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Rules of Law and Economic Realities: an Historical Reconsideration

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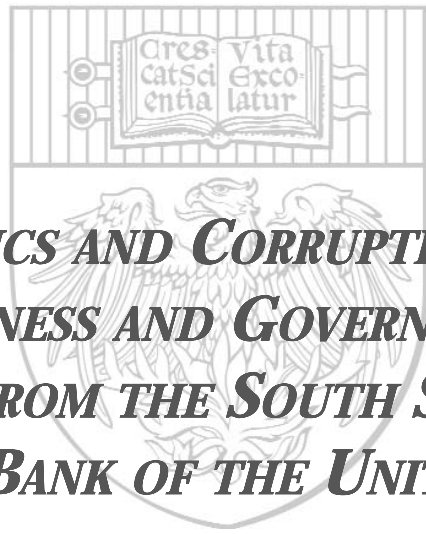

Ethics and Corruption in Business and Government: Lessons from the South Sea Bubble and the Bank of the United States

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Richard W. Painter[*]

This lecture addresses a phenomenon that arises repeatedly in history: concurrent and interrelated corruption in the political system and in business that puts political and business establishments on the defensive. When corruption from business spills over into government, the story is likely to end with politicians seeking to cover for their own actions or to elevate themselves on an ethical pedestal above their peers. Resulting legislative action -- hostile to business and driven by self serving political considerations in the wake of scandal -- is often not well thought out, and may hinder economic growth and stability.

Today, I focus on two examples of this phenomenon in England and the United States respectively. First, the South Sea Bubble of 1720 - during which many Members of Parliament took bribes in South Sea Company stock and traded in the stock on inside information - was followed by Parliament's draconian restriction in the Bubble Act on transferability of shares for over 100 years thereafter. Second, there were two attempts at the end of the Eighteenth and the first half of the Nineteenth Century to establish a permanent Bank of the United States modeled on the Bank of England. This undertaking was championed by Federalist and Whig politicians who, while they may have sought economic stability, also encouraged speculation in government securities on inside information, and bribery by the Bank of Members of Congress. The debate over the Bank was in part a debate over corruption that came with it. The First Bank of the United States was opposed and eventually allowed to expire by Jeffersonian Democrats and the Second Bank was attacked, and then pushed out of business, by

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President Jackson. Congress failed to establish a national bank until the Wilson Administration in 1913, two and a quarter centuries after establishment of the Bank of England.

I conclude that corruption of government by business is not only bad for government, but in the long run bad for business. Business sometimes overreaches in influencing government officials, but at the risk of a backlash in which politicians - in self righteous indignation or in order to cover up for their own actions - embrace harsh anti-business policies, regardless of whether those policies are in the national economic interest.

Modern parallels do come to mind. Some might think of Enron, Worldcom and the Sarbanes-Oxley Act. As a current White House employee, I will not say more about these scandals beyond what I said before I entered government service.

I reviewed former SEC Chairman Arthur Levitt's book in 2003.[1] While I disagreed with some of Levitt's substantive views on securities law, I shared his concern that accounting firms - including Arthur Anderson while it audited Enron's books -- undermined the SEC's independence by making an end run to Congress to complain about proposed SEC rules. Levitt pointed out that campaign contributions were a significant part of the strategy.

Enron and Worldcom embarrassed government and business. There is considerable speculation about whether Congress overreacted. If so, the Enron/Worldcom fiasco would fit into the broader phenomenon I discuss in today. Harsh legislative action follows political backlash when business exerts excessive influence on government. Legislative action taken in an atmosphere of moral indignation does not necessarily rid the political system or the economy of corruption, but may leave a body of corporate law, or a banking system, or a capital market that is weaker than what existed before.

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[1] *Standing Up to Wall Street*, 101 Mich L Rev 1512 (2003) (reviewing Arthur Levitt, *Take on the Street* (2002)).

