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The Other Foundings
Federalism and the Constitutional Structure of American Government

John Joseph Wallis

6.1 Introduction

One of the distinctive features of American society from the Revolution onward was the sustained development of the polity and the economy. Economic development can be measured in rising per capita income, but more important aspects were the development of an integrated and well-organized market economy, the development of the most important forms of business organization—the partnership and the corporation—and the consolidation of secure property rights in land and moveable wealth. Economic development was matched by political development through a broader suffrage, the emergence of political parties at the state and national level, hotly contested but generally fair elections, a reliable legal system, and increasing ability to guide government decisions through democratic institutions. Economic, political, and general historians have always suspected that the two development processes were intimately connected. Economists have come to understand quite clearly that modern economic development is not possible without modern political development, and vice versa, if not quite understanding how they are connected. The United States should offer a rich laboratory for understanding the dynamic interplay of economics and politics.

Traditionally, however, questions about social dynamics in the early republic have been framed by the founding choices made at the national level. The ability of the founders to construct a democratic republic capable of defending and expanding its territorial sovereignty, providing security of property and persons to its citizens, and, until 1861, ensuring relative stabil-

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ity of government institutions and policies constituted a bedrock for the subsequent development of American society. The national history has strongly influenced our attempts to understand American development since, from 1790 to 1860, national government structures and policies basically stayed the same. The national Constitution was amended just twice between 1791 and 1865.[1] Policies with respect to public lands, taxation, the military, and internal improvements (transportation) were often hotly debated but underwent no fundamental change. Policies regarding patents, banks, and international trade did change, but not dramatically so, even though arguments about policies were intensely argued as well. While history focuses on the arguments, one major implication of the founding choices were unexpectedly stable national government policies.

Interplay is the result of action and reaction. If economic and political development are connected, then political actions should lead to economic consequences and economic actors should change their behavior and, in turn, pressure political actors to make political changes. Unlike the static national government policies, state governments were deeply involved in actions, new experiments, and fundamental changes that affected the economy from 1776 through 1860. State political development was, in turn, affected by economic changes. Historians have always known that a history written from the perspective of the national government is important, but incomplete, because most of the political policies affecting economic development in the new nation originated at the state level. The assumption has often been that the interplay between capitalism and democracy at the state level followed the same pattern as at the national level. Indeed, it is often implicitly assumed that the national level dominated the interaction between economics and politics because of the central importance of national constitutional guarantees for security of property and contract.

This chapter argues the opposite: if we want to understand the relationship between political and economic development in the United States, then we need to understand American history at the state level. It was at the state, not the national, level that the critical interplay between political and economic development, between democracy and capitalism if you will, occurred between the 1780s and 1840s and on into the late nineteenth century. The chapters in this volume by Howard Bodenhorn and Robert Wright look closely at banking and corporations, two areas of the economy in which the states were the primary government actors that exerted profound influence over the economy. Symmetrically, the growing economy also posed profound questions for democracy. Early Americans feared that their new democracies would not be sustainable. It was by no means clear that governments could promote development without corrupting democracy.

1. The Bill of Rights was ratified in 1791, the 11th amendment in 1795 concerned states and judiciary, and the 12th amendment in 1804 was a technical modification in the presidential election system; the 13th amendment banned slavery in 1865.

The states led the process of political and economic development. The first three sections of the chapter document the rapid and continuous state constitutional change, the persistent expansion of democracy at the state level, and the relative inaction at the federal level. Then we turn to the fears of early Americans that the energetic promotion of economic development threatened new democratic institutions by using public power to promote private interests that would derail and corrupt the political process. On the economic side, fundamental changes were made in the nature of business organizations, both partnerships and corporations; the nature and regulation of entry into markets, including financial markets; the ability of private firms to draw on capital from public sources; and the structure of taxation. On the political side, fundamental changes were made in constitutional provisions that specified the kind of economic activity state and local governments could engage in directly, government relationships with private organizations; the methods, procedures, and limits on the creation of government debts; and, ultimately, on the kinds of laws state governments could pass. Understanding how Americans gradually learned, over time, to create more powerful and productive private economic organizations at the same time that they secured the democratic process from being unduly influenced by those organizations is the fundamental story of this chapter.

The national government faced the same challenges as the states but was unable to deliver significant investments in finance and transportation. The emphasis placed here on state governments does not imply that states played a more important role than the national government in the development of early nineteenth century America: both were important. The role of states has, however, been slighted by historians of all types and redressing the balance is important. Understanding how America promoted political and economic development is impossible if we ignore the states because we get an incomplete picture of how American institutions changed. Equally important, there has long been both a (raw) political and (sophisticated) theoretical explanation of American development neatly conveyed in the motto of *The United States Magazine and Democratic Review,* a standard bearer of the Jacksonian Democrats, published from the late 1830s into the 1850s: “The best government is that which governs least.” The intense political debate about how active a role the national government should take, epitomized by the struggle between the Democrats and Whigs in the 1830s and 1840s but present from 1790 through to the Civil War, by and large resulted in a relatively inactive national government. Undue focus on the national government can lead to the simple conclusion that American development was the result of inactive and quiescent government.

Almost all of the important constitutional development in the United States between 1787 and 1865 occurred at the state level, changes that can be documented in the state constitutions. Presenting that evidences makes up

the bulk of this chapter. A continuous interplay between the people's desire to promote economic development and secure democracy produced a long record of institutional change. When the pieces are lined up correctly, it is easy to see the tension and interplay. In the simplest terms, Americans feared that organized economic or political groups posed a threat to democracy, the fear of faction so persuasively described by Madison in Federalist Paper no. 10. At the same time, Americans wanted to promote economic development (although there were enormous differences about how that should be done) and saw the creation of economic organizations as the best way to achieve those ends. The tension was particularly acute in the area of financial and transportation infrastructure. The states figured out how to resolve the tension. Their constitutional flexibility and innovation shows clearly when we look at the right places in our history.

6.2 Constitutional Change

Between 1800 and 1900, the national government amended its Constitution four times, once to correct a defect in the procedures for electing the president and vice-president and three times in the wake of the Civil War. During the same period, thirty states wrote new constitutions when they entered the Union, and sixty-four existing state constitutions were revised for a total of ninety-four complete constitutions. States also amended their constitutions hundreds of times during the century.

Table 6.1 lists the dates of state constitutions, new and revised, for states in existence up to 1850. States are grouped by region: New England, Mid-Atlantic, South, Southwest, Northwest, and the trans-Mississippi West. The columns reflect roughly twenty-year time periods, except for the 1860s and 1870s, which were particularly active constitutional times. There are four main points to take away from the table.

First, states actively reconsidered constitutional arrangements in the nineteenth century. Of all the states in the table, only Massachusetts and New Hampshire did not revise their constitution at least once between 1800 and 1900. In addition, only South Carolina, North Carolina, Georgia, Alabama, Missouri, Arkansas, Texas, and California did not revise their constitution at least once between 1800 and 1860.

Second, after a wave of constitution making and revising in the 1790s, New England states were much less active. Connecticut and Rhode Island operated with revised versions of the colonial charters until writing new constitutions in 1818 and 1843, respectively. Vermont was the only other state to revise its constitution in 1836, and the Vermont changes were relatively small. Although New England states did amend their constitutions, the region as a whole stands apart from the rest of the country when it comes to constitutions. New Englanders were willing to change laws, with-

Table 6.1 **New or revised state constitution dates**

State	1776–1799	1800–1819	1820–1839	1840–1859	1860–1869	1870–1879	1880–1899
CT	1662	1818					
MA	1780						
NH	1776,1785,1792						
RI	1663			1843			
VT	1777,1786,1793		1836				
DE	1776,1792		1831				1897
NJ	1776			1844			
NY	1777	1821		1846			1894
PA	1776,1790		1839			1874	
MD	1776			1851	1864,1867		
SC	1776,1790				1861,1865,1868		1896
VA	1776		1830	1850	1864	1870	
GA	1777,1789,1798				1861,1865,1868	1877	
NC	1776				1868		
KY	1792,1799			1850			1890
TN	1790,1796		1834			1870	
AL		1819			1861,1865,1868	1875	
MS		1817	1832		1861,1868		1890
LA		1812		1845,1852	1861,1864,1868	1879	1898
OH		1802		1851			
IN		1816		1851			
IL		1818	1848			1870	
MI			1835	1850			
WI			1848				
IA			1846	1857			
MN				1857			
MO			1820		1865	1875	
AR			1836		1864	1874	
TX			1845		1866,1869	1876	
CA			1849			1879	

out changing their underlying constitutions, where other states found it necessary, or advisable, to change their constitutions and the laws. New England exceptionalism appears often in what follows.

Third, the most active period for constitutional revision stretched from the early 1830s through the early 1850s. States in the South and in New England were less likely to revise their constitutions in this period; all other states replaced their constitutions at least once. It was in the 1840s, in particular, that changes in constitutional provisions with respect to the economy and public finance changed that later spread through the rest of the country.

