

Taxing Conditions: The Fiscal Interest of the State and the Rise of Modern Corporate Law

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Abstract

In 1896 New Jersey passed the first modern corporate law, enabling capitalists to reduce ruinous competition by consolidating industries. Existing sociological explanations of the transformation of corporate law argue that the actions of powerful interests interacted with historically specific events, including bad public infrastructure investments, anticorporate agitation, and depressions, creating a critical juncture that privatized the corporation and from which the law developed path-dependently. But these conditions did not occur in New Jersey. To understand why modern corporate law still emerged there, this article examines a longitudinal sample of 28 failed and successful attempts to change its corporate law. Combining original datasets of laws, legislative bills, votes, and corporations, with existing tax data, this article shows that corporate law changed less because of historically specific conditions than because of how the law served the interests of political and economic incumbents. Corporate law was more contested than previously recognized, but attempts to change the law that ran counter to economic incumbents' interests only succeeded when political incumbents were not invested in those laws through the tax revenue they provided. The fiscal consequences of corporate laws connect the political and economic fields and operationalize the conditions for path-dependency.

Introduction

Today, American corporate law allows corporations to exist forever, engage in any lawful business, own other corporations, and limit investors' risk through limited liability. Creating a corporation is as simple as filling out a form. But in the 19th century, corporations were created by individual laws passed by state legislatures, who dictated what business each corporation could engage in, how long it would exist, and who reserved the right to change the terms at any time (Cadman 1949; Seavoy 1982). Corporations could not own other corporations. In 1896, New Jersey enacted the first modern corporate law, assembling all the modern properties into one law (Chausovsky 2007; Yablon 2007). Several states soon followed: within six years, Delaware, New York, Maine, Pennsylvania, North Carolina, Connecticut, Virginia, and Alabama had enacted almost identical laws (Larcom 1937:68 - 69). Using these laws capitalists solved their problem of

ruinous competition by consolidating American industries in a great merger wave at the turn of the century (Fligstein 1990; Lamoreaux 1988; Nelson 1959; Prechtel 2000; Stearns and Allan 1996).

The causes of this large and consequential change in corporate law are poorly understood. Economic sociologists have refuted claims derived from efficiency theory (Chandler 1977, 1990) and challenged its functional logic by showing that changes in corporate law were not unproblematic adaptations to changing technological and market conditions. Instead, they argue, corporate law changed as a result of powerful actors pursuing their interests but also because of contingent events and conditions (Berk 1994; Perrow 2002; Roy 1997). The critical juncture came when the 1837 and 1857 depressions, combined with states' bad infrastructure investments and laissez-faire agitation, forced legislatures to stop creating corporations by individual laws and allow corporations to be created by filing paperwork. This privatized the corporation and it subsequently developed in a path-dependent way into its modern, permissive form (Roy 1997).

But these conditions did not occur in New Jersey, where the modern corporation first emerged in America. The state did not lose public money in failed infrastructure projects, and did not decisively change incorporation method until decades later, when it did so despite the resistance of incumbent capitalists. The problems of the economic sociology explanations stem from not adequately considering counterfactual cases. By focusing on a few instances of change without fully considering the instances when the law did not change, or when it changed in unanticipated ways, these accounts cannot explain why the law sometimes changed and sometimes persisted. To address this problem, and to explain why modern corporation emerged in New Jersey despite lacking the cited conditions, this article develops falsifiable claims about when the law will change and when it will persist. It then examines these claims using a longitudinal sample of 28 failed and successful attempts to change corporate law in New Jersey. Combining original datasets of New Jersey laws, legislative bills, votes, politicians, and the corporations formed under those laws, with existing data on tax revenues, it shows that corporate law changed less because of historically specific conditions than because of how the law served the interests of political and economic incumbents. Attempts to change the law in ways that ran counter to economic incumbents' interests only succeeded when political incumbents were not invested in those laws through the tax revenue they provided.

The argument that institutions of capitalism such as corporate law have developed path-dependently is attractive to sociologists because it so powerfully refutes the argument that they are efficient and functional

adaptations. For path-dependent phenomena, small, even random initial differences can accumulate into large, sustained advantages for an institution, technology or actor, regardless of its efficiency (Arthur 1988, 1989; David 1985; Mahoney 2000; Pierson 2000). But explanations relying on path-dependency are difficult to translate into general claims about when institutions will change or persist. This article provides an explanation for why American corporate law developed like it did, that, like existing sociological explanations, sees its development as the result of political conflict between powerful actors. But it improves on those explanations by showing that both persistence and change in the law can be explained by the degree to which those institutions solved the problems of those powerful actors, rather than specific, unpredictable conditions and events.

It does so by making three moves. First, rather than viewing the transformation of corporate law as a privatization of the corporation, it locates corporate law as an institution lying between, and connecting, the political and economic fields (DiMaggio and Powell 1983; Fligstein 1990, 1996, 2001a,b). By making the institution rather than the field the unit of analysis change becomes much easier to understand as endogenous: what is exogenous from the perspective of one field becomes endogenous, and explainable, from the combined vantage point (Fligstein and McAdam 2012:99-101). Second, it operationalizes the mechanism by which corporate law would become path-dependent, arguing that institutions that solve the problems of incumbents will persist because those incumbents will defend them against challengers (Haydu 1998; Pierson 2004). This allows the conditions for path-dependency to be empirically observed as the extent to which corporate law limited competition among incumbent capitalists (Fligstein 1990; Kolko 1977; Schumpeter 1934; Smith 1776; Swenson 2002; White 1981) and provided revenues tax for incumbent politicians (Grandy 1989, 1993; Stoke 1930). Third, by relaxing the assumption that institutional change is contingent and unpredictable, and that institutional persistence is deterministic (Thelen 2004:28), this article sees institutional persistence as the natural counterfactual to institutional change, making it easy to extend the analysis to failed attempts to change the law.

It concludes that the institutions underlying our economy are both more and less malleable than existing views allow. They are more malleable because institutions are not inherently path-dependent: once they stop solving incumbents' problems they are vulnerable to challenges, which occur regularly. At the same time institutions are less vulnerable to contingent events, because as long as they serve incumbents' interests they

will survive.

Existing Explanations

Prior research explains the emergence of modern incorporation by its efficiency, as the result of interactions between powerful interests' actions and historical contingencies, or as the result of politicians' search for tax revenues. The power and contingency view successfully refutes the efficiency explanation, but cannot explain why some law changes were consequential and others were not. In the next section I outline these problems. I then develop an alternative theoretical framework that explains both change and persistence in corporate law as a function of how well the law serves the interests of political and economic incumbents. I discuss the problems of existing fiscal explanations, the lack of attention to conflict among politicians and the too narrow focus on specific law changes, in the context of this framework.