I. The South Sea Bubble

I turn first to the South Sea Bubble of 1720 and the disruption of English corporate law that followed. The South Sea Bubble is one of the most famous financial crises in modern history and continues to fascinate scholars of capital markets.[2]

Economic historians disagree over the extent to which investors behaved rationally during the South Sea Bubble. Irrationality has been long been identified in the Bubble, most notably by Charles Mackay in his 1841 book *Extraordinary Popular Delusions and the Madness of Crowds*. More recently, some economic historians - such as Gary Shea[3] -- argue that some investor behavior, and some pricing, was rational during the South Sea Bubble.

I sidestep this debate and focus instead on actions of government officials who invested in the South Sea Company, who received shares in the Company at favorable prices and often for little or no money down, and who then participated in enacting legislation and other official acts affecting the Company.[4] Alexander Pope's verse reflected widespread public disgust, not just with corruption in the South Sea Company, but also disgust with a corrupted government:

> At length corruption, like a general flood,
>
> (So long by watchful Ministers withstood)
> Shall deluge all, and avarice creeping on,
> Spread, like a low-born mist, and blot the sun.

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[2] For a compilation of original sources on the Bubble, see John G. Sperling, *The South Sea Company: An Historical Essay and Bibliographical Reading List* (Baker Library, Harvard Business School, 1962).

[3] See Gary S. Shea, *Rational Pricing of Options During the South Sea Bubble: Valuing the 22 August 1720 Options* (2004) (working paper).

[4] Part of this discussion is based on my earlier research. See Richard W. Painter, *The South Sea Schemes of 1711 and 1720: The Perpetrators and their Motives* (1984) (on file at Harvard University Archives, HU92.84.670) (Hollis Library Catalogue No. 001156668).

Statesman and patriot ply alike the stocks,
Peeress and butler share alike the box;
And judges job, and bishops bite the town,
And mighty dukes pack cards for half-a-crown:
See Britain sunk in lucre's sordid charms

And France revenged of Anne's and Edward's arms!
--Alexander Pope (*Epistle to Allen Lord Bathurst*).

The scandal that inspired this verse emerged out of a plan to refinance the national debt from England's frequent wars at the end of the 17'th Century. France was experimenting with its own plan to finance debt from the wars of Louis XIV, fueling an "arms race" in instruments of finance. Both countries tried funding government debt through private companies, with disastrous results for both.

France's scheme involved a trading company that, like England's South Sea Company, had purported business operations so distant that investors could not possibly monitor them. In 1717, John Law, a Scotsman of dubious reputation at home, acquired the Mississippi Company, which the French government had given control over trade in the Louisiana Territory and elsewhere. Law also persuaded the government to implement a banking scheme described in Law's 1705 treatise, *Money and trade considered, with a proposal for supplying the nation with money*. Law set up the Banque General, which issued bank notes and dealt in shares of the Mississippi Company. The Banque General persuaded gullible investors to exchange outstanding government debt for shares in the Company. By 1719, speculative frenzy drove the price of the Company's shares up over 30 fold. By May of 1720, the bubble burst, and Law fled France. The experience left the French distrustful of national banks with power to issue paper money. Not until 1800 - when Napoleon needed money for his wars -- was the Banque de France finally established, over one hundred years after the Bank of England.

The Bank of England was founded in 1694 by prominent Whig

financiers - under the guidance of another Scotsman, William Paterson -- in order to act as the government's banker. Paterson proposed a loan of £1.2 million from the Bank's subscribers to the government in return for the receipt of a Royal Charter which bestowed banking privileges including issuance of notes. The interest rate on the loan was a high 8% per year plus a service charge of several thousand pounds per year. Unlike Law's bank in France, however, the Bank of England was not tied to a trading company or another glamorous business that could fuel speculation in its own securities.