Fourth, the 1860s and 1870s were a period of intense constitutional revision in South. This was triggered by secession in 1861 and 1862, the return of states to the Union in 1865 and the period of reconstruction up to 1877, and a third wave of Southern constitutional reaction to reconstruction constitutions after 1877. Many of the constitutional reforms of the 1840s were adopted in Southern constitutions under reconstruc-

tion, and those provisions were generally not removed in later Southern constitutions.

In short, states actively considered and reconsidered their constitutional arrangements throughout the nineteenth century. They were not content to rest on the laurels of their revolutionary constitutions. As we will see, after changing their constitutions in the early nineteenth century to make them more democratic, by widening the suffrage and making officials more responsive to direct selection by voters, they engaged in another round of constitutional changes that reflected the changing relationship of their democratic polities to their growing economies.

6.3 Suffrage and Democracy

Control over elections in the early republic was left completely up to the states. Table 6.2 reports restrictions on suffrage at the state level. All of the original states, with the exception of New Hampshire and Vermont, imposed either property or tax paying requirements for voting in the 1770s. Kentucky imposed no requirements (except color) when it entered in 1792, Tennessee had a property requirement when it entered in 1796, and Ohio had a tax paying requirement when it entered in 1802. Ohio was the last new state to impose property or tax paying requirements when it entered the Union; every state after that allowed free, white, male, adult suffrage in their initial constitutions. Existing states began opening suffrage by reducing or eliminating requirements, as shown in the table. By 1855, only Rhode Island, New York, and South Carolina still imposed a property requirement and, as Keyssar notes (2000, appendix A.3), Rhode Island exempted native-born citizens from the requirement, New York's property restrictions applied only to African Americans, and South Carolina offered a residency alternative to the property qualification.

The movement toward free, white, male suffrage was matched by a movement toward direct election of state officials. By the 1850s, almost all the states elected their governors by direct popular vote; only half had done so in their original constitutions. States moved to eliminate extralegislative bodies with the power to review laws or propose constitutional amendments, such as the Council of Revision in New York or the Council of Censors in Pennsylvania and Vermont.

Beginning in the 1830s, states also began selecting judges by popular election, taking the power of appointment and approval from legislatures and governors. Table 6.3 lists the years when states considered electing judges, sometimes accepting and sometimes rejecting the idea (taken from Shugerman 2008).

After independence, American states moved steadily toward more democratic institutions: wider suffrage and a direct selection of more government office holders through popular election.

Table 6.2 Suffrage requirements

State	1776–1799	1800–1819	1820–1839	1840–1859	1860–1869
CT	T,P			1845 0	
MA	P		1821 P0, T		
NH	0				
RI	P			1842 P-,T	
VT	0				
DE	T				
NJ	P	1807 T,P		1844 0	
NY	P	1804 P-	1821 P0		Note property requirements still applied to blacks after 1821.
PA	T		1838 T		
MD	P	1801 P0			
SC	P,T	1810 P, T0			
VA	P	1804 P-	1830 P	1850 0	
GA	T				
NC	P,T		1835 P-,T	1854 P0, T	
KY	0				
TN	1796 P		1834 P0		
AL		0			
MS		0			
LA		1812 T			
OH		1802 T		1851 0	
IN		0			
IL		0			
MI		0			
WI		0			
IA		0			
MN		0			
MO		0			
AR		0			
TX		0			

Notes: "P" denotes a state with a property requirement for voting; "T" denotes a state with a tax paying requirement for voting. The first appearance of state gives a "P," "T," or "0" to denote whether a state had either provision or none when it became a state (or in 1800). Successive appearances, moving from left to right, indicate whether a state continued the requirement, "P" or "T"; reduced the requirement "P-" or "T-" or eliminated one or both of the requirements: "P0," "T0," or "0." The dates were taken from Keyssar (2000).

6.4 Federal Inactivity

Between 1790 and 1860, the federal government spent only $60 million on transportation improvements and chartered two banks.[2] Over the same period state and local governments spent over $450 million and chartered thousands of banks. Why was the federal government unable to make transportation investments? The federal government not only stood to gain from

2. The argument in this section is developed in full in Wallis and Weingast (2005).

Table 6.3 Timeline for judicial elections

Year	Elections	Against elections
1777	The territory of VT for lower courts	
1812	GA for "inferior" courts	
1816	IN for associate circuit court judges	
1832	MS (C)	
1833		
1834		MO (A), TN (C)
1835		NC (C), GA (A)
1835–1936	MI for circuit judges (C)	
1837		
1838		PA (C)
1839–1843		
1844	IA for lower courts (C)	NJ (C)
1845		TX (C), LA (C), MO (C)
1846	NY (C)	
	WI (C)	
1847	IL (C)	
1848–1850	PA (A)	
1848	AR for circuit court judges (A)	
1849	CA (C)	
1850	MO (A)	
	OH (C)	
	KT (C)	
	MI (C)	
	TX (A)	
	AL, CT, and VT for circuit court judges (A)	
	VA (C)	
1851	MD (C)	NH (C)
	IN (C)	
1852	LA (C)	
1853	TN (C)	MA (C)
	FL (A)	
1857	MN (C)	
	IA (C)	

Source: Taken from Shugerman (2008).
Note: C = convention; A = amendment(s).

tying the nation more closely together through a system of transportation, the federal government could be expected to be a more efficient provider of such investments. The federal government was larger, in fiscal terms, with well-established domestic and international credit (after the 1790s), and the federal government could internalize the external benefits of transportation investments. When New York built the Erie Canal, many of the benefits of the canal accrued to residents of the Ohio River Valley in Ohio, Indiana, and Illinois who were able to ship their good to the eastern seaboard via the canal. All of those benefits could, in principle, have been internalized by a national system of internal improvements.

The problem wasn't lack of effort. As Goodrich (1960) and Larson (2000) both document, Congress continually wrestled with proposals to involve the federal government in transportation projects.[3] Even Thomas Jefferson, in his second inaugural, suggested that a national system of transportation improvements be considered, leading to the famous Gallatin plan. Gallatin was Jefferson's secretary of the Treasury, and his proposed system of eight major and several minor projects would have tied the nation together, both north and south, and east and west, at an estimated costs of only $25 million. Why was Gallatin's plan rejected? Democracy.

The major obstacle was the competing interests of geographic areas: the unwillingness of one area to incur costs for projects that would benefit other areas. For example, in the debate over the building the Cumberland Road, which the federal government was obligated to build because of promises it made when Ohio was admitted to the Union (so there was no constitutional question that the road was going to be built), the issue was where the road would be located. Throughout the debates over siting the road, geographic rivalries stood in the way of the adoption of specific route. One Maryland congressman declared that Pennsylvania seemed more inclined "to put a mountain in the middle of the Cumberland road than to repair it."[4] Opposition to the Maryland route, for example, came primarily from Pennsylvania and Virginia. When sectional rivalries dominated the debate, as they sometimes did, it was the rivalry between the East and West that mattered, not the North and South.[5]

How were these centrifugal forces inherent in democracy to be overcome? One way was to charter a privileged corporation to provide the public good so that taxes would not have to be raised on anyone. This mitigated the opposition of regions that paid taxes but received little or no benefits. Both the first and second Banks of the United States were created by giving a charter to a small group of investors and guaranteeing them control over federal financial business. The federal government investment in the stock of both banks was financed by loans from the banks themselves. No federal taxes were raised to create or invest in the banks; in fact, both banks paid a nice dividend regularly into the federal treasury. But both Banks generated an enormous amount of political opposition based on fears that the Banks were powerful configurations of private interests that would use their power

3. Nettels (1924) found 117 grants by Congress that funded federal transportation projects and discusses a large number of bills that were proposed but failed of passage. Feller (1984) details the long association of proposals to use revenues from public land sales with attempts to obtain federal financing for internal improvements.

4. See Goodrich (1960, 45). See Larson (2001, 54–57).

5. "[John Quincy] Adams's charge that the national program was overthrown by what he called 'the Sable Genius of the South' is therefore a great over-simplification" Goodrich (1960, 46). Nettels (1924) focuses on the importance of the West's growing voting power and awareness of their collective interests as the key factor that forced a decision about the national government's role in transportation improvements early in the Jackson administration.

to dominate the polity: the first Bank at its origins in the 1790s, the second Bank when its charter was renewed in 1832.

Fears over organized economic interests, articulated clearly in Washington's farewell address, suggest that the struggles over the Banks were a good indicator of the stiff opposition that any nationally chartered corporation would face in Congress. Building transportation infrastructure by creating privileged corporations appeared to be beyond the capacity of the federal government. Alternatively, the federal government could borrow the money and hope that revenues from the transportation improvement would repay the bonds (that was how the transcontinental railroads were financed), but there was little support for peace time federal borrowing in the early nineteenth century.