Two substantive points are worth keeping in mind. First, American corporate law is state law, because there is no federal incorporation law (see Lamoreaux 1988:169-173). Second, there are two kinds of incorporation: special and general. Under special incorporation, each corporation is created by a dedicated law passed by the state legislature. Each law specifies the exact rights and responsibilities of each corporation. Under general incorporation, one general law specifies the rights and responsibilities of all corporations, which are then created by filing paperwork with the state bureaucracy. Since the 1880s, American corporate law consists almost exclusively of general laws.

Efficiency, Power and Contingency

Chandler argues that the large modern American corporation emerged because it was more efficient (1990:18) and explains the legal changes necessary for its emergence by their very necessity: "what was needed was a general incorporation law that permitted the formation of holding companies [...]. The New Jersey legislature quickly obliged." (1977:319).

Economic sociologists and others have tested and refuted claims derived from efficiency theory, for example finding that industries with high capital intensity, high productivity, and rapid growth did not have more incorporations than other industries (Roy 1997:21-40), and that smaller railroads could be just as efficient as their larger competitors despite lacking economies of scale (Berk 1994:116-152). They also

challenge the functional logic of the efficiency explanation, arguing instead that corporate law developed as the result of political processes which were shaped by powerful actors but also by contingent events and conditions. In this model, corporate law is path dependent, but can change at critical junctures (Berk 1994; Perrow 2002; Roy 1997). This lack of support for efficiency-derived hypotheses combined with empirical evidence of the political processes that resulted in law changes provides a compelling argument against the efficiency explanation.

But the empirical conditions cited by Roy (1997) did not occur in New Jersey. Similarly, Perrow (2002) argues that the legal foundation for the large, private corporation was laid in early Supreme Court cases that limited the power of the states to regulate corporations. But the states often changed their laws in reaction to how the judiciary interpreted them. For example, the *Dartmouth (1819)* case simultaneously established corporations as “mere creatures of the law, [possessing] only those properties which the charter of its creation confers upon it” and held that states could not change those charters once they were enacted. State legislatures subsequently started reserving the right to revoke charters or limiting their validity to a fixed time period (Hurst 2004:9, 17, 62 - 63).

American states changed their corporate laws many times and in many ways during this period, including by reacting to judicial interpretations as described by Hurst, and by enacting different general laws for different industries while at the same time creating individual corporations through special laws (Cadman 1949; Chausovsky 2007). By arguing that corporate law for most of the time was path-dependent, and then explaining specific instances of change as partially contingent, the power and contingency studies select on the dependent variable. They cannot explain why some of these many law changes were consequential and others were not. This article improves on the power and contingency explanation by 1) providing falsifiable claims about when corporate law will change, and 2) applying those claims to a sample of cases including both failed and successful attempts to change the law.

Towards a New Model

To address the problems with existing explanations, I develop a theoretical framework that provides falsifiable claims about when the law will change and when it will persist. This model also distinguishes between challengers and incumbents among both capitalists and politicians, thus allowing for conflict within and

between both groups.

One reason the empirical conditions cited by Roy (1997) did not occur in New Jersey is that he focuses on the shift from special to general incorporation. Roy reveals the public origins of the modern corporation by showing how many of the first corporations provided publicly useful goods and were created under special incorporation, and then conceptualizes the shift from special to general incorporation as a privatization of the corporation. But the private and public aspects of corporations are not easily separated. Many early New Jersey corporations were chartered to provide publicly useful turnpikes, canals, and railroads, or to provide credit and currency. Subject to regulation, they were still private entities. Unlike other states, New Jersey did not fund canal and railroad corporations but instead made them profitable by guaranteeing their monopoly (Cadman 1949; Lane 1939). In New York, limited special bank incorporation stabilized the money supply, funded the patronage system which maintained party cohesion, and limited competition (Seavoy 1982). These are all examples of distinct mixes of the public and private: often using public resources – the law – to further private gains in either power or profit.

Institutions like corporate law consequently lie between political and economic fields (DiMaggio and Powell 1983; Fligstein 2001a), activating the interests of actors¹ in both. The key to understanding the development of American corporate law lies in the agreement rather than divergence of economic and political actors' interests: laws solving the problems of both persisted (c.f. Haydu 1998). Actors' interests vary by fields and positions: incumbents benefit more than challengers from existing institutions (Fligstein 1996; Thelen and Mahoney 2009), and try to protect them from attacking challengers. The increasing returns accruing to incumbents over time make them more powerful than challengers, but also more invested in existing institutions. Both mechanisms contribute to making existing institutions persist (Pierson 2004). That successful institutions serve the interests of actors in multiple adjacent fields² (Abbott 2005b:247) further reinforces their persistence.

Economic sociologists studying the development of corporate law refer to this tendency of existing institutions to persist as path dependency. Originally developed to explain the trajectory of technological development (Arthur 1988, 1989; David 1985), path dependency has spread to institutional economics (North 1990) and the study of political institutions (Pierson 2004). Given this strong tendency for existing institutions to persist, how does institutional change happen? Pierson (2004:134-140) lists critical junctures

(contingent events), marginal groups, overlapping processes and institutional entrepreneurs, or, more generally, institutional layering, conversion, and diffusion as potential sources of change, but also adds that none of these provide general claims about when institutions change and persist.

That not "all of social space is equally 'constituted'" is an important source of change: institutional development is easier in areas lacking developed institutions and entrenched incumbents (Abbott 2005b:249). New institutions can thus emerge (through the mechanisms listed above) in the shadow of the old. This point is complementary to the view of institutional change in which new institutions emerge by overcoming or transforming existing ones (c. f. Skowronek 1982): new institutions can more easily emerge in areas lacking existing institutions precisely because they can do so without transforming or overcoming existing ones. Once developed, new institutions provide alternatives to existing institutions enabling incumbents to switch from older to newer institutions.

There are theoretical arguments both for and against that incumbents would switch institutions. Against is the asset specificity of their adaptations to existing institutions, because of the "transaction costs" they create (Pierson 2004:147, see also Williamson 1979), while for is the mobile capital logic, in which capital moves to the most favorable regime (Weber 1978:352, see also Arrighi 1994). In this article the tendency of incumbents to defend existing institutions is an empirical question, answerable by measuring how well those institutions solve their problems. Incumbents are more likely to switch out of institutions that no longer solve their problems, and as they do so, the institutions left behind become vulnerable to attacks by challengers, which can then change these institutions. Recent work on institutional change emphasizes gradual, endogenous change of existing institutions over the "critical juncture" model of institutional change (Thelen and Mahoney 2009:2). The model presented here has elements of both: institutional development or creation is slower, and more gradual, while institutional change (specifically change that is anti-incumbent in nature) is abrupt.