In 1711, Robert Harley, Earl of Oxford, sought to establish a Tory alternative to the Bank. He enlisted a group of Tory financiers including John Blunt, Elias Turner, Jacob Sawbridge, and George Caswall. These men had all stood for election as Tory candidates to the board of directors of the Bank of England or the East India Company, and had lost to Whigs. Of modest background, they were Tories out of convenience more than conviction; the Whig financial establishment wanted to have little to do with them. In 1700 they had obtained control of another company, the Sword Blade Company, and diverted it from manufacturing sword blades to acting as the government's banker under Tory Administrations.[5] Now they sought, with Harley's blessing, to establish a bigger Tory rival to the Bank of England that would engage in a more glamorous business than manufacturing sword blades. This business - perhaps the '.com' equivalent of the day -- was trade with vast territories in the Caribbean and Latin America that Spain could no longer militarily defend as its own monopoly.

The South Sea Company in 1711 received from the English government a monopoly on English trade with Spain's South American territories. In return, the Company agreed to assume a significant portion -- approximately £9.5 million -- of floating army and navy debt at a rate of 6% per year, a discount over then prevailing interest rates. The value of the South Sea trade was supposed to make up the difference.

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[5] For discussion of these men's exploits see John Carswell, *The South Sea Bubble* at 32-35 (1960); Sperling, *The South Sea Company* at 5 (cited in note 2); and Painter, *The South Sea Schemes* at 9 (cited in note 4).

Subscribers to the Company's stock provided the needed capital, and some of these shareholders were government annuity holders who exchanged their government obligations for Company stock. Although the shareholders would eventually elect the Company's directors, the initial slate of directors was chosen by the Queen, and hence by Harley. Harley also made himself Governor of the Company.[6]

The trade concession was of modest value. King Philip V of Spain limited the Company to one shipment of merchandise each year to South America. In the treaty negotiations leading up to the 1713 Peace of Utrecht, Philip would yield little more to England. England's Tory ministers never liked England's wars on the Continent - and the enormous cost of these wars - and would not sacrifice peace in order to extract trade concessions from Spain.

What followed was a pattern of widespread deception from 1711 through 1720. In secret peace negotiations with Spain, Harley's government obtained almost nothing of value by way of trade concessions, a fact never revealed to the Company's directors and shareholders who continued to be told how lucrative trade would be. The Government also had no moral reservations about using public funds to pay journalists - most prominently Daniel Defoe[7] - to write wildly optimistic and bellicose pamphlets promoting the Company and England's

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[6] Painter, *The South Sea Schemes* at 6-13 (cited in note 4) (describing formation of the South Sea Company) and Appendix II (listing its directors in 1711). See Carswell, *The South Sea Bubble* at 58 (cited in note 5) (pointing out that the directors "[a]part from their stock, had only one thing in common. Not a single one of them had any experience of the South American, or even the West Indian trade ...").

[7] See Daniel Defoe, *A True Account of the Design and Advantages of the South Sea Trade* (London, 1711) (printed for J. Morphew) ("It will open such a vein of riches, will return such wealth, as, in a few years, will make us more than sufficient amends for the vast expenses we have been at since the [1688] Revolution.") See also *An Essay on the South Sea Trade* (London, 1712) (Printed for J. Baker and attributed to Daniel Defoe); *The True State of the Case between the Government and the Creditors of the Navy as it Relates to the South Sea Trade* (London, 1711) (Printed for J. Baker and attributed to Daniel Defoe). Copies of these pamphlets are available in Kress Library, Harvard Business School (other pamphlets in this collection hereinafter designated with a "K").

prospects for encroaching on Spanish commerce in the South Seas. In reality, there was no such luck - the first annual voyage was not made until 1717, and trade was interrupted the following year because of a disagreement with Spain. Meanwhile, the Company's directors were engaged in self dealing at the expense of shareholders by dispatching Company ships and crew on private "off the books" trading missions, profits from which were paid into directors pockets.[8]

Things got worse when George I succeeded Queen Anne, who had been a Tory sympathizer, and the Whigs came to power. Two of the Company's founders and political supporters, Harley and Lord Bolingbroke, were charged with treason. Suggesting some efficiency in stock markets at the time, South Sea Company stock - despite all the hype coming from Defoe and others - continued its mediocre performance and was trading well below par as late as 1719.