The importance of geographic and fiscal factors is illuminated by the two types of transportation investments that could command a majority of votes in Congress and were successfully pursued by the federal government. The first type was funding small, geographically diverse projects continued on an annual basis. Every state got something. Lighthouse construction began with the first Congress in 1790, with the addition of roads in 1802, rivers in 1824, harbors in 1824, and the first "rivers and harbors" bill in 1826.[6] Small omnibus lighthouse, roads, and rivers and harbor legislation account for $41 million of the $60 million in federal transportation expenditures between 1790 and 1860. Funding for small and scattered rivers and harbors type of transportation projects was continuous and, with the exception of Jackson's 1830s vetoes, never frustrated by the president.

The second important federal initiative, and the second most important in fiscal terms, began in 1802 with the enabling act admitting Ohio to statehood. This act set aside 5 percent of land sales revenues in Ohio for the "building of public roads" to and within the state of Ohio.[7] The Ohio legislature asked that 3 percent of the funds be expended inside Ohio and Congress agreed. The "2 percent" fund for roads leading to Ohio began to accumulate, and in 1805, Congress authorized a survey of the route for the National, or Cumberland, Road. Construction began in 1808, continued into the 1850s, and accounted for $6.8 million in expenditures.[8] Similar land funds in other states, along with grants of acreage to states, account for $10 million in expenditures. Together, rivers and harbor improvements and state

6. See Goodrich (1960, 40). See Malone (1998) and Senate Executive Document 196, 47th Congress, 1st Session, "Statement of the Appropriations and Expenditures for Public Buildings, Rivers and Harbors, Forts, Arsenals, Armories and Other Public Works from March 4, 1789 to June 30, 1882." Malone's book analyzes the information in the report. He comes up with a total of $54 million on transportation expenditures. Our calculations total $60 million. We have chosen to go with our total and have been unable to determine from where Malone derived his $54 million total.

7. The arrangement was an explicit deal in which Congress agreed to build roads to and within Ohio in return for Ohio's promise not to tax federal lands for five years after they were sold to private individuals. See Larson (2001, 54–55).

8. See Goodrich (1960, 24–26).

land funds amounted to $58 million of the total of $61 million in federal transportation investments in the antebellum period.

River and harbor projects worked in a democracy because they provided something for everyone. Each state was able to get its share of rivers and harbor appropriation. If a state wanted to it could bargain away its river and harbor money for some advantage in another piece of legislation. The land funds built roads out of out of land sales revenues. Presumably these funds paid for themselves, as land sales in the states who received the funds would be more vigorous because the roads were being built.

Confirmation of such political forces were at work can be found in three successful attempts to get Congress to pass funding for a general system of transportation improvements that were eventually vetoed or nullified by presidents. Henry Clay of Kentucky shepherded each bill through Congress, in 1816, 1831, and 1841. The first bill, the Bonus Bill, was tied to the $2 million bonus the second Bank of the United States paid for its charter and the expected flow of dividends from the bank stock the federal government owned. Clay and Calhoun proposed that a fund be established with the money to distribute among the states to finance transportation projects. After Congress got through with Clay and Calhoun, the fund had been changed to a formula: each state would get a share of the bonus (or dividends) equal to its share in the Congressional allocation (two senators + representatives). Small states would get slightly more per capita than large states, but there would be no discretion in the allocation of funds. Something for everyone. President Madison unexpectedly vetoed the Bonus Bill on his last day as president.

In 1831, and again in 1841, Clay pushed bills through Congress allocating the residual revenues from federal land sales, after the costs of administering the public land process, to the states on a Congressional allocation formula. The 1831 bill was part of the compromise that ended the Nullification Crisis, but Andrew Jackson double-crossed Clay and pocket vetoed the distribution bill. The 1841 legislation was part of the Land Act of 1841, which made preemption the general federal land policy from that time forward. The distribution provision would lapse if tariffs were raised beyond a specific level, and President Tyler scotched the deal by raising tariffs.

The presidential vetoes are remarkable in light of the Ohio enabling act. Similar provisions were included in the enabling acts of every state that entered the Union after Ohio.[9] The Ohio enabling act clearly authorized the federal government to redistribute funds from one revenue source, sale of public lands, to another expenditure purpose, public roads (that were not post roads, which were explicitly authorized in the Constitution). The

9. Terms of the other enabling acts varied slightly but contained the same principles. See Gates (1968). The Michigan enabling act in 1837 did not contain fund provisions.

Ohio act authorized the construction of public roads within one state, with the consent of the state. As president Madison had signed enabling acts for states that implemented exactly the same type of legislation that Madison vetoed in the Bonus Bill, Madison and Jackson vetoed the Bonus and Distribution bills as unconstitutional, despite those bills containing exactly the same procedures and policies as the state enabling acts.

Despite the strong and persistent calls for a national transportation system, the operation of democratic forces at the federal level prevented much from being done. What was done amounted only to a collection of small and scattered projects.

6.5 Democratic Dilemmas

The United States has, since the first state constitutions were written in 1776, always been a republic, which James Madison defined as "a government in which the scheme of representation takes place." If by democracy we mean, as Madison defined "a society consisting of a small number of citizens who assemble and administer the government in person," then the United States has never been a democracy, except perhaps in some of its local governments. If a democratic republic is a society with a government made up of representatives and offices, where selection of representatives and office holders is by direct election of all duly certified citizens, then the United States started out as a republic with some democracy and gradually evolved into a democratic republic. Democracy could be dangerous. As Madison's definition of democracy in the Federalist papers continued, democracy "can admit of no cure for the mischiefs of faction. A common passion or interest till, in almost every case, be felt by a majority of the whole; a communication and concert, results from the form of government itself; and there is nothing to check the inducement to sacrifice the weaker party, or an obnoxious individual."[10] Would a democratic republic be any better?

Madison laid out the dangers of tyranny by the majority in Federalist Paper no. 10 and how an extended republic could mitigate the dangers of faction. He clearly stated that such fears were justified by the experience of the states up until 1787:

> Complaints are every where heard from our most considerate and virtuous citizens, equally the friends of public and private faith, and or public and personal liberty, that our governments are too unstable; that the public good is disregarded in the conflicts of rival parties; and that measures are to often decided, not according to the rules of justice, and the rights of the minor party, but by the superior force of an interested and overbearing majority. However anxiously we may wish that these complaints had no

10. See Hamilton, Jay, and Madison (2001, 46) in the Liberty Press's reprint of the Gideon edition of the Federalist Papers.

> foundation, the evidence of well known facts will no permit us to deny that they are in some degree true.[11]

The charge that the original state constitutions set up governance institutions that were too democratic, that they allowed too much control to rest in the hands of legislatures without sufficient checks and balances, has flavored our view of early state constitutions ever since.[12] Because most of the constitutional changes discussed in this chapter limited or modified the capacity or procedures of state legislatures, this explanation needs to be kept in mind.

On the other side, Madison and the founders also feared tyranny of the minority. Tyranny of the minority was rooted in fears of faction, which Madison defined as "a number of citizens, whether amounting to a majority or minority of the whole, who are united and actuated by some common impulse of passion, out of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the country" (Hamilton, Jay, and Madison 2001, 43). Factions were groups, however organized, that pursued their own interests to the detriment of the larger society (so whether a group was a faction or not was, to a certain extent, in the eye of the beholder). Earlier republics were not democracies, but contained competing groups of people, usually powerful people, whose interests needed to be kept in balance to prevent civil war, violence, and tyranny.

The key to good government was mixing the interest of different groups so that the interest of each group would keep any one group from seizing control and tyrannizing the excluded groups.[13] Polybius, Aristotle, Machiavelli, Harrington, and Montesque had all written how a mixed government could balance competing factions and prevent tyranny. In eighteenth-century Britain, these ideas coalesced into what came to be known as Whig or Commonwealth theory. In the Whig's view, the British constitution protected the interests of British citizens because of a balance between the interests of the

11. The quote is from page 42. In the penultimate paragraph of Federalist Paper no. 10, he again warned that "factious leaders" had kindled a flame in their states, but that "a rage for paper money, for an abolition of debts, for an equal division of property, or for any other improper or wicked project, will be less apt to pervade the whole body of the union, than a particular member of it" (48).

12. Gordon Wood (1969) bought Madison's argument that the state constitutions gave too much unchecked power to legislatures, although Marc Kruman's (1997) argument that state constitutions were as keenly aware of the power of government and of legislatures in particular, seems persuasive to me.

