizations created and mobilized by Britain's ongoing war effort, threatened the balance. Systematic corruption was the result of political manipulation of economic interest. The crown's evil ministers used access to economic privileges to secure political power. Thus,

politics corrupted economics. While Britain grew and prospered, Whig writers worried that tyranny and slavery were at hand, just a slip of Parliamentary independence away. Americans believed them.

The American constitution embodied Whig theories. Indeed, as Pocock claimed, true Whig theories could not be put in place in Britain, they required the American experiment to be tried. Critical problems awaited the new American government. How were government finances to be saved? What role should governments play in promoting economic development? What should the role of federal and state governments be in the process? Hamilton's brilliant reorganization of government finances saved the credit and honor of the federal government, but at the cost of raising fears about systematic corruption. Hamilton deliberately set out to recreate a system of government finance based on the British model, a model that most, if not all, Americans understood to be the reason the revolution had to be fought in the first place. Importantly, Hamilton's plan passed Congress, was signed into law by Washington, and then the debate over corruption broke out in earnest. The result was a stalemate and inaction at the federal level.

States, however, stepped forward and began enthusiastically promoting banks and transportation improvements. States provided organizational support and encouragement, in the form of corporate charters. By the 1810s they borrowed money and invested their own funds in projects like the Erie Canal and the Pennsylvania State works. States promoted banks, canals, and railroads and chartered corporations of all types; all the while worrying whether their policies were the right ones. Some states experimented successfully with open and free entry into corporate status. Massachusetts, for example, had de facto free banking from the early

1820s. Most states, however, found the fiscal advantages of limiting entry and selling or investing in more valuable corporations too tempting to pass up. States like New York followed the recipe for systematic corruption to the letter. Politicians limited access to bank charters, granted a few valuable charters to their political supporters, and used the financial and organizational they raised to dominate the political system.

The states promoted economic development and worried about the paradox of creating privileged corporations to pursue economic growth they hoped all could enjoy. In the 1840s, in part in response to the state default crisis and in part in consideration of the role that rent seeking came to play in democratic polities, the states began opening up access to charters to everyone. General incorporation acts reduced the rents associated with limited entry, reduced the pressure on state legislature to create special privileges, and opened up the economic system to greater competition. The movement towards general incorporation in the 1840s was a solution to a political problem, not an economic problem. If there is a lesson to draw from the American experience, it is that the institutional supports for competitive markets with open entry emerged as a solution to a political problem, not simply an economic problem. Viable economic policy reforms will only work if they are politically viable as well.

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