Perhaps in order to deal with difficulties in a Whig dominated political environment, the Company turned to a strategy of selling stock to politicians, and eventually to bribery. The Company avoided trouble with the Crown by approaching the King's two Hanoverian mistresses, Madam Schulenburg and Madam Kielmansegge, each of whom was given shares in the Company (it is unknown whether the Queen received similar benefits). The Company issued shares, sometimes for little or no cash down, to senior government officials, including John Aislabie, Chancellor of the Exchequer, James Craggs, Postmaster, and Charles Stanhope, Secretary of the Treasury. The Company may have been founded by Tories, but enough Whigs could be bought so that business could go on.

The Company's principal business would not be trade in the South Seas, but instead a greatly expanded program of meeting the government's debt restructuring needs when interest rates declined after the

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[8] At least one prominent shareholder publicly complained about these trading missions using Company ships and crew. See *Some Considerations Relating to the Management of the Affairs of the South Sea Company* (London, 1716) (printed by J. Morphew) (K) (the anonymous author complained that he made a large investment in the Company only to see profits siphoned off by its directors).

Peace of 1713. The government in wartime had been unwise to borrow large sums over a long term at fixed rates of interest ranging from seven to nine percent. Parliament now sought ways to redeem and refinance this high-interest debt by persuading a large number of government bond holders to give up what had been a fabulous investment. The government had every motive to allow investors to be deceived in order to accomplish this task.[9]

The King's speech opening Parliament in 1717 referred to the continuing need to finance the debt. By early 1720, it was proposed that the South Company assume almost all of the government debt, offering stock in exchange for government bonds. This fed further speculation in the shares and the price finally began to rise. Some of the speculators were MPs or members of the Administration, trading on inside information about the role that Parliament would assign to the Company in refinancing the national debt.

In January 1720, the Commons began considering competing proposals from the South Sea Company and the Bank of England to finance the remainder of the national debt, about 31 million pounds. Both companies offered to assume this debt for seven years, through 1727, in return for interest at five per cent. In order to compete with the Bank, the South Sea Company agreed that the government could redeem the debt after four years, instead of seven, if rates continued to fall. The Bank matched this proposal. Robert Walpole, First Earl of Oxford, was the main advocate in Parliament for the Bank, and Mr. Aislabie, the Chancellor of the Exchequer, the main advocate for the South Sea Company. One key difference between the proposals was

[9] There were some honest proposals, but these would have cost the government more money. Archibald Hutcheson, M.P. for Hastings on Sussex, observed that the government had put itself in a bind by selling ninety-nine year irredeemable annuities in order to borrow during wartime, and he proposed that this debt be gradually retired by expanding the government's sinking fund. *Some Calculations and Remarks Relating to the Present State of the Public Debts and Funds and a Proposal for the Entire Discharge of the National Debt and Incumbrance in Thirty Years Time* (London, 1718) (printed for Henry Clements and attributed to Archibald Hutcheson) (K).

that the exchange ratio of Bank of England shares for government debt was fixed, being tied to the par value of Bank stock. The South Sea Company's proposal was instead tied to market value; the higher the market value of Company stock the more government debt would be redeemed in exchange for a share of stock.[10] The House of Commons chose the proposal of the South Sea Company, in part because the Company's faction had more political pull and in part because the Company, without the par value provision, could offer the nominally higher price and redeem more debt, provided its stock continued to rise. When the proposal went to the House of Lords, there were only seventeen peers against the scheme, and eighty-three in favor.

Many MPs and Lords had invested in South Sea Company stock and then voted on bills to extend the Company's monopoly on South Sea trade. Now they voted again on the Company's proposal to fund the national debt. The Company meanwhile accelerated its program of bribing MPs and other officials by selling them stock for little or no money down. Robert Knight, the Company's Treasurer, kept a record of these transactions in a green book, but many of these "sales" were never transferred to the Company's official records, and when scandal broke neither the green book nor Knight were ever seen again.[11]

As speculation in the Company's stock grew, others prominent Londoners climbed on the bandwagon, including Jonathan Swift, John Gay, Issac Newton and Thomas Guy. At its peak, the South Sea Company's market capitalization was over 150 million pounds, about ten times the value of the national debt and other assets then held by the Company.