13. As Quentin Skinner (1998, 49) noted, in the late eighteenth century, tyranny represented a very clear state of affairs:

> "These writers are no less insistent, however, that a state or nation will be deprived of its liberty if it is merely subject or liable to having its actions determined by the will of anyone other than the representatives of the body politic as a whole. It may be that the community is not as a matter of fact governed tyrannically; its rulers may choose to follow the dictates of the law, so that the body politic may not in practice be deprived of any of its constitutional rights. Such a state will nevertheless be counted as living in slavery if its capacity for action is in any way dependent on the will of anyone other than the body of its own citizens."

one, the few, and the many represented in the king, the House of Lords, and the House of Commons. The Whig's charged that the British constitution was being corrupted over the course of 1700s by an expansion of royal authority and influence in the House of Commons. The king and his ministers used the granting of economic privileges, stock in the Bank of England, shares of the national debt, pensions, and offices to members of Parliament in return for their political support. A political faction (the king) used the granting of economic privileges to suborn the independence of Parliament and obtained complete control of the government. The inevitable result would be tyranny. So went at least part of the justification for the American Revolution.[14]

One result of this way of thinking about how government worked was that the Founding Fathers feared the dangers to liberty presented by organized interests in general and, in particular, any close links between political parties (or factions) and economic corporations. They were paranoid—to use Bailyn's phrase—about the possibility that political factions would use organized interest as a tool to subvert democracy. These fears were not merely muttered under the breath of a few elite members of the Constitutional Convention, they were broadcast wholesale from the 1770s up through the 1850s. The founders worried that political factions would use the creation of economic and other privileges to create interests that could be used to dominate the government. They were much more concerned that politics would corrupt economics than our modern concerns that economics would corrupt politics.[15]

Other chapters in this volume trace the development of political parties, the business corporation, banks, and the financial system in general. Given their deep fear of organized interests, of parties and corporations, as threats to liberty and democracy, it is curious that by 1850, the United States came to have the world's first mass political parties, ten times more corporations than Britain and France combined, and the first institutions that allowed free and open access to the corporate form.[16] Something had to give somewhere before 1850. Ideas about factions and governments must have changed, but there is little evidence of these changes in the national debates or national policies.

A key to understanding the American experience is to realize that Ameri-

14. The classic statement of this hypothesis about the causes of the Revolution is in Bailyn (1967). For Whig thinking in Western political thought, see Pocock (1975), for Whig thinking in Britain, see Robbins (1959); and for a general survey of Whig thought in America, see Shalhope's review articles (1972, 1982).

15. In an earlier paper (Wallis 2006), I used the term "systematic corruption" to denote Whig fears that a faction would use political manipulation of the economy to secure political power, in contrast to the modern notion of "venal corruption" in which economic interests distort the political process to obtain economic benefits.

16. For estimates and counts of the number of corporations for the United States, see Wright (2008); for Britain, Harris (2000); for France, Freedeman (1979) and the comparative work of Guinnane, Harris, Lamoreaux, and Rosenthal (2007) and Lamoreaux and Rosenthal (2005, 2006).

cans did not really understood how democracy would actually work in 1776 or 1787. No one could have understood how democracy worked because no democracy on the scale of the United States had ever existed before. As Americans tried to use their governments to accomplish widely shared goals, like increasing the value of land through investments in transportation and finance, aspects of how democracy worked became apparent to them. In order to create transportation and financial infrastructure, Americans needed to create small, well-organized groups. Given their predisposition to fear organized interests, the creation of such groups raised alarms and fears that the government was being corrupted, systematically corrupted in the sense that the organized economic groups would serve as tools for assembling a political majority. How those fears were relieved through changes in the constitutional structure of state governments is the story of this chapter.

6.6 Democracy and Development: The Example of Canals

Let me begin with the example of a canal. Canals dramatically reduced overland transportation costs. Because farm products could be shipped to market much more cheaply, the construction of a canal into a region without existing water transportation raised the farm gate price of farm products and increased the value of farm land commensurately.[17] Given the wide distribution of land ownership in the United States, many people were interested in building canals. But it wasn't easy for a democratic republic to build a canal. Canals were geographically specific investments. Only people living in close proximity to the canal received direct benefits. Yet if a state attempted to build a canal, all taxpayers potentially had to pay higher taxes. Because most voters expected higher taxes and little or no benefits from the canal, they and their representatives voted against the canal.

Scenarios like this played out in the band of northern states that attempted to build canals in the 1810s, 1820s, and 1830s, stretching from New York, Pennsylvania, Maryland, and Virginia on the eastern seaboard and west into Ohio, Indiana, and Illinois. Canal proponents were concentrated among people who stood to benefit directly from the canal, typically because they owned land on or near the canal. Canal opponents were either people who stood to lose directly from the canal or people who worried that their taxes would increase. For example, in New York, opposition to the Erie Canal included farmers on Long Island who opposed building a canal into western New York that would increase competition, but also merchants in New York City who feared higher taxes. The second group turned out to be spectacularly wrong about the Erie Canal, which helped make the fortune of New York merchants.

17. For estimates of the impact of transportation costs on the price of land, see Coffman and Gregson (1998), Craig, Palmquist, and Weiss (1998), and Wallis (2003).

One possible solution to the impasse was to follow the existing European pattern of chartering a privileged corporation to undertake the project. The corporation might be given a monopoly on transportation services along the canal route, help in obtaining property through eminent domain proceedings, favorable access to credit, and perhaps guarantees of limited public funds. In return for their privileges, shareholders in the private company would endeavor to build and operate the canal. The interests of the private actors was coordinated with the public welfare through granting privileges. No taxes needed to be raised, muting opposition from potential taxpayers. The deal could be even sweeter for taxpayers if the corporation promised to grant an ownership share to the state. Rather than paying taxes, voters might enjoy a stream of dividends from the canal. Something like this arrangement was how New Jersey encouraged the construction and operation of the Camden & Amboy Railroad connecting New York and Philadelphia.[18]

Another possibility was for those who benefitted most from the canal to offer to pay a higher share of the taxes. This is how the deadlock over the Erie Canal was ultimately resolved in New York in 1817, the counties along the canal route agreed that to pay a property tax surcharge in the event that the canal fund ran out of money (Miller 1962). In Ohio, Indiana, and Illinois, part of the deal leading to the passage of legislation committing the state to borrow money and build a canal(s), was a change in property taxation. All three states had previously levied a per acre tax on land (graduated by the value of land), which meant that farm land bore the largest burden of the tax. In Indiana, for example, most settled farm land in the 1830s was in the southern part of the state along the Ohio river. Southern farmers opposed the Wabash and Erie Canal, which served the western and northern part of the state. The farmers had the most land to tax and the least to gain from the canal. In 1836, Indiana moved to an ad valorem property tax, which shifted the burden of taxation from farm land more towards towns and urban areas (who were agitating for the canals). Under the ad valorem tax system, land nearer the canal bore a greater share of the tax burden. Indiana set out on its mammoth system of internal improvements in January of 1836, the same month they switched to the ad valorem property tax.[19]

A third option was not to raise taxes at all. The positive experience of the Erie Canal, which began construction in 1817 and before its completion in 1825, was already returning a steady revenue to the state of New York (which owned and operated the canal). Other states began funding canal projects in the anticipation that revenues from the canal would eventually be available to service bonds issued to cover construction costs. By borrowing a bit more than the cost of building the canal, the state could use borrowed funds to

18. For the Camden & Amboy story, see Cadman (1949).
19. For events in Indiana and Illinois, see Wallis (2003); for Ohio, see Scheiber (1969).

pay bond interest in the early years of the project, then redeem the bonds when the canal came on line. This method of financing did not entail raising taxes, but it did entail the taxpayers incurring a contingent obligation to repay the bonds if canal profits did not materialize. Taxpayers also stood to gain, however, because any canal profits left over from servicing canal bonds would go into the general fund of the state and enable other taxes to be reduced. This is what had happened in New York, which was able to eliminate the state property tax in the 1820s as revenues from the Erie Canal came on line. This method of financing canal construction through borrowing and anticipating canal revenues was used in Pennsylvania and Maryland in the 1820s, and interestingly by New York in the 1830s when it decided to expand its canal network.[20]

The central feature of all these finance schemes was to shift the benefits and burdens of government policy in ways that affected voters directly. Only if a majority of the voters, or their representatives, felt that they benefitted from the canal when both benefits and taxes were taken into account could legislation funding a canal pass a state legislature. This is how democracy actually worked.

Canals, railroads, and banks were all potentially large investments that state governments could make. Many local groups sought to promote economic development through local promotion (see Majewski 2000), but only a state could charter a corporation. The financial resources of local governments were limited, particularly in frontier areas in the West. The pressures on state governments to deliver these important public goods was high, but so were the dangers. First, as discussed, Americans were always suspicious of organized economic interests in the form of a corporation. The manipulation of economic interests through corporate chartering to advance the fortunes of a political faction was an essential danger to a republic in Whig political theory. The opportunity to trade privileges for tax revenues, however, proved to be enticing for American voters and taxpayers. Borrowing offered an even greater danger. A faction might convince voters and taxpayers to extend state credit, either to a private corporation or a public entity, to build or finance an investment in which most of the benefits would go to the minority faction in the hopes that the same minority would bear the burden of repaying the debt.