In the case of American corporate law, the most important economic actors are incumbent capitalists who want to limit competition to preserve profits (Schumpeter 1934; Smith 1776). Competition can be limited by differentiating products into niches (Carroll and Swaminathan 2000; Harrison 2002; White 1981), running competitors out of business (Dobbin and Dowd 2000; Fligstein 1990), consolidating existing firms, limiting entry, agreeing to not compete, or by state regulation (Kolko 1977; Swenson 2002). Industries with high

fixed costs, such as railroads or mass production, are especially vulnerable to ruinous competition (Dunlavy 1994; Hovenkamp 1991). In nineteenth century America, frequent demand shortfalls during recessions and depressions activated such competition (Lamoreaux 1988), illustrating the collective action problem competition poses to capitalists (Bowman 1989). While cooperation causes all capitalists to be better off, individual capitalists have an incentive to lower prices to sell more. Solving these collective action problems is an important way the state shapes markets. After trying cooperation in pools and cartels, which the courts ruled illegal or unenforceable (Fligstein 1990; Freyer 1992; Sklar 1988), industrialists solved the ruinous competition problem by consolidating many smaller firms into larger corporations using modern incorporation law in a wave of mergers at the turn of the century (Fligstein 1990; Lamoreaux 1988; Nelson 1959; Prechtel 2000; Stearns and Allan 1996). Thus, that we view corporate law as regulating relationships within the firm, between owners, managers, and workers (e.g. Alchian and Demsetz 1972; Berle and Means 1932; Fama 1980; Jensen and Meckling 1976) and not regulating relationships between firms in a market is a direct result of the historical development of corporate law. During the nineteenth century, corporate law was often used to regulate relationships between corporations (Hovenkamp 1991; Lamoreaux 1988), for example, prosecuting corporations cooperating in trusts for violating the terms of their charter (Sklar 1988:99).

While a voluminous literature³ examines the nature of the state itself and its relationships to capitalists, because the American state during this time consisted of "courts and parties" with most of the power lodged in the states (Skowronek 1982), I focus on state parties and politicians as the state actors interested in corporate law. Their most important interest in corporate law is the state revenues it can provide. While some contemporaneous sources accuse politicians of being corrupt, I only focus on state tax revenues, not the party or personal economic interests of politicians. Law scholars have long argued that New Jersey enacted the first modern corporate law to attract incorporation activity to the state, thereby bolstering flagging tax revenues (Grandy 1989, 1993; Stoke 1930). But these accounts have not recognized conflict among politicians over corporate law (captured here by distinguishing incumbent from challenger politicians), nor that the ebb and flow of tax revenues can be used to systematically explain change and persistence in corporate law rather than only specific changes⁴. In line with recent sociological interest in taxation (Martin et al. 2009), this article sees taxation as a durable connection between the interests of capitalists and politicians and between

political and economic fields.

Political actors' investment, which is one way path dependency operates, can be operationalized as the share of state revenues generated by each corporate law regime, and economic actors' investment as the share of total incorporations or mergers done using a particular state's laws or a particular law within a state. Within these broader constraints of how invested incumbents are, additional conditions such as the availability of institutional alternatives and the presence of challengers can combine to cause both persistence and change. Regardless, the more invested incumbents are in a specific law, the less likely it will be to change, and conversely.

Analytic Strategy and Methods

Existing accounts explain change in the law using historically specific conditions without applying those conditions to counterfactual cases of when the law did not change. By focusing on successful changes to the law, they underestimate the amount of conflict surrounding corporate law.

This article improves on these explanations by considering a longitudinal sample of both failed and successful attempts to change the law. I focus on New Jersey because that is where modern corporate law first emerged, despite it lacking the conditions cited in the most thorough existing explanation. Comparing instances of change and persistence within the same state also helps isolate the conditions for change, at the expense of omitting potentially important differences between states⁵. Comparing these cases shows that whether or not incumbent politicians and capitalists' interests are served by the laws determine whether those laws will change or not. Lack of incumbents' investment in the law is a necessary condition for it to change, but the precise nature of the outcome is determined by other parts of the model. For example, New Jersey did not pass a general incorporation law for railroads in 1869, when the special law regime stopped providing revenues, but in 1873, when the special law regime was attacked by both economic challengers and political reformers. This is not a contingent outcome because the appearance of challengers is a regular feature of the model. The goal is not to replace contingency with determinism, but rather to peel back contingency by first specifying necessary conditions for change and then explaining the precise nature of change in a theoretically-grounded way.

This article's analytic strategy proceeds accordingly. Bivariate comparisons of 28 attempts to change the

law show that changes in incumbent politicians' and capitalists' investment explain whether the law changed or persisted. Process-tracing then provides additional evidence of how incumbents' investment worked, and how key changes happened once the conditions for change were in place. Process-tracing identifies the intervening causal process between independent and dependent variables, in an effort to move beyond covariation alone as a source of causal inference (George and Bennet 2005:224) and is thus a good complement to the crosstabulations. It is also especially well suited for the analysis of path-dependency and contingency (Bennett and Elman 2006). Concretely, it consists of 1) building a continuous and theoretically coherent account between substantively motivated starting and ending points, and 2) explicitly accounting for the evidence that should be present if the theorized explanation is true and the evidence that is inconsistent with alternative explanations (Bennet and Elman 2006:460).

The process-tracing also guards against spuriousness by introducing additional data against which the competing explanations can be evaluated. Such evaluation is easy when one theory fits the data better than another. But a contingency-based explanation can by definition fit any data. The Bayesian approach outlined by Western (2001) provides a principled way of comparing models that both fit the data. Bayesian reasoning shows that when two models explain the data equally well, we can prefer the simpler model because it has higher posterior probability (2001:366). More complex models explain a greater range of outcomes, but at the cost of spreading out their probability (2001:367). A simpler model concentrates its probability, so that when it is correct it is so with a higher probability. When contingency implies unpredictability and not just conditionality, theories based on it become "the extreme case of [...] explanatory complexity" (2001:369). Roy (1997:280) uses contingency in a conditional sense, but even such a model quickly becomes complex. To see why, consider its mode of explanation: each change is explained by a condition specific to that change, so that the number of conditions in the model grows with the number of cases explained. Therefore, I treat the incumbency-investment model as the simpler of the two, and take any failure of it as evidence for contingency, but any success of it as evidence against contingency.

Data

The data consist of secondary sources, published statistics, contemporaneous newspaper accounts, and primary documents such as laws. Using software to extract data from published sources, I also construct several

new datasets of incorporation activity in New Jersey and the political makeup and activity of the New Jersey legislature (see the Appendix). These datasets are summarized in Table 1. They have two advantages. First, their longitudinal nature allows comparisons over time, essential to understanding the conditions under which institutions change and persist. Second, the Session Laws, NJ-Incorporations, Bills, and Votes datasets are much more comprehensive than existing sources, allowing for a more detailed empirical analysis. For example, the Bills and Votes datasets uncover many failed challenges to the liberal corporate law from 1896 to 1913 which existing research has overlooked, leading it to underestimate the amount of conflict surrounding corporate law.