Then came the Bubble Act of 1720. The Act was not as much a reaction to the Bubble as part of an effort to keep the Bubble afloat by

[10] South Sea company partisans rejected suggestions that the Company should adopt the Bank's approach of fixing the exchange ratio. See *An Argument to Show the Disadvantage that Would Accrue to the Public From Obliging the South Sea Company to fix what Capital Stock they Will Give for the Annuities* (London, 1720) (printed for J. Roberts and attributed to Daniel Defoe) (K).

[11] See Painter, *The South Sea Schemes* at 79-92 (cited in note 4) (detailing the stock "sales" by Mr. Knight to politicians).

stifling competition from hundreds of other copy-cat joint stock company schemes, many boasting of other nonexistent or grossly exaggerated ventures. Some were actually called Bubbles. Some lasted for weeks, some for less than that. Many involved leading aristocrats.

On June 11, 1720 the King proclaimed these projects a public nuisance that should be prosecuted. On July 12, the Lord Justices in privy council published an order "taking into consideration the many inconveniences arising to the public from several projects set on foot for raising of joint stock for various purposes." This same order dismissed a large number of petitions for patents and charters, and dissolved over 80 bubble companies established for various purposes, including one "for drying malt by hot air."[12]

Parliament soon thereafter passed the Bubble Act.[13] The preamble of the Act claimed its objective to be protecting investors from "fraud traps." The Act prohibited formation of joint stock companies or other partnerships with freely transferable shares. This left only two ways to form such a company - a Crown charter or a charter granted by separate statute, both of which were extraordinarily difficult to obtain. The Bubble Act was not repealed until 1825.

The Bubble Act thus proclaimed that there should be no bubbles but those bubbles officially sanctioned by Parliament. The South Sea Company, formed by statute, would survive the Bubble Act, but now without competitors for investors' capital. Members of Parliament would also have similar advantages - including manipulating markets by passing legislation and trading on inside information - if they invested in future Bubbles that were creatures of statute. The Bubble Act thus arguably was motivated by rent seeking for Members of Parliament more than concern for investor protection.[14]

The Bubble Act was also political cover. MPs, themselves part

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[12] See Charles Mackay, *Extraordinary Popular Delusions and the Madness of Crowds* at 52 (1841)

[13] 1720, 6 Geo 1, ch 18 (Eng.).

[14] See Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J Legal Stud 101 (1987) (arguing that government offi-

of the South Sea Company craze, probably wanted to show that they were doing something to protect investors from Bubbles in general, if not from this particular Bubble. The ruinous Mississippi Bubble in France gave Parliament ample grounds to denounce bubbles, and at the same time distance MPs from an impending South Sea Bubble scandal that was their own making. Parliament could continue to inflate one bubble while proclaiming that there should be no more bubbles.

In any event, the Bubble Act did not shore up the price of South Sea Company stock, and indeed may have precipitated its collapse.[15] Joint stock companies banned by the Act had to wind up, and many demanded that shareholders pay money still owing for purchase of shares. These shareholders in turn raised cash by selling other assets, including shares in the South Sea Company. The price of South Sea Company stock then collapsed in September 1720, causing bank failures and collapse of other stock prices.

Parliament responded with self righteous indignation. The House of Lords on January 26, 1721 resolved that giving credit for South Sea stock without consideration; or the purchase of stock by the Company for a Member of the Administration or of Parliament, while the South Sea Bill pending, was an act of corruption.[16] Another resolution condemned for fraud and breach of trust those directors and officers of the Company who had secretly sold their own stock. The House of Commons passed resolutions condemning stockjobbers, and targeted both the Company's officers and directors and even some of their own Members with investigations.[17]

South Sea Company directors were ordered to give a full

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cials create rent-seeking opportunities for themselves by enacting and threatening regulation, and that extensive regulation promotes corruption by encouraging private actors to seek favors from government officials).

[15] See generally, Larry Ribstein, *Bubble Laws*, 40 Hous L Rev 77 (2003) (discussing the Bubble Act).