Second, it turned out that democracies were neither capable of correctly evaluating the costs and benefits of such proposals, nor was democracy particularly good at turning down such proposals. Whether improvement efforts were the result of corruption, excessive optimism, or naïvete, by the 1830s, American states found themselves deeply engaged in such projects. After 1839, their large debts came back to haunt states and taxpayers.

20. The standard work on government transportation investments is in Goodrich (1960), which is now supplemented by Larson (2001).

6.7 What States Did

With the coming of independence, the United States turned its economic focus and energies of the country inward. The major economic opportunities were within the United States, not outside of it, and the most important and potentially profitable investments were in transportation and finance. The process of opening the West required enormous resources. The role of states in finance and transportation far outstripped the national government in importance. The financial system that arose between 1790 and 1860 was based on banks not only chartered by state governments, but in some cases owned by state governments. Nine out of every ten dollars spent on public transportation investment came from state and local governments. Banking was always under the control of state governments, with the exception of the two Banks of the United States, and it was not until 1863 that the national government took an active role in chartering and regulating banks. State governments were at the center of the development process.

There were no banks in America before the Revolution. States began chartering banks in the 1780s and 1790s. By the 1830s, there were over 600 state chartered banks with a capital of over $400 million dollars.[21] A corporate charter often, although not always, endowed the bank with limited liability, which was important to bankers whose profits came mainly from borrowing money in the form of bank notes. The legal ability to issue bank notes soon became a privilege that required a bank charter. The first bank charters in the eastern states often gave the state ownership shares in the bank as part of the cost of obtaining the charter. Massachusetts, New York, Pennsylvania, Maryland, Virginia, and South Carolina all came to hold a financial interest in banks in this way. Most early banks were chartered as public utilities. The rational ran along the traditional European lines: the charter was an explicit exchange of a privilege for a public service. That dividends on bank stock were an important element in the revenues of state governments in the East was an added bonus.[22] These banks were often opposed by antibank or anticorporation groups, but they were fiscally attractive. Because the banks generated revenues, they lowered state taxes.

Once a state acquired an ownership interest in one bank, it faced conflicting incentives when asked to charter a second bank. The profitability of a bank depended, in part, on competition. As more banks were chartered, rates of return on the capital invested in individual banks declined. Existing banks opposed the formation of new banks, but states were constantly asked to open new banks, particularly in developing areas where financial systems were primitive (for example, the western parts of New York and

21. Fenstermaker (1965) provides detailed information on the chartering of state banks before 1837.

22. Sylla, Legler, and Wallis (1987) and Wallis, Sylla, and Legler (1994) provided information on state banks and their importance to state revenues.

Pennsylvania in the 1810s.) States that held large amounts of stock in existing banks were less likely to charter new banks, as happened in Pennsylvania. Other states, like Massachusetts, decided to sell their bank stock and tax bank capital. States that taxed bank capital tended to have many more, and smaller, banks (Wallis, Sylla, and Legler 1994). The interaction of a state's fiscal interest and the way states regulated bank entry through their chartering policies is an early example of the interaction between political and economic forces.

By the 1810s, all of the states on the eastern seaboard were promoting or involved in banking in some way. In places like New York, Philadelphia, Baltimore, and Boston, many groups of businessmen aspired to have a bank. In these places, states could sell bank charters and receive substantial revenues from doing so. In per capita terms, there were more banking services in the northeast than in the rest of the country: more bank notes per capita, more bank credit, more bank capital, and so on.[23] Moving west and south from the northeast, however, the size and sophistication of commercial centers decreased (the exception was New Orleans), the number of banks decreased, the number of farmers increased, but the need for banking services did not decline. States in the South and West wanted banks just as much as New Englanders, but the low density of population, the high share of farmers, and the geographic concentration of crops meant that banking was riskier. Banks in Mississippi, for example, made loans on cotton, both directly to farmers to plant crops and by discounting bills of exchange to facilitate getting the crop to market. If the cotton crop failed or cotton prices collapsed, all the banks in Mississippi were in trouble. The ability to diversify banking risk in Mississippi was limited, unlike banks in major eastern commercial centers with many opportunities to diversify. The same was true in the northwest, where markets for wheat, corn, and other grains dominated.

Economic conditions determined political options. Conditions in the South and West were less conducive to banking, and potential bankers were not willing to pay states for charters. States responded in two way. First, states invested their own funds in banks, providing bankers with larger amounts of public capital (eastern states usually received bank stock as part of the charter process, and did not put state funds *into* the bank.) States did not raise current taxes to invest in banks, however. Typically states chartered banks and then bought stock in the bank, paying for their investment by issuing state bonds, which were given to the bank. The banks were, supposedly, responsible for servicing the state bonds.

Second, because states held large ownership shares in the banks, there were fewer banks, and the banks tended to be larger. Table 6.4 gives the number of banks, total capital, and capital per bank for five regions in 1837. Western states had many fewer banks. Ohio and Louisiana were the only

23. See Bodenhorn (2000, 63, 2003).

Table 6.4 Banks and bank capital and state investments in banks in 1837

State	Banks (1)	Capital (2)	Capital per bank (3)	Bank debt (4)	State investment share of capital (5)	Bank debt, share all debt (6)
ME	55	5,226,700	95,031			
NH	27	2,839,508	105,167			
VT	6	510,000	85,000			
MA	123	37,074,690	301,420			
RI	62	9,837,171	158,664			
CT	31	8,744,697	282,087			
NY	98	37,101,460	378,586			
NJ	25	4,142,031	165,681			
PA	49	23,750,338	484,701			
DE	4	818,020	204,505			
MD	21	10,438,655	497,079			
DC	7	2,204,415	314,916			
VA	5	6,731,200	1,346,240			
NC	3	2,525,000	841,667			
SC	10	8,636,118	863,612			
GA	16	11,438,828	714,927			
FL	4	2,046,710	511,678	1,500,000	73%	100%
AL	3	7,572,176	2,524,059	7,800,000	103%	72%
LA	16	36,769,455	2,298,091	22,950,000	62%	97%
MS	9	12,872,815	1,430,313	7,000,000	54%	100%
TN	3	5,092,665	1,697,555	3,000,000	59%	42%
KY	4	7,145,326	1,786,332	2,000,000	28%	27%
MO	1	250,000	250,000	2,500,000	100%	100%
IL	2	2,014,760	1,007,380	3,000,000	149%	26%
IN	1	1,585,481	1,585,481	1,390,000	88%	12%
OH	32	9,247,296	288,978			
MI	9	1,400,000	155,556			
Total	627	293,015,515	467,329			
Regional shares or Averages						
New England	48%	22%	211,292			
Mid-Atlantic	33%	27%	384,583			
South Atlantic	6%	11%	825,733			
Southwest	5%	21%	2,009,907			
Northwest	8%	7%	441,691			

states west of the Appalachians with more than ten banks, and they were the two oldest and most-developed western states by the 1830s. Most frontier states had four or fewer banks.[24] Southern states in general had larger banks than northern states, but banks overall were much larger in the West than in the East. Banks in the southwest had ten times the average capital of banks in New England.

The last three columns of the table provide some insight into state investment in banks in the West. Column (4) gives the amount of state debt incurred to invest in banks up 1837. Only states in the frontier South and West borrowed money to invest in banks. Column (5) gives state investment

24. The numbers for Mississippi and Michigan are larger because of the creation of banks in 1835 and 1836.

as a share of total bank capital. With the exception of Kentucky, Ohio, and Michigan, state governments provide more than half of bank capital in each of these states.[25] State involvement was critically important to the development of banks in the south and west. Column (6) gives the share of all state borrowing that went to investments in banks. We'll return to this shortly.

The First and Second Banks of the United States were extremely important to the development of American financial systems. They spanned the country with their branches, provided a uniform paper currency, and stabilized the conduct of national financial activities. But they were not the only, or even the most important, elements of the banking system that developed in the early nineteenth century. By 1836, state chartered banks had ten times the capital of the Second Bank. When the Second Bank lost its charter, it was quickly rechartered as the Bank of the United States of Pennsylvania. The banking system continued to develop without a national bank, and there is no reason to believe that the banking system would not have developed before 1836 if there had not been a national bank, although the system would have looked somewhat different.

State involvement in transportation investment has as a long history as well. By the 1780s, states were chartering private companies, providing subsidies, and purchasing stock in canal, bridge, road, and turnpike companies.[26] Virginia chartered the Potomac Company and the James River Company in 1785 and the Dismal Swamp Company in 1790. In 1792, New York chartered two companies, the Western Inland Lock Navigation Company and the Northern Inland Lock Navigation Company, to open canals to Lake Ontario in the west and at the St. Lawrence in the north via Lake Champlain. Maryland chartered the Chesapeake and Delaware canal in 1799. By 1811, Pennsylvania had spent $825,000 to build turnpikes. Massachusetts also invested in turnpikes. Unlike their investments in banks, however, transportation projects were rarely profitable investments for state governments. For a few brief years around 1805, it appeared the national government might get involved in transportation. Jefferson's second inaugural message led Congress to ask the Secretary of the Treasury, Albert Gallatin, to prepare a report laying out a possible system of internal improvements. Gallatin's famous report proposed a network of canals that would have connected the disparate parts of the country at a cost of over $20,000,000. Most of the projects envisioned in the report were eventually carried out in one form or another by state or private interests, but the national government spent very little on transportation before the 1820s.