[Table 1 about here.]

Findings

[Table 2 about here.]

According to the succeeding analysis, New Jersey corporate law developed in four phases, shown in Table 2⁶. In the first phase (1830-1873), politicians and the incumbent railroad corporation used special incorporation (corporations created by the legislature) to limit competition by denying competitors corporate charters. In return, the state received transit duties making up a majority of state revenues. When these expired, incumbent political actors became disinvested in special incorporation, allowing a combination of political and economic challengers to enact general incorporation (corporations created by an administrative procedure). To replace transit duties, politicians tried raising property, railroad and incorporation taxes, while gradually liberalizing corporate law. Capitalists' investment in New Jersey's corporate law then increased incorporation tax revenues, making politicians invested in the new, liberal corporate law institution. This investment protected the new form of corporate law against political reformers until 1906/08 when New Jersey raised railroad taxes, again disinvesting politicians from corporate law as a revenues source and allowing its restriction in 1913. The 1913 restriction ended up not affecting the development of American corporate law because by that time capitalists had moved to more favorable regimes in states that adopted similar laws, most notably Delaware. In the next section, a comparison of failed and successful attempts

to change the law shows that whether the law served the interests of incumbent capitalists and politicians largely determines whether it will change or persist.

Incumbent investment and change in the law

[Table 3 about here.]

Table 3 lists the cases, 28 attempts to change important parts of the dominant corporate law of the time, grouped by year and type of change they sought. In Phase 1, they are bills and laws about general and special incorporation for railroads, and several changes to general manufacturing laws which become the template for laws in later phases. In the first phase, I rely on several detailed secondary sources (especially Cadman 1949; Lane 1939; Reilly 1952; Sackett 1895) to identify cases (I then verified those bills and laws in the New Jersey Journal and Minutes of the Legislature and New Jersey Session Laws). In later phases the cases are bills and laws that either liberalize or restrict important aspects of general incorporation. Following (Chausovsky 2007; Yablon 2007) I define these most important aspects as those codified in the 1896 general incorporation law. The New Jersey 1896 law allowed incorporation "for any lawful business purpose whatever", except for insurance, banking, railroad, or any other purpose requiring the right to take and condemn lands, although railroad companies operating "wholly in other states" were allowed (New Jersey Laws 1896:ch. 185, p. 277, §6). It also expressly allowed corporations to own the stock of, and merge with, other corporations (§51, §104); to operate in other states (§7) and to exist forever (§1); and limited liability for stockholders as long as the entire capital stock had been paid in (§21). Perpetual existence allows firms to exist independently of the comings and goings of individual owners, workers and managers. The ability to own the stock of other corporations allows capitalists to limit competition and to shape the population of firms through mergers and acquisitions. The ability to engage in any lawful business allows corporations the to enter new and exit old industries. Last, but not least, limited liability shifts the risk of ownership away from stockholders. In Phases 2, 3 and 4 I use all bills concerning these aspects of corporate law found in the Bills dataset (see Table 1). Much of the existing literature relies on newspaper accounts, but this dataset covers the legislative activity more exhaustively, including the important counterfactual bills that did not pass. While this dataset only covers the Senate, it also voted on bills that passed the Assembly, so some Assembly bills are included. The several attempts to make corporate law more restrictive in 1888

and from 1897 to 1910 shows that existing explanations, by focusing on successful attempts to change the law, underestimate the amount of conflict surrounding corporate law.

I operationalize political incumbents' investment as the share of total state revenues provided by the associated corporate law (calculated from Sylla et al. 1993). During the first phase, the associated revenue source is taxes on railroad traffic, and during the other phases it is incorporation fees and taxes. Figure 1 shows the development of the largest revenue sources in the New Jersey state budget. There are important shifts in where the revenue is coming from, corresponding to the expiration of transit duties in 1869, the enactment of an incorporation fee in 1883, a railroad tax in 1884, and another railroad tax in 1906⁷.

[Figure 1 about here.]

The Governor's annual messages⁸ to the Legislature shows how politicians subjectively understood these revenues (c.f. Haydu 1998). For example, in 1903, Governor Franklin Murphy (Republican) explicitly connected the state's liberal corporate laws to its sound finances and low taxes:

[S]o great a number of corporations have organized under [New Jersey] laws that the fees and taxes from this source are sufficient to pay the annual expenses of the State, to pay a large proportion of the cost of our public education and to leave a handsome surplus besides. Other States, envious of our prosperity, have copied our laws, reduced our fees and solicited our business. Their success has not been important. Our revenues from this source continue to increase.

In the crosstabulations below, I dichotomize incumbent politicians' investment in the existing law, by setting it to "Yes" if the associated revenue source is the largest source of revenues⁹. During the first phase I code economic incumbents' investment using secondary sources, setting it to "Yes" from 1836 because that is when the dominant railroad in New Jersey, the Camden and Amboy, became committed to preserve their monopoly by political means (Cadman 1949), and until 1874, the year after New Jersey allowed general incorporation for railroads, at which point corporate law no longer limited competition among railroads. For the later phases I operationalize economic incumbents' investment in the current corporate law as the share of the nationally incorporated capital incorporated in New Jersey, setting it to "Yes" if New Jersey's

share exceeds 60%. For the period 1888-1904, I rely on data in the Trusts dataset (see Table 1), for the period 1905-1913 I rely on data coded from Nelson (1959:67).

Because economic incumbents' actions towards bills will vary with whether those bills challenge or support their interests, I code whether each bill went against economic¹⁰ incumbent interests or not. Before 1873, the anti-incumbent bills are those introducing general incorporation laws for railroads. In years after that they are bills restricting what corporations can do (typically restrictions on owning stock or using mergers to limit competition), coded from the secondary literature, the Bills, and the Session Laws datasets. While it is easy to determine which laws are anti-incumbent, because they are directed at an existing interest, it is harder to determine whether other changes are neutral or positive with respect to incumbents' interests. Part of the problem is that a change that may be incumbent-neutral at the time it is enacted may become pro-incumbent at a later stage. Such is the case with the 1865 out of state provision, which at the time was probably neutral with respect to the Camden and Amboy Railroad, but then became important to later incumbents (e.g. interstate holding companies). For ease of presentation, I call all the bills that were neutral or positive for incumbents' interests pro-incumbent.

[Table 4 about here.]