[16] *The History and Proceedings of the House of Lords from the Restoration in 1660 to the Present Times*, Vol. VI at 135 (London, 1742) (printed for Ebenezer Timberland).

[17] Several reports were printed on the investigation. See *A Supplement to the*

account of their conduct. In keeping with a tradition extending to more recent times, evidence was destroyed and accounting records altered to conceal wrongdoing. Company books produced before Parliament contained fictitious entries; some entries stated amounts paid for shares, but left blanks for names of purchasers. Erasures appeared in some places, alterations in others, and pages were torn out. A royal proclamation offered a reward for the apprehension of Knight, the Treasurer of the Company, who fled to Calais with his green book recording stock sales to political insiders, but he was never brought back to England for questioning.[18] Sir John Blunt was called before both the Commons and the Lords to answer questions, including about sales of stock to members of the Administration and Members of Parliament, most of which he refused to answer.

The House of Lords ordered an investigation of Mr. Aislabie, Chancellor of the Exchequer, who was forced to resign, and of Mr. Craggs, another member of the ministry. Several Members of the House of Commons were expelled, including Sir Theodore Janssen, Mr. Sawbridge, Sir Robert Chaplin and Mr. Eyles. Mr. Aislabie was committed to the Tower for a year.[19] The Earl of Sunderland was eventually acquitted by a vote of 233 to 172. Daniel Defoe quickly distanced himself from the scandal by denouncing these politicians and supporting Parliament's right to pass a bill of attainder against them.[20] Over two million pounds was also confiscated from the estates of the South

Reports of the Committee of Secrecy (London, 1721) (printed for A. Moore) (K); *An Abstract of the Supplement to the Reports of the Committee of Secrecy* (London, 1721) (printed for J. Lapworth) (K).

[18] Sperling, *The South Sea Company* at 3 (cited in note 2).

[19] According to a contemporary political pamphlet, the Committee of Secrecy "discovered great dealings in South Sea stock by John Aislabie Esq. with one broker, Nathaniel Wymonfold, whilst the South Sea scheme and the Bill were depending in Parliament, and soon after the Bill passed." *The Skreen Removed in a List of the Names Mentioned in the Report of the Committee of Secrecy* at 13 (London, 1721) (printed for J. Lapworth) (K).

[20] *A Vindication of the Honour and Justice of Parliament Against a Most Scandalous Libel Entitled: "The Speech of John Aislable, Esq."* (London, 1721) (printed for A. Moore and attributed to Daniel Defoe) (K).

Sea directors, each only being allowed to retain a relatively small portion, depending on the proportion of the harm attributed to him.[21]

One of the most curious actors in this drama was the Whig politician Robert Walpole who used the scandal to advance his career. Walpole entered Parliament in 1701 and later became Secretary of War and Treasurer of the Navy. The Tories, led by Robert Harley and Viscount Bollingbrook, then regained power and sought Walpole's downfall in 1712. In a politically motivated prosecution Walpole was impeached by the Commons and convicted by the Lords for accepting illegal payments while he was Secretary of War. He spent six months in the Tower. His constituents, however, reelected him in 1713. When the Whigs came back to power in 1714, Walpole headed a Parliamentary committee of secrecy investigating corruption in the prior Tory ministry, leading to impeachment of Oxford and Bollingbrook for treason (impeachment was a staple of politics in the rivalry between Whigs and Tories).

Walpole spoke out against the South Sea scheme in the House of Commons. He warned that "the dangerous practice of stockjobbing would divert the genius of the nation from trade and industry." He was ignored. Ironically, Walpole joined the speculative frenzy and invested in, and lost money in, South Sea Company stock. He did, however, get out sooner than many investors (he apparently was warned by his banker to sell his stock, although he also had an inside view of Parliament's own involvement with the Company).