Despite national inaction, there was widespread support for internal improvements. In 1811, the New York legislature authorized the issue of

25. The 148 percent figure in Illinois is the result of a large state investment in 1837, which occurred after the figure on bank capital was collected in January. The same is true for Alabama.

26. The classic history of government involvement in transportation remains Goodrich (1960) which has been supplemented by Larson (2001).

$5,000,000 in state bonds to build a canal, a plan sidetracked by the outbreak of the War of 1812. Virginia created a Board of Public works in 1816. In 1817, after failing to receive national support, New York embarked on the largest infrastructure project of its time, the Erie Canal. The canal turned out to be a phenomenally successful investment. Completed in 1825, it soon returned funds to the state over and above maintenance costs and interest payments. Now it appeared canals could prove as profitable as banks. The pattern of state transportation investment, after the Erie success, was influenced by two factors.

The first was geography. States with access to ocean transportation did not need to build canals, although they often improved their rivers and built short canals to bring their interior regions into contact with ports. The real payoff was the construction of interregional canals, like the Erie, that reached into the northwestern interior. In the late 1820s Ohio, Pennsylvania, and Maryland started canals, all with hopes they would pay for themselves and return a handsome dividend to the state treasury. Virginia, South Carolina, and Georgia contemplated projects that would open up routes into Tennessee and Kentucky.

The second factor was the youth of western states. Indiana became a state in 1816, Mississippi in 1817, Illinois in 1818, Alabama in 1819, and Missouri in 1820. Indiana was the largest of those states in 1820, with a population of just 147,000. It was not until the early 1830s that western populations, swelled by rapid population inflows, and western state budgets, spurred by the rapidly expanding economy and the boom in national land sales, enabled these young states to contemplate transportation investments of their own. In 1836 and 1837, Indiana, Illinois, and Michigan started new canal and railroad systems. In the same years, New York, Ohio, and Pennsylvania committed to expanding their existing systems. Rising western populations raised land prices; rising land prices stimulated public land sales; increased sale of public land raised the property tax base; and states began to think they could afford to build better transportation systems, which would further raise land prices, increase land sales, and expand the property tax base. The direction of causation in this story is difficult to disentangle, but all the factors came together to produce a major economic boom in the 1830s.

Again, the development of transportation investment reflects the interaction of economics and politics. Both Goodrich and Larson tend to view the timing of state investments as dependent on federal policy, arguing that states only took up the challenge of building canals when it became clear that the federal government would not. But there is little support for their view. Before the War of 1812, almost all of the non-New England states either actively engaged in transportation investments or were contemplating them. The early model, again, was the European model, with state chartering of privileged private corporations. That model failed in the 1790s to produce results. States had begun to consider alternatives before the war. After the

war, state investment picked up again, notably in New York. The Erie Canal example (1817) forced states on the eastern seaboard to move; Pennsylvania and Maryland borrowed and began construction on their canals in 1825; Maryland was also involved in the Baltimore and Ohio railroad.

States farther west, Indiana, Illinois, and Michigan, were simply not in an economic position to begin transportation investments until the 1830s. There was neither a population nor tax base in place. In 1835 and 1836 alone, public land sales in Indiana amounted to twice the taxable acreage in 1834. The land boom represented a fiscal windfall for these states, and they began investments soon afterward: Indiana in 1836, Illinois and Michigan in 1837.

The boom affected southwestern states as well, but southern states were not in need of major transportation investments. Their already navigable rivers ran to the sea. In the South, banks dominated state investments. Louisiana invested $23 million in banks beginning in 1824. Alabama, Georgia, and Florida made substantial investments in the early 1830s, while Mississippi and Arkansas committed millions to banks in 1837 and 1838. More than half of the banking capital in each of these states by 1837 came from state investment, and almost all of the debt in these states was issued for the purpose of investing in banks (see table 6.4).[27] In most southern banks, it was the banks, and not the states, that had the obligation to service the bonds. Southern voters were willing to support banks, but they had no anticipation that they would have to pay any taxes to obtain those banks. The history of banking in the east suggested that bank investments were profitable. Northwestern states needed banks, too; Illinois and Indiana made significant investments in their state banks.

States had always borrowed money to finance long-term capital projects. But the pace of state borrowing increased dramatically in the 1830s. State debts expanded from a few million in 1820, to $80 million in 1830, and to $200 million in 1841. The relative size of some of the state debts is truly amazing. In 1836, Indiana, with a population of roughly 600,000 and a state budget of $50,000 a year, authorized a bond issue of $10,000,000 in 5 percent bonds. Interest payments on the bonds alone would come to $500,000 a year, ten times the entire state budget of 1836. Michigan, with a population of no more than 200,000 and state revenues of $17,000 in 1836, authorized a bond issue of $5,000,000 of 5 percent bonds in 1837.[28] Total and per capita state debts outstanding in 1841 are given for each state in table 6.5.

In 1837, the American economy was hit by a financial panic, and in 1839, a depression began that lasted until 1843. Many of the transportation and

27. Arkansas became a state in 1837, and the first act of the state legislature was to create a bank capitalized by state bonds.

28. Information on state finances in the 1830s and 1840s is available at Inter-University Consortium for Political and Social Research (ICSPR), Richard Sylla, John Legler, and John Wallis "Sources and Uses of Funds in State and Local Governments, 1790–1915: [United States]," Data set 1993-05-13.

Table 6.5 **Total state debt and debt per capita in 1841, and whether a state defaulted**

State	Total debt ($)	Debt per capita ($)	Default?
FL	4,000,000	74.07	Yes
LA	23,985,000	68.14	Yes
MD	15,214,761	32.37	Yes
IL	13,527,292	28.42	Yes
AK	2,676,000	27.31	Yes
MI	5,611,000	26.47	Yes
AL	15,400,000	26.06	No
PA	33,301,013	19.32	Yes
MS	7,000,000	18.62	Yes
IN	12,751,000	18.59	Yes
NY	21,797,267	8.97	No
MA	5,424,137	7.35	No
OH	10,924,123	7.19	No
WI	200,000	6.45	No
SC	3,691,234	6.21	No
TN	3,398,000	4.10	No
KY	3,085,500	3.96	No
ME	1,734,861	3.46	No
VA	4,037,200	3.23	No
MO	842,261	2.19	No
GA	1,309,750	1.90	No
NH	0	0.00	No
CT	0	0.00	No
VT	0	0.00	No
RI	0	0.00	No
NC	0	0.00	No
NJ	0	0.00	No
DE	0	0.00	No

Note: Debt in 1841 and 1880 taken from 1880 Census.

banking projects of the western states were abandoned. Indiana, Illinois, Michigan, Arkansas, Louisiana, Mississippi, Florida (still a territory), Maryland, and Pennsylvania stopped paying interest payments on their state bonds in 1841 and 1842. Mississippi and Florida formally repudiated their debts, while Louisiana, Arkansas, and Michigan ultimately failed to repay part of the money they had borrowed. Indiana and Illinois worked out a deal with their creditors. Maryland and Pennsylvania quickly resumed payments on their bonds and, in the end, repaid all of the principal and most of the back interest. New York, Ohio, and Alabama narrowly avoided default.

It is tempting to think of the "canal" boom of the 1830s as the result of naïve western states optimistically thinking they could borrow to build canals, railroads, and banks and live off the dividends and tolls. Such a view is inconsistent with the history. States had been deeply involved in the creation of banks and transportation companies since the 1780s. In the case

of banks, state involvement had proven profitable. States who owned stock in banks received substantial and steady dividends, and those states that taxed banks earned a hefty share of state revenues from bank revenues. In the case of transportation, until the Erie Canal, state investments had rarely been directly profitable, but there is little reason to doubt that the overall returns to the state treasury in terms of higher property tax revenues on increased land values made these good investments.[29] What happened after 1839 was an unexpected economic depression. Just as the land and economic boom in 1835 and 1836 was fed, in part, by the anticipation of state investments in transportation and finance, the bust was caused, in part, by the realization in 1839 that many states would have trouble repaying their debts.

6.8 How States Reacted

There is no doubt about why states defaulted. As table 6.5 shows, nine of the ten states with the largest per capita debts defaulted, and Alabama, Ohio, and New York narrowly avoided default. State legislatures throughout the country were asking "how did we get into this mess?" and "how can we prevent this from happening again?" Although conditions in every state were unique, the answers given in the 1840s shared a common theme that echoed the fears of systematic corruption that had been heard since the Revolution. States felt that they had gotten into trouble because they allowed small, well-organized groups to exert a disproportionate influence in the legislative process. These groups were able to sway democratic legislators and voters to support their schemes because they promised a significant return to the state in the form of a bank, canal, or railroad, and at the same time promising taxpayers that they would not have to foot the bill.