Table 4 shows the success and failure rates of pro- and anti-incumbent attempts to change existing law. All pro-incumbent attempts succeeded, validating the view that legislatures in general favored business during this period (Fligstein 1990). But only focusing on pro-incumbent changes obscures that some anti-incumbent changes also succeeded.

[Table 5 about here.]

Table 5 shows that anti-incumbent attempts to change the law never succeeded when the existing law provided much tax revenues. Table 6 shows that only one attempt to change the law against the interests of incumbent capitalists succeeded when existing law limited competition.

[Table 6 about here.]

These tables show that anti-incumbent attempts to change existing law were less likely to succeed when either political or economic incumbents were invested in those laws, exactly as the actor investment model

predicts. We can be reasonably certain that the relationship between politicians' investment and institutional change is not spurious, but the relationship between capitalists' investment and institutional change is more uncertain. The 1873 enactment of general incorporation for railroads passed despite special incorporation limiting competition for incumbent capitalists. This is the unexplained case in the bottom-right cell of 6 that needs further analysis. Focusing in more detail on this case also allows us to address the question of why New Jersey did not experience the empirical conditions cited by Roy (1997).

Limiting competition with special incorporation

According to Roy (1997), the 1837 and 1857 depressions combined with states' bad infrastructure investments and laissez-faire agitation forced legislatures to prohibit special incorporation and only allow general incorporation. This privatized the corporation by decreasing legislatures' power and control over it.

But while New Jersey promoted infrastructure projects like many other states, it did not invest public money because the main project was a railroad across the state and citizens from counties not on the route feared future tax hikes to pay for the debt¹¹. Instead, in 1830 it created a corporation, the Camden and Amboy Railroad¹², to build and run the road. In 1832 the state granted the company a monopoly on the route, in exchange for some stock and transit duties on through traffic. Following a failed attempt to sell to the state in 1836, the company tried to control the legislature more directly (Lane 1939:332), supporting the Democrats and occasionally the Whigs (Lane 1939:334 - 336).

The monopoly was contested by promoters of laissez-faire, but also by those critical of corporate power¹³, its customers¹⁴, and by potential competitors, who tried to incorporate from 1833 to 1836, in 1853, and 1854 but were all defeated, so that railroads chartered during this time were either subsidiaries or not competitors (Cadman 1949; Lane 1939). Bills to enact a general incorporation law for railroads (see Table 3), which would have opened the field to competitors, were also defeated (Cadman 1949). In these struggles, the incumbent Camden and Amboy and its challengers used a wide range of tactics¹⁵, but the Camden and Amboy had an advantage in that the tax revenues from its traffic made up 50-90% of all tax revenues (see Figure 1), making state politicians invested in the existing regime. Not all politicians were sympathetic to the Camden and Amboy, but opposition within the Democratic Party was never strong enough to resist the influence, partly because of the party's electoral success under the regime (Reilly 1952:147). Support for

special incorporation did not fall along, but cut across, party lines¹⁶.

In 1854, the legislature started debating taking over the Camden and Amboy when its charter was set to expire (either in 1864 or 1869, depending on how the charter was interpreted). The legislature ultimately extended the charter, but set the monopoly clause and the transit tax to expire in 1869 (Lane 1939:356 - 359, Dunlavy 1994:81). I code this case as pro- or incumbent-neutral, because the corporation's charter (which allows it to exist) was extended. That it would expire later could be seen as anti-incumbent, but, a more conservative approach is to only code it with respect to its contemporaneous outcome, which was to allow the company to continue to exist as a private corporation.

The decline in state revenues in 1869 created the conditions for the shift from special to general incorporation, but by itself does not explain it because a general incorporation law for railroads did not pass until 1873. Politicians were no longer invested in the special law regime since it ceased to provide revenues, but it still limited competition for the Camden and Amboy so why it changed despite solving incumbent capitalists' problem is what needs explaining. Several observers attribute the Legislature passing the law despite the resistance of the Camden and Amboy to contingencies due to legislative tactics (e.g. Steffens 1905:654 and Sackett 1895:62, Stoke 1930:551). This argument starts with the National Railroad's challenge to the monopoly in the form of a bid to incorporate in New Jersey to build a rival railroad. The Camden and Amboy defeated the National Railroad's special incorporation bill by advocating a general railroad incorporation bill introduced the same year instead. Stoke (1930:566) describes this tactic as "too subtle": once defeated, the National instead threw its support behind the general bill, and the Camden and Amboy was forced to "either continue to support the bill or admit it had tricked the New Jersey legislature" (Stoke 1930:566).

Attributing the outcome to the legislative tactics of the parties involved offers an attractive contingent turning point explanation. But a focus on tactics is too narrow.¹⁷ Similar tactics were commonplace,¹⁸ and the contingency argument cannot explain why such tactics did not lead to a change in the law in the previous challenges. In contrast, the timing of the change fits with the incumbent investment model: the 1869 expiration of transit taxes makes the incumbent political actors disinvested in special incorporation, making them less likely to defend it. But it is not until there is a combination of political and economic challengers occurring at the same time that change happens. The National Railroad's push for a special law charter was deflected into support for the general law, and it invested in it immediately, incorporating

"forty minutes" after it had been signed by the Governor (Sackett 1895:63). The appearance of an economic challenger is not a contingency but a regular feature of the actor investment model, and such challengers also appear from 1833 to 1836, and in 1853 and 1854. But change only happens once the broader conditions of actor investment were favorable.

[Figure 2 about here.]

Once general incorporation for railroads passed, the conditions for completely prohibiting special incorporation in 1875 were in place. The prohibition was accompanied by the passage of a new, general and comprehensive corporate law. Figure 2 shows how railroad incorporations under general laws increase in 1873. In combination with Figure 1 it shows how by 1875 both incumbent political and economic actors were no longer invested in special incorporation: politicians because it no longer gave the state money, and capitalists because they could no longer use it to control competition among railroads.

The railroad field in New Jersey was from its inception stabilized by a special law regime that created an incumbent in a monopoly position, the Camden and Amboy, limited entry from challengers by requiring all railroads to seek a special charter of incorporation from the legislature, and therefore prevented ruinous competition in a field with high fixed costs (e.g. Dunlavy 1994; Hovenkamp 1991; Lamoreaux 1988). Observers such as Steffens (1905) and Lockard (1964) draw a direct connection between the dominance of the railroad monopoly and the later modern incorporation. But at the time, the 1873 general railroad incorporation law was not seen as business-friendly, as evidenced by this description of the law in a *New York Times* editorial:

"An apparent honest attempt to release the commonwealth from that thralldom to a corporation which gave it the ignominious name of the State of Camden and Amboy. That a general railroad act has been passed in New Jersey not only shows that the people are ready for constitutional changes in consonance with the spirit of the age, but is of general importance as indicating that the opposition to corporations has become aggressive." (New York Times 1873)

The special law regime solved the same problem in railroads that modern incorporation would later solve for manufacturing, but in different way, by allowing large firms in fields already populated with many firms to merge to lower competition. How could an institution, modern incorporation, that emerged despite

the resistance of market incumbents, come to serve the very interests¹⁹ of those incumbents? The key to understanding this paradox is that both served business incumbents, but in fields with different structures. In special law fields, incumbents wanted to limit entry; in manufacturing, they wanted to consolidate an already existing, too large, population of firms. Which kinds of corporate laws will be preferable to incumbents depends on the overall field structure. Economic interests are consequently neither singular, uniform, nor necessarily opposed to political interests.