Lords Stanhope and Sunderland, Walpole's chief Whig rivals, were both implicated in the scandal, clearing his rise to power. Walpole devised a plan for the Bank of England and the East India Company to bail out the South Sea Company. Eventually, the Company had to be

[21] Sir John Blunt, Sir John Fellows, Sir Theodore Janssen, Mr. Edward Gibbon, and Sir John Lambert lost the most. Blunt, who had been so reticent to answer questions from Parliament, did years later set forth his version of what had happened. See John Blunt, *True state of the South-Sea-scheme, as it was first formed, &c.: with the several alterations made in it before the act of Parliament passed: and an examination of the conduct of the directors in the execution of that act* (London: Printed and sold by J. Peele, 1732).

completely restructured. Over eight million pounds was taken from the Company, and given to the stockholders. Persons who had borrowed money from the Company against their stock were forgiven all but ten percent of their debt to the Company (subscription agreements were thus considered as if they had been options-to-buy, which arguably had been the intent to begin with).[22] Walpole became Prime Minister in 1721 and served until 1742. He probably was not personally corrupt, but he had a reputation for tolerating bribery and corruption in his Administration.[23]

In addition to Walpole's long tenure as Prime Minister, the legacy of the South Sea Bubble was the Bubble Act, which shaped English corporate law for over a century. The Bubble Act, and continued hostility to joint stock companies in Parliament and sometimes in the judiciary made raising capital more complicated, if not more difficult.

The Act was not vigorously enforced for much of the 18th Century.[24] Prevailing legal opinion, was that the Act was violated only if there were no restrictions on transfer of shares. Thus, companies continued to be formed, but shares were in some respects not freely trans-

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[22] Making subscribers pay would have been difficult. See Armand Dubois, *The English Business Company after the Bubble Act, The Coercion of Defaulters* 367-9 (1938) (describing legal and practical difficulties with making defaulters pay on subscription agreements). Subscription shares thus arguably were options to buy shares, and were priced as such. See Gary Shea, *Financial Market Analysis Can Go Mad (in the Search for Irrational Behaviour During the South Sea Bubble)* (July 2005) (Centre for Dynamic Macroeconomic Analysis Working Paper No. 0508 Available at SSRN: http://ssrn.com/abstract=779025) (attributing price differences between subscription shares and original shares to difficulties the Company would have collecting subscription payments if the stock price declined), responding to Richard Dale, Johnnie V. Johnson, and Leilei Tang, *Financial Markets Can Go Mad: Evidence of Irrational Behavior during the South Sea Bubble*, 58 Econ Hist Rev 233 (May 2005) (arguing that subscription shares were overpriced by the market).

[23] Alexander Pope and other writers criticized, among other things. Walpole's excessive use of patronage to secure political power. See Alexander Pope, *Imitations of Horace* (1738).

[24] See Larry Ribstein, *Should History Lock in Lock-in?*, Illinois Law and Economics Working Paper Series at 14 (2006) (posted on SSRN); Edward H.

ferable. Lawyers sought ways around the Act, whether by creating trusts to manage businesses or creating partnerships with insignificant formal restrictions on transferability. London solicitors built up a practice based on interpreting the Act, and transaction costs rose. In the early nineteenth century, however, enforcement picked up with a number of judicial rulings between 1808 and 1812. The Act was formally repealed in 1825, although the legal landscape for incorporation remained uncertain because some judges insisted that common law imposed similar prohibitions.[25]

Thus, despite extraordinary economic change during the Industrial Revolution, the legal framework of business organization in England was highly restrictive for a century and a quarter. Other countries with far less developed economies had more permissive laws of business organization.[26] Change did not come until sweeping reforms - including freedom of incorporation by registration -- in the General Incorporation Act of 1844. Limited liability did not get full legal sanction until the Limited Liability Act of 1855. As Ron Harris observes, a dynamic industrial economy still evolved within this static legal framework. This may be due to lack of enforcement of the Bubble Act and to lawyers' creative navigation around it. Nonetheless, economic growth might have been even greater if Parliament and the judiciary had

Bubble Act had a positive effect on private ordering by encouraging experimentation with alternatives to joint stock companies, such as partnerships.