Was this kind of corruption a real problem? Or was the language of corruption (of systematic corruption) so dominant in political discourse that Americans expressed their concern over how democracy worked in terms that focused attention on small privileged groups when the serious problems lay elsewhere? A complete answer to the questions involves detailed examination of each state, something I can't venture to do here, but some general observations seem warranted.

There were cases of systematic corruption. The clearest examples occurred in chartering banks in the South, particularly in Real Estate Bank of Arkansas and the Union Bank of Mississippi.[30] These were cases where a small group had obtained privileges from the state and resources in the form of state bonds, had used the distribution of those economic resources to build

29. For a paper that estimates the effect of railroad construction on land values and property tax revenues in the late nineteenth century, see Heckelman and Wallis (1997), and for a direct measure of canal construction on land values in Indiana in the mid-1830s, see Wallis (2003).

30. For an overview of banking in the South, see Schwiekart (1987); for banking in Mississippi, see Bentley (1978); Brough (1970), and Kilbourne (2006); for Alabama, see Brantley (1961); for Arkansas, see Worley (1950); for an overview of the corruption question in Southern banking, see Wallis (2008).

or enlarge a political coalition, and then had defaulted on the state, leaving taxpayers and bondholders holding the bag. Systematic corruption played a significant role in explaining why Arkansas and Mississippi didn't just default on interest payments for a time, but repudiated their bonds.[31] The manipulation of bank chartering by Martin Van Buren and the Albany Regency in New York in the 1820s and 1830s borders on systematic corruption as well (Bodenhorn 2006).

In most cases, however, states had not been hoodwinked. Deliberation over whether to build canals was usually a multiyear process, involving different groups and interests, many of whom had full opportunity to put their case before the people and the legislature. Bank chartering policy evolved over a number of years and was also the subject of an extended public debate (Wallis, Sylla, and Legler 1994). The debates were so long lasting that they formed the basis for informal (or formal in some cases) political parties and organizations. The Albany Regency was a consciously designed political machine that used control of bank chartering as an element in funding the party machinery.[32] There were canal Democrats in New York, bank Democrats in Indiana, and the canal faction and the railroad faction in Pennsylvania (Holt, 1999). In most states, the ongoing debate over internal improvements and banking provided the structure and interest for the formation of durable patterns of interests that were often reflected in nascent political parties.

In Whig theory, political parties were an anathema to republican government. George Washington's farewell address notably pointed to factions and parties as one of the greatest dangers the new nation faced. Even as Madison and Jefferson organized a political party to oppose the Federalists and their Bank of the United States, in the 1790s, they did all that they could to deny that they were actually forming a party. Madison, in particular, struggled with the legitimacy of party.[33] The Whig party formed in the 1830s to oppose the Jacksonian Democrats, along battle lines laid out by Jackson's veto of the second Bank of the United States rechartering and Jackson's opposition to a national system of internal improvements. One of the strongest arguments in the Whig arsenal was Jackson's conscious development of a political party, something still regarded as inherently systematically corrupt in the political debates of the 1830s. It was no accident that the fault lines in the first two prominent party struggles at the national level, between the Federalists and Republicans in the 1790s and between the Democrats and Whigs in the 1830s and 1840s, concerned political promo-

31. The Arkansas constitution still contains a provision preventing the state from ever repaying the "Holford bonds."

32. Bodenhorn (2006) is the most recent investigation into New York banking. Benson (1961) uses the Albany Regency and the adoption of free banking in 1837 as his test case for understanding Jacksonian democracy. Hofstadter (1969) places Martin Van Buren at the center of the process by which Americans realized that parties were not inherently corrupt, but instead an inherent part of a democratic society. Leonard (2002) expands on Hofstadter's themes and provides a better understanding of how Van Buren and his contemporaries viewed parties.

33. Madison wrote a series of articles about parties in the early 1790s; see Sheehan (1992).

tion of economic development through government involvement in banks and transportation projects.

Factions and parties were inherently corrupt in Whig theory. As suffrage widened and state governments became more democratic, pressure on state governments to deliver economic infrastructure intensified. Successful early examples of banking and canal investments raised expectations that those favorable results could be duplicated in other states. Promoters and supporters of projects formed natural alliances from which to build political coalitions and parties.[34] Partisans on both sides, those for or against the bank, canal, or railroad, claimed at the top of their lungs that the other side was corrupt, that the other side was forming a political party to subvert democracy.

The clinching feature that often culminated debates about internal improvements turned out to be taxes. Promoters who could figure a way to package their proposal in a way that did not involve raising current taxes or that shifted tax burdens away from project opponents and toward project supporters, for example, New York, were often able to craft the final compromise that enabled them to build a coalition sufficient to win legislative support. Americans complained in the 1840s that unscrupulous promoters had promised them canals and railroads for nothing, banks and financial services for free, and that somehow they had been tricked into assuming obligations unknowingly. They cried corruption, but what they had really learned was that an unstructured democracy with simple majority rule decision-making processes was liable, indeed invited, decisions to be made that looked good ex ante but subsequently turned out to be very expensive.

When states went on their internal improvements borrowing binges in the 1820s and 1830s, they were not acting naïvely. They based their forward looking expectations on a half century of experience with financing bank and transportation projects.[35] As Americans have learned again in 2008 and 2009, when a financial crisis hits, investments that looked good and were good can suddenly turn disastrous. Something similar happed after 1839. Rather than blaming the crisis on bad men, states blamed the basic structure of democratic decision making and so moved to make changes in the way politics and economics interacted. The new institutions dealt with taxation, borrowing, the creation of organizations (largely corporations), and the structure of legislation. The states responded to the crisis by making fundamental changes in their state constitutions that altered their simple democracies into governance structure with considerably more subtlety and sophistication.

34. Ershkowitz and Shade (1971) examine party differences over a range of issues in early nineteenth-century state legislatures. Banking and corporation chartering were two of the most divisive issues, internal improvements somewhat less so.

35. Wallis (2003) examines Indiana, which was one of the largest borrowers in the 1830s, and shows that with very reasonable expectations the state could expect to repay its debts.

The simplest solution to preventing another crisis like the early 1840s from happening again was prohibiting government debt altogether. Goodrich (1950) took his ironic title "The Revulsion Against Internal Improvements" from Henry Adams's suggestion that was what occurred in the 1840s. But the point of Goodrich's paper was that the wave of constitutional reforms in the 1840s did *not* stop states, and certainly not local governments, from continuing to pursue internal improvements in the 1850s and after the Civil War. States did not close off the possibility of financing internal improvement projects by borrowing. Instead, they required that any legislative authorization to borrow new funds be matched with an immediate increase in taxation that had to be approved by the voters, what today are called bond referendums. The primary aim of the procedural debt restrictions was to pair tax increases with borrowing. Debt provisions affected the procedures by which debt could be issued rather than imposing absolute limits on borrowing.

The first complete debt clause was Article 4, Section 6, Part 4 of the New Jersey Constitution of 1844.[36]

> The legislature shall not, in any manner, create any debt or debts, liability or liabilities, of the State which shall, singly or in the aggregate with any previous debts or liabilities, at any time exceed one hundred thousand dollars, except for purposes of war, or to repel invasion, or to suppress insurrection, unless the same shall be authorized by a law for some single object or work, to be distinctly specified therein; which law shall provide the ways and means, exclusive of loans, to pay the interest of such debt or liability as it falls due, and also to pay and discharge the principal of such debt or liability within thirty five years from the time of the contracting thereof, and shall be irrepealable until such debt or liability, and the interest thereon, are fully paid and discharged; and no such law shall take effect until it shall, at a general election, have been submitted to the people, and have received the sanction of a majority of all the votes cast for and against it, at such election; and all money to be raised by the authority of such law shall be applied only to the specific object stated therein, and to the payment of the debt thereby created. This section shall not be construed to refer to any money, that has been, or may be, deposited with this State by the government of the United States.

The New Jersey restrictions were repeated, with alterations, in other states. New Jersey limited "casual" debt to $100,000.[37] Issue of more debt than that

36. A procedural restriction was included in the Rhode Island constitution of 1842, but it simply required the consent of the people before the state could borrow more than $50,000. Its essence, but not its details, are the same as in New Jersey. All references to constitutions in the paper are to Thorpe, *Federal and State Constitutions,* as corrected by John Joseph Wallis in the NBER/University of Maryland State Constitution Project (see www.stateconstitutions.umd.edu).

37. The language of the New Jersey clause follows closely the language of an amendment proposed to the New York constitution in 1842. Adoption of the 1842 amendment was delayed until the New York constitutional convention in 1846. See the discussion in Gunn (1988).

required legislation that specified the purpose of the debt, and the "ways and means," that is, the tax revenues, to service the debt within thirty-five years (such legislation was "irrepealable"). The legislation authorizing the debt issue could not take effect until it was approved by a majority of the voters in a general election. The key element in the procedural restrictions was the requirement that the "ways and means" shall be provided. Legislation authorizing the bond issue had to include new taxes sufficient to service the debt, and the new taxes had to be approved by the voters. In New York and Iowa, "ways and means" was replaced with "direct annual tax," that is, a property tax. In most states, the property tax would be the tax used to provide revenues.

Table 6.6 gives the year when states adopted procedural debt restrictions of some type. By 1900, only Delaware, Vermont, Connecticut, New Hampshire, Massachusetts, Rhode Island, and Arkansas did not have debt restrictions. New England states were, again, different in this regard. Of the twelve states that revised their constitutions between 1840 and 1851, every state but Virginia adopted procedural restrictions on debt issue.[38]

Procedural restrictions on debt issue dramatically changed the political process for approving debt issues. By requiring voters to raise their own taxes immediately before any bonds could be issued, the debt provisions ensured that a political coalition encompassing at least half the voters had to be put together to secure passage. The next step was to prevent a political coalition from manipulating interests by creating special privileges for small groups.

The initial wave of constitutional changes directed at special privileges in the 1840s focused on corporations. A requirement that mandated legislatures pass general incorporation acts, was tied with a restriction, and in some cases prohibition, on special incorporation. General incorporation was a administrative procedure that enabled individuals to get a corporate charter by filing the appropriate paperwork and paying a fee. Special incorporation was any charter issued by the legislature.[39] Most (though not all) states required general incorporation and prohibited special incorporation. In some states, special incorporation was explicitly prohibited: "The General Assembly shall pass no special act conferring corporate powers" (Ohio, 1851, Article 13, Section 1). In other states, special incorporation was prohibited "except for municipal purposes, and in cases where in the judgment of the Legislature, the objects of the corporation cannot be attained under general laws" (Wisconsin, 1848, Article 11, Section 1). In these states, the prohibition on special corporations was implicit. New York initially con-

38. Indiana banned all debt issue, while Ohio, and Michigan banned new debt issue for internal improvements. Issues in Virginia revolved around the apportionment of political power between the western and eastern parts of the state.

39. Many acts of special incorporation did not create corporations that were special in any way; many corporate charters were virtually identical. What was special about special incorporation was the legislative grant.

Table 6.6 When states adopted constitutional provisions regulating the issue of state debt

State	Year
New Jersey	1844
Texas	1845, 1876
Louisiana	1845,1879
New York	1846
Maine	1848
Wisconsin	1848
Illinois	1848,1870
California	1849,1879
Michigan	1850
Kentucky	1850
Ohio	1851
Indiana	1851
Maryland	1851,1867
Iowa	1857
Oregon	1857
Minnesota	1857
Pennsylvania	1858,1873
Kansas	1859
Nevada	1864
Nebraska	1866,1875
South Carolina	1868,1873,1884
Florida	1868,1875
Tennessee	1870
Virginia	1870
West Virginia	1872
Missouri	1875
Mississippi	1875
Alabama	1875
North Carolina	1876
Colorado	1876
Georgia	1877
Idaho	1889
Wyoming	1889
Montana	1889
Washington	1889
North Dakota	1889
South Dakota	1889
Utah	1895

Note: Delaware, Vermont, Connecticut, New Hampshire, Massachusetts, Rhode Island, and Arkansas did not have a procedural debt restriction in 1900.

sidered a ban on special incorporation, but in the end, adopted language similar to Wisconsin because of the need to specify special terms in charters for municipalities and, on occasion, the need to grant specific powers of eminent domain to transportation or communication companies.[40] Banks

40. See New York Constitution, 1846, Article 8, Section 1: "Corporations may be formed under general laws; but shall not be created by special act, except for municipal purposes, and

were inextricably linked with corporations in the constitutions. While some states banned banks outright, most states required that banks be incorporated under general laws approved by the voters (free banking).[41] Table 6.7 gives the years that states adopted constitutional provisions making general incorporation acts mandatory.

As the table shows, the New England states were, again, the exception. General incorporation acts were legislative acts, not constitutional acts. The constitutional provisions only required that the legislature pass a general incorporation act. The first general incorporation act appears to have been passed by New York in 1783; it was an act to incorporate churches.[42] New York adopted general incorporation for manufacturing companies in 1810. Massachusetts established a general regulatory act for banks, which essentially established general incorporation for banking by 1820. I do not want to imply that general incorporation was an invention of the 1840s; it was clearly not. New England states managed to effect general incorporation through legislation and never found it necessary to mandate general incorporation in their constitutions. But most states found such a mandate necessary.

The third major change also had earlier precedents but first appeared in 1851, when Indiana adopted a constitutional provision prohibiting the state legislature from passing special legislation to benefit individuals, in seventeen different categories. Some of the categories concerned legislation that affected individual persons, like acts granting divorces to individuals and changing the names of individuals. But others acts reflected more general concerns: setting judicial venues, locating highways, regulating county and township business, providing for the support of common schools or of school funds. Table 6.8 presents the dates for prohibitions on special laws. Some states adopted prohibitions on special laws for specific purposes earlier than 1851, the "partial" restrictions listed in the table. Full restrictions varied somewhat in their content across states, and not every state adopted them, including many states in New England.

6.9 Conclusions

The history of state constitutional development often treats the constitutional changes that began in the 1840s as a continuation of the trend toward limiting the discretion of state legislatures that began in the 1780s with the

in cases where in the judgment of the Legislature, the objects of the corporation cannot be attained under general laws. All general laws and special acts pursuant to this section, may be altered from time to time or repealed." See the discussion in Gunn (1988, 231–2).

41. States also began asserting their absolute authority to govern corporations, even after they had granted corporate charters, special or general: "All general laws or special acts, enacted under the provisions of this section may be altered or repealed by the Legislature at any time after their passage" (Ohio, 1851, Article 13, Section 1).

42. See Seavoy (1982). There is some doubt about the first general act and whether it was in Massachusetts; see Handlin (1943), Handlin and Handlin (1945, 1969), and Maier (1992, 1993).

Table 6.7 Dates that states adopted mandatory general incorporation laws in their constitutions

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

Source: Evans (1948, table 5, 11).
Note: As of 1940, only Massachusetts, New Hampshire, Rhode Island, and Connecticut did not require general incorporation laws in their constitutions.

adoption of the second national constitution.[43] Because the changes clearly did limit state legislatures, it is impossible to argue with the general point.

This perspective, however, misses two very important developments in early nineteenth century America. First, on several dimensions, state constitutions and political institutions were becoming more democratic, not less. The excesses of democracy led James Madison to press for a national veto over state laws at the constitutional convention in 1787. The institutions that led to the excesses had certainly become stronger, not weaker, over the course of the early nineteenth century. The suffrage had been broadened considerably. Direct election of governors and judges increased the ability of the electorate to effect changes in policy through the ballot box. Before

43. Tarr (1998) makes this point and provides a useful summary of the literature on state constitutions.

Table 6.8 When state adopted restrictions on "special laws" in their constitutions

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

the mid-1830s, state constitutions were regularly modified to widen the scope of democracy, not to narrow it.

Americans were continually learning about how democracy worked. The interplay between politics and economics at the state level continually evolved as states chartered and invested in banks, chartered and invested in transportation enterprises, and responded to the demands of voters that they pursue policies that brought prosperity and higher land values to the average citizen. State politics were intense, and internal improvement debates

pitted those who would gain against those who would pay. The nature of the democratic process itself led to legislative compromises in which taxes often were not raised at all, or deferred to some hopeful future.

The trade-off of lower taxes in return for granting special privileges to small groups was not a new dilemma in the United States. European governments had faced those trade-offs for centuries. As the first democracy with widespread popular inclusion, however, the United States had to wrestle with how to balance different options for providing public goods that were an important element in a growing economy. American states made two basic choices. First, they attempted to remove the possibility of avoiding taxes, forcing voters being wooed by the benefits of government policies to also take into account the costs of those policies. Second, they opened access to public support for organizations to everyone without approval of the legislature. General incorporation came for businesses, but it also came for churches, schools, municipal governments, and eventually for political parties as well.

As much as guarantees of contract and property, these institutions enabled the American economy to grow and the American polity to develop. None of these changes were preordained or prefigured by the national Constitution in 1787. We must not overlook that the free, open, and competitive economy Americans managed to create by allowing anyone to form an organization and enter into almost any line of business, was not a given in early America. The early history of banking and transportation enterprises illustrate privilege, not open access. Nor should we forget that an important reason for opening economic access was to solve a political problem of making democracy work better, not to promote economic growth in an abstract sense. Economics and politics went together; it was an integral part of the American genius for building institutions.

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