That the empirical conditions cited in the path-dependency and contingency model did not occur in New Jersey reduces our faith in it. At the same time, the conditions that did occur conform to the incumbent investment model, thereby increasing our belief in it. That the shift from special to general incorporation ran counter to incumbent capitalists' interest at the time is further evidence against existing path-dependent explanations. The general laws started out being anti-incumbent, and only later, under different industrial conditions, became useful to different incumbent capitalists. If the most powerful actors of the time had been able to shape events, special incorporation would have persisted.

Conclusion

Existing explanations for why modern incorporation emerged in America have focused on efficiency or power and historically specific conditions. The power and contingent conditions view successfully refutes the functionalist efficiency explanation, but the empirical conditions it cites did not occur in New Jersey, which passed the first modern corporate law. This article shows that attempts to change the law in ways that ran counter to economic incumbents' interests only succeeded when political incumbents were not invested in those laws through the revenue they provided. This systematic explanation for institutional change refutes the claim that corporate law developed the way it did due to historical contingencies.

Mid-century depressions did not force the New Jersey legislature to change the way it created corporations because the state derived large tax revenues from its main infrastructure project, the railroad across the state. Special incorporation gave politicians the ability to limit competition on this route by not passing any laws to create new corporations. This kept it profitable for owners and lucrative for the state. Once the railroad ceased to provide tax revenues, politicians had no reason to protect it, and special incorporation for railroads became vulnerable to challenges. The first general incorporation law for railroads passed as soon

as a political and economic challenge occurred in the same year. Once railroad corporations switched to general incorporation the state soon prohibited special incorporation completely and passed the first comprehensive general law that became the template for later laws.

The revenues brought by increasing incorporation activity under the new general laws made politicians invested in permissive corporate laws, protecting them against a series of challenges by political reformers. By focusing on successful attempts to change the law existing explanations have not recognized this more complex history: corporate law was on the one hand more contested than previously recognized, but at the same time, because the revenues they brought were seen as benefiting their constituents also defended by politicians.

This article argues that the restriction of New Jersey's laws in 1913 was made possible by raising railroad taxes in 1906/08, again making it the largest revenue source, and thus making politicians less invested in liberal corporate laws and the revenues they brought. New Jersey's liberal corporate laws were a parenthesis in the state's history, sandwiched between periods of relying primarily on the railroads for revenues. It ended up having such decisive effects because other states, notably Delaware, had by then adopted similar laws. Future research should examine what determined which states adopted and which did not adopt similar laws.

The most general implication of these findings is that the institutions underlying our economy are both more and less malleable than the contingency and path-dependency view allows. They are more malleable because institutions are not inherently path-dependent: once they stop solving incumbents' problems they are vulnerable to challengers, which occur regularly. At the same time institutions are less vulnerable to contingent events, because as long as they serve incumbents' interests they will survive. This analysis shows that the development of American corporate law was not a privatization of the law as much as a shift in how the law served incumbent interests. Earlier special incorporation served incumbent capitalists' interests by limiting competition by making incorporation difficult for competitors. Modern incorporation served incumbent capitalists' interests by making the creation of corporations simple and holding companies legal, which served to limit competition by consolidating an existing population of firms. Both forms of law served incumbent politicians interests by providing tax revenues. Their willingness and ability to restrict the law once it did not serve their purposes anymore in 1913 shows that politicians continued to exert control over corporations.

An important question in the study of the state is the degree to which the state is autonomous from larger society (Evans et al. 1985). This analysis reveals two consequences for this question. On the one hand, it shows that politicians were able to exert control over corporations if it was in, or at least not against, their interest. It also shows that they were autonomous enough to impose taxes on powerful economic incumbents, but, that this power also made them more reliant on the associated economic activity and therefore reluctant to impose restrictions on it. Sociologists have recently rediscovered these connections between fiscal and other policy areas (Martin et al. 2009). For example, Krippner (2011) shows how state actors' attempts to solve the fiscal problems of the state inadvertently resulted in financialization. Similarly, Prasad (2013) shows how progressive taxation backfired and undermined the American welfare state. Given these complex linkages between policy areas and the interests of political and economic incumbents, contingency is an attractive explanation for institutional change. But the central conclusion of this article is that institutional change of this kind can be succinctly explained by connecting institutional change to the distributional effects of those institutions among both political and economic incumbents.

Appendix A: Data sources and gathering procedures

This appendix describes the sources and code used to build the datasets used. For the Session Laws, Politicians, Bills, Votes, and Messages dataset, digitized originals of the New Jersey Session Laws, Legislative Manuals, and Senate Journals were downloaded from the New Jersey State Library²⁰, Google Books²¹ and Hathi Trust²². Sources in PDF format were converted to plain text using tesseract²³. Sources in EPUB format were converted to plain text using the Python²⁴ EPUB module²⁵. The plain text files were parsed using software written in Haskell²⁶ to build datasets. The NJ-Incorporations dataset was built from tables of incorporations made available by the New Jersey State Library²⁷. All figures, most tables, and all statistical analyses were done using R²⁸. All data, programs, and analyses are available upon request.

Notes

¹This approach shares with existing economic sociological explanations the conviction that powerful actors shaped corporate law. But following Thelen (2004:32-33) I focus on actors and interests rather than power, in part because the former are more easily empirically observed.

²Abbott discusses linked ecologies, not fields. For the purposes of this article they are sufficiently similar. One possible difference between them is the role of domination: according to (Abbott 2005a) ecologies "has no concept of dominance or subordination", while fields, made up of incumbents and challengers seem fundamentally hierarchical. But, the relationship between incumbents and challengers is primary one of competition or conflict. Fields are only stable hierarchies under specific conditions.

³The nature of the state and power lies at the center of the debate between pluralists (Dahl 1961), marxists (Poulantzas 2000), and power-elite theorists (Domhoff 1990; Mills 1959), while later conceptions have moved on to the organizational state (Laumann and Knoke 1987), state autonomy (Evans et al. 1985), and the state as both place and actor (Mann 1988).