[25] See *Duvergier v Fellows*, 5 Bing. 248 Bext, c. 5 (1828) ("The scheme in which the parties to this action were engaged was one of those bubbles by which, to the disgrace of the present age, a few projectors have obtained the money of a great number of ignorant and credulous persons, to the ruin of those dupes and their families . . . Although the statute of 6 Geo. 1 [the Bubble Act] be repealed, the common law relating to such schemes is expressly reserved by the repealing statute; and no one doubts, if it can be shewn, and it easily may, that such schemes are fraud-traps and injurious to the public welfare, that the forming of them is an indictable offense at common law.").

[26] See Ron Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720-1844* (2000). See also Ribstein, *Should History Lock in Lock-in?* at 14 (cited in note 24); Warren, *Corporate Advantages* at 333 (cited in note 24) (noting that Bubble Act restrictions on transferability of shares were not part of the United States legal system at the time).

not obstructed utilization of the joint stock company. The Bubble Act restrictions were certainly a very blunt instrument with which to combat excess financial speculation.

II. The First and Second Banks of the United States

The history of political hostility to banks in the United States has been discussed extensively by scholars. Mark Roe, for example observes that populist fears of concentrated economic power, interest group maneuvering, and a federalist American political structure all had a role in pressuring Congress to fragment U.S. financial institutions.[27] The history of the Bank of the United States is part of this story, and corruption by the Bank of the political system had its role in fostering hostility to the idea of a national bank.

Assumption and Speculation

Like the Bank of England, the First Bank of the United States began with a scheme to refinance the national debt, in this case the Revolutionary War debt of the Continental government and the various states. Speculators had bought up much of this debt for fractions of par value; some of the certificates and notes made their way into the hands of members of Congress and their allies. Any proposal to pay off the debt in its entirety would be seen as an unjustified reward for speculators who had political connections.

In 1781, Robert Morris, as Superintendent of Finance, issued a *Report on Public Credit* proposing that the Confederation government assume the states' Revolutionary War debt, issue bonds, impose import duties to finance payments, and establish a national bank.

The Constitution, ratified in 1788, gave Congress power to impose tariffs and collect taxes. Alexander Hamilton - Secretary of the Treasury from 1789 to 1795 -- and other Federalists wanted an eco-

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[27] See Mark J. Roe, *The Political Roots of American Corporate Finance*, 9 J of Applied Corp Fin 8 (Winter 1997).

nomic system that would include a judiciary, enforcement of contracts, payment in full of obligations including public debt, and promotion of manufacturing. Hamilton's economic model looked to England, which had established the Bank of England in 1696 and taxed spirits to fund the national debt. The anti-Federalists or Republican-Democrats were deeply suspicious of Hamilton's economic program, particularly to the extent it gave taxation and other powers to the federal government. They also disliked the idea of a Bank.[28]

Hamilton, in his *Report on Public Credit* of January 1790 proposed that Congress redeem at full par value the debt of the Continental government. Old Continental government certificates (totaling about $50 million) would be exchanged for new government bonds with maturities of up to 30 years yielding 4 percent to 6 percent. Hamilton also proposed that the federal government assume the Revolutionary War obligations of the states. Interest on the federal debt was to be paid with customs duties and excise taxes.[29]

This proposal would give a windfall to speculators who bought up debt of the Confederation at a portion of its face value from desperate sellers - farmers, small businessmen and Revolutionary War veterans who had received the certificates in lieu of soldiers' pay. Thomas Jefferson and Hamilton's other critics envisioned not only speculation but corruption.

Senator William Maclay of Pennsylvania, for example, accused other Members of Congress of speculating on inside information about Congress's intention of paying off the debt in full.

In his Journal, Maclay wrote on January 15, 1790:

> "I call not at a single house or go into any company but traces of speculation in certificates appear. Mr.

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[28] See generally Ron Chernow, *Alexander Hamilton* (2004).

[29] See generally id at 225; Stanley Elkins and Eric McKitrick, *The Age of Federalism* at 112-21 (1993).

Langdon,[30] the old and intimate friend of Mr. