Investment in physical and social infrastructure is one of the most obvious ways that
governments can promote economic development. In the nineteenth-century American
governments built or supported the building of roads, highways, toll roads, canals,
railroads, bridges, river and harbor improvements, water and sewage works, schools,
libraries, and other public buildings. Governments chartered, and sometimes invested
in, thousands of corporations. These included the banks and insurance companies that
formed the basis of the nation’s financial network, and the manufacturing firms that
would, by the end of the century, transform the United States into a modern industrial
economy. From 1800 to 1840, almost all of this activity was promoted by state
governments. Corporations were chartered by special acts of state legislatures. State
governments made the vast majority of government investments in transportation
systems as well as in banks, and several states were actively involved in the
management of transportation and financial companies. States had incurred a bonded
debt for infrastructure investments of roughly $200 million in 1840; eight times local
government debt in that year. States increasingly relied on “asset finance” to secure
their revenues. That is, states earned income from investments or taxed business
activities and did not rely on the property tax. By 1835, over a third of the state
governments had abolished their state property tax entirely.

By 1900, local governments dominated infrastructure investment. Almost
every state had a constitutional prohibition on incorporation by special act of the

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legislature, and businesses in every state were able to incorporate by a simple administrative procedure governed by a general incorporation act. In many states, state and local governments were constitutionally prohibited from investing in any private corporations. State governments were much less financially involved in banking, although there were still thousands of state chartered banks. The major banks in the financial system were national banks, chartered by the national government, and the national government had assumed a much larger role in regulating the banking system. Only a few state governments had active investments in transportation systems. Local government debt, issued primarily for infrastructure investments, was $1.8 billion in 1900; eight times state government debt in that year. Property taxes accounted for over half of all state government revenues and every state had a state property tax. Local governments had largely stepped in to fill the void in transportation and public utility investment.

This fundamental shift in the structure of American government from state to local prominence has largely been ignored in the history of public finance. It was, however, a transition of enormous importance, and understanding it gives us insights into why governments make investments in these important infrastructure projects. This chapter attempts to articulate the changes in political institutions constraining state and local governments that drove the shift to local investment. The explanation revolves around a simple, majority-rule public choice model focusing on the size of government units. The model is animated by differences in the incidence of taxation and the distribution of project benefits across voters. Only if a majority of voters expect to realize positive net benefits will an investment project be approved. If, as is typical, the costs and benefits of an investment project are unequally distributed in a geographic sense, then, even if a majority of voters in the larger jurisdiction (the state government) will not support the project, it is possible that some geographic subset of voters in some smaller jurisdiction (a local government) can be found where a majority will approve the project.

What makes this model particularly applicable to the early nineteenth century is the sources of state revenues. State financing was more likely to occur when many voters had reason to believe that their taxes would not increase in order to service larger state debts. As states were able to eliminate their property taxes, often the only tax that citizens paid directly to the state government, it was plausible to argue that investment projects would not raise direct taxes. Constitutional changes in the 1840s made it more difficult for promoters of state projects to make that claim. State property taxes rose, and with rising state property taxes came a shift to local investment. Since the shift from state to local investment in the nineteenth century is not widely appreciated, one task of this chapter is to document the transition from state to local government provision of infrastructure investment between 1840 and 1900.

The constitutional changes play an important role in nineteenth-century political history and represent one example of “Jacksonian democracy” at work. Later sections show how four basic changes in state constitutions after the 1840s altered citizens’ expectations and realities regarding the incidence of taxation. Provisions prohibited incorporation by special legislative act and mandated that states enact general incorporation acts. This eliminated the possibility that a state government could raise revenues through the sale of lucrative special charters. Provisions prohibited