⁴Stoke (1930) argues that declining tax revenues in the 1880s caused New Jersey to liberalize its corporate law, but does not acknowledge how decreased revenues from special incorporation in 1869 made possible the passage of the first general law for railroads in 1873, which he instead sees as the historically specific result of particular legislative tactics. Similarly, Grandy (1993) agrees that failure to tax railroads in the 1880s made New Jersey liberalize its corporate laws, but does not acknowledge how reassessing the railroads in 1906/08 reduced the state's reliance on corporate taxes, enabling it to restrict its corporate laws in 1913.

⁵A working paper by this author examines the causes of subsequent corporate law liberalization and restriction across the American states. Preliminary results from discrete time logistic event history models indicate that the share of tax revenues generated by business taxes decreases the likelihood a state will restrict, and increases the likelihood that a state will liberalize, its corporate laws. This is consistent with the argument presented here, but the strength of farmers is also important, and business revenues seem to at least have partially the opposite effect in the South and the West.

⁶Existing accounts agree that the 1896 law assembled elements of corporate law introduced previously (Chausovsky 2007; Roy 1997; Yablon 2007), but do not specify exactly when those elements were introduced and how they mattered. Additional analyses of capitalists' incorporation under New Jersey laws (not shown here but available upon request) show that the legalization of intercorporate stock ownership in 1888 was the key change that made national capitalists start using New Jersey laws to limit competition.

⁷The passage of laws determining taxes had important effects on corporate law, by making politicians invested in it. I compared both individual politicians' and political parties' voting on tax laws to see if they were consistent with their preferences on corporate laws, but found no relationship. So to limit the scope of this study I do not consider their passage further here.

⁸Both Democratic and Republican Governors described corporations in terms of the revenues they provided both in the early 1890s and in the 1900s. Both Democrats and Republicans mentioned the efforts of corporations to limit competition as trusts in their party platforms in the early 1890s, but the Democrats also did so during the 1900s. (Governors' Messages and Party Platforms datasets, see Table 1). There is no partisan pattern in the passage and failure of attempts to change corporate laws.

⁹Using the yearly change in the smoothed share of total revenues yields substantively the same results. I smooth the raw values

using local regression to remove yearly fluctuations and identify the trend. These analyses are available upon request.

¹⁰Politicians don't have a theoretically motivated, intrinsic interest in particular forms of corporate law like capitalists do.

¹¹While I primarily cite Lane (1939), this section also draws on Cadman (1949); Reilly (1952).

¹²The Camden and Amboy changed name and structure several times, first merging with the canal company into the Joint Companies, then into the United Companies, then leasing all its property to the Pennsylvania Railroad in 1871. For ease of presentation, I refer throughout to the company as the Camden and Amboy Railroad.

¹³Like political economist Henry Carey, who accused the company of simultaneously overcharging customers and underpaying the state, resulting in several legislative commissions and investigations (Lane 1939:343-344).

¹⁴In 1848 Philadelphia and New York merchants petitioned the federal government to open a post road across New Jersey to break the monopoly, but involving the federal government only rallied support for the Joint Companies in New Jersey (Lane 1939:341-342).

¹⁵Such tactics included newspaper articles and editorials, mass meetings, petitions, citizen delegations to the Legislature, procedural tactics by loyal members in the Legislature, lawsuits, and finally, stock purchases when the Camden and Amboy bought a controlling interest in the challenger the Philadelphia and Trenton Railroad (Reilly 1952:56-75), (Lane 1939:328-329).

¹⁶In 1853, some Democrats wanted to start a new party (including some Whigs), but were discouraged by the Whigs who thought it would weaken their own party even more. (Lane 1939:353), (Reilly 1952:147).

¹⁷There is also some evidence that the National was more powerful than previous challengers. For example, the Camden and Amboy Railroad ultimately neutralized the 1833-1836 Trenton and Philadelphia Railroad challenge by buying a controlling interest in their stock (Reilly 1952:56-75 and Lane 1939:328-329). The National Railroad defended against this tactic using an early form of takeover defense (e.g. Davis 1991), transferring a controlling interest of its stock to "The American Trust Company of New Jersey", and stipulating that "no part of the said stock shall ever be voted [...] so as to give any [company or corporation], which may own, control or operate the existing lines of railroad between Philadelphia and New York, any power or control over the management of the affairs of the National Company" (Hamilton 1873:85).

¹⁸Sackett (1895:89-90) describes the following tactics used to defeat attempts to dismantle unelected city commissions. A bill to make the commissions elective was introduced, and none of the Republicans dared to openly oppose it. Instead, "they resorted to the old expedient of meeting every movement for a change by proposing something more liberal, which they, of course, had no idea of enacting." They could then vote against the first bill claiming they preferred the more liberal bill they had themselves proposed. They then debated the more liberal bill until the session ended without voting on it.

¹⁹It is because of this ambiguity with respect to the interests of incumbents, and because this analysis shows that the 1873 law was more important, that I do not include the 1875 special incorporation prohibition as a QCA case.

²⁰http://law.njstatelib.org/slic_home/law_library/historical_laws

²¹<http://books.google.com/books>

²²<http://www.hathitrust.org/>

²³<http://code.google.com/p/tesseract-ocr/>

²⁴<http://www.python.org/>

²⁵<https://pypi.python.org/pypi/epub>

²⁶<http://www.haskell.org>

²⁷http://slic.njstatelib.org/slic_files/searchable_publications/corp/NJCORPIntro.html

²⁸<http://www.r-project.org/>

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List of Figures

- 1 Largest New Jersey Revenue Sources' Share of Total Revenues 1850 - 1915. Source: (Sylla et al. 1993). 32
- 2 Capital stock Incorporated in New Jersey, by Law. Data: NJ-Incorporations (Table 1) 33



Figure 1: Largest New Jersey Revenue Sources' Share of Total Revenues 1850 - 1915. Source: (Sylla et al. 1993).

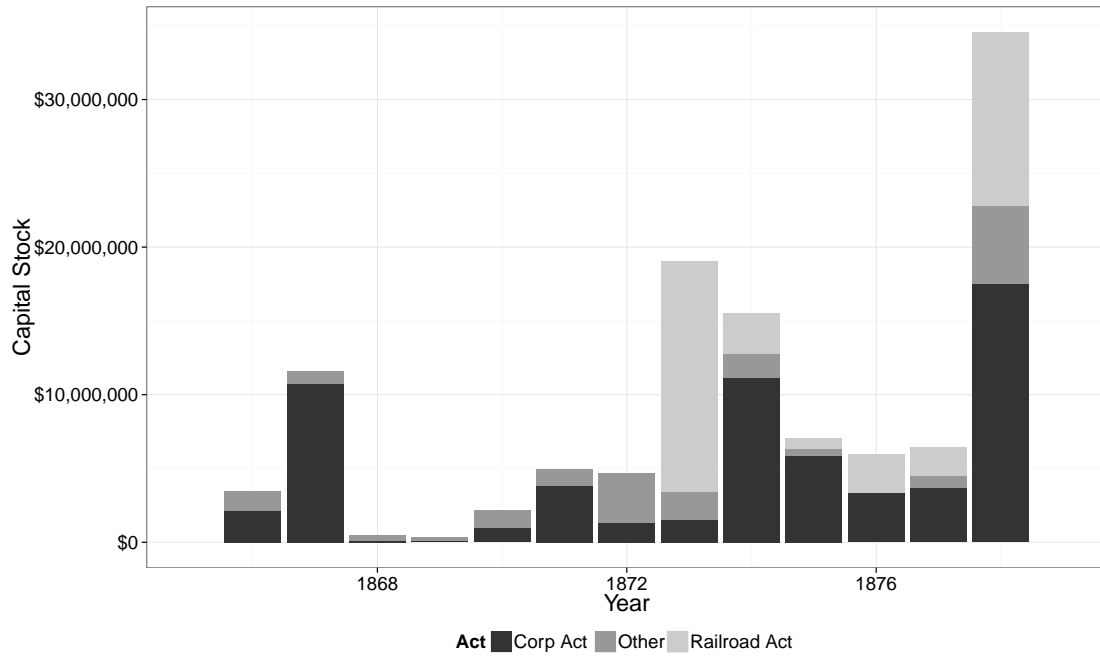


Figure 2: Capital stock Incorporated in New Jersey, by Law. Data: NJ-Incorporations (Table 1)

List of Tables

1	Scope, Sources, and Methods for Main Datasets Used.	35
2	Four Phases of Corporate Law and Revenue Sources, 1830-1915.	36
3	Failed and successful attempts to change corporate law in New Jersey, 1846-1893. $N = 28$. Source: see text.	37
4	Success and failure of pro- and anti-incumbent attempts to change existing law. Row percentages, number of attempts in parentheses. Fisher's exact test, $p < 0.01$. $N=28$	38
5	Success and failure of anti-incumbent attempts to change the law, by whether existing law provided tax revenues or not. Row percentages, number of attempts in parentheses. Fisher's exact test, $p = 0.06$. $N=20$	39
6	Success and failure of anti-incumbent attempts to change the law, by whether existing law limited competition or not. Row percentages, number of attempts in parentheses. Fisher's exact test, $p = 0.60$. $N=20$	40

Period	Name	Variables	Source	Method
1865 - 1914	Session Laws	Name, date, text	NJ Session Laws	OCR, text parsing
1860 - 1911	NJ-Incorporations	Name, date, location, agent, capital	New Jersey State Library (2011)	HTML parsing
1875 - 1913	Bills	Name, date, number, introducer	NJ Senate Journals	OCR, text parsing
1875 - 1913	Votes	Bill, member, vote	NJ Senate Journals	OCR, text parsing
1875 - 1913	Messages	Governor, year, text	NJ Senate Journals	OCR
1875 - 1913	Platforms	Party, year, text	NJ Legislative Manuals	OCR
1888 - 1903	Trusts	Name, date, state, plants, capitalization,	Moody (1904)	hand-coded
1834 - 1920	Revenues	Year, state, category, amount	Sylla et al. (1993)	N/A
1800 - 1907	US-Incorporations	Year, state, number	Lamoreaux (2006), Evans (1948)	N/A

Table 1: Scope, Sources, and Methods for Main Datasets Used. The starting year for NJ-Incorporations is approximate. Datasets marked OCR, text parsing were created by converting digitized copies of the source texts to machine-readable text, which was then parsed by custom software (available upon request). The NJ-Incorporations dataset was created by parsing HTML tables made available by the New Jersey State Library. The Revenues and US-Incorporations datasets are published datasets for which no data-gathering method was necessary. See also the Appendix.

Time	Corporate Law	Means of limiting competition	Revenue sources
1830/32 – 1869/73	Special Incorporation	Limiting entry by withholding corporate charters	Transit duties
1869/73 – 1883/88	General Incorporation	Pools and cartels	Property, railroad, and incorporation taxes
1883/88 – 1906/13	Modern Incorporation	Mergers using holding companies	Railroad, incorporation taxes
1908/13 –	Restriction	Mobile capital: move to more favorable regime	Railroad taxes

Table 2: Four Phases of Corporate Law and Revenue Sources, 1830-1915. When multiple years mark the end or beginning of a phase, the first year marks a shift in political investment, the second a shift in corporate law, except for 1830/32, where the incumbent railroad was created in 1830 and the state started receiving revenues from it in 1832. The law reassessing railroads passed in 1906 but had its largest revenue effects in 1908.

Phase	Year	Law change	Bills	Passed (%)
1	1846	Ability to operate in any industry	1	100
1	1851	General railroad law	1	0
1	1852	General railroad law	1	0
1	1854	Camden & Amboy charter extension	1	100
1	1865	Allowing out of state operation	1	100
1	1873	General railroad law	1	100
2	1875	General corporate law	1	100
2	1875	Prohibiting special incorporation	1	100
2	1888	Allowing intercorporate stock ownership	3	100
2	1888	Prohibiting cartels	2	0
3	1896	General corporate law	1	100
3	1897	Restricting 1896 law	2	0
3	1898	Restricting 1896 law	1	0
3	1906	Restricting 1896 law	3	0
3	1910	Restricting 1896 law	1	0
4	1913	Restricting 1896 law	7	86

Table 3: Failed and successful attempts to change corporate law in New Jersey, 1846-1893. $N = 28$. Source: see text.

	No change in existing law	Change in existing law
Pro-incumbent	0 (0)	100% (8)
Anti-incumbent	60% (12)	40% (8)

Table 4: Success and failure of pro- and anti-incumbent attempts to change existing law. Row percentages, number of attempts in parentheses. Fisher's exact test, $p < 0.01$. $N=28$.

	No change in existing law	Change in existing law
Existing law did not provide revenues	47% (7)	53% (8)
Existing law provided revenues	100% (5)	0% (0)

Table 5: Success and failure of anti-incumbent attempts to change the law, by whether existing law provided tax revenues or not. Row percentages, number of attempts in parentheses. Fisher's exact test, $p = 0.06$. $N=20$.

	No change in existing law	Change in existing law
Existing law did not limit competition	53% (8)	47% (7)
Existing law limited competition	80% (4)	20% (1)

Table 6: Success and failure of anti-incumbent attempts to change the law, by whether existing law limited competition or not. Row percentages, number of attempts in parentheses. Fisher's exact test, $p = 0.60$. $N=20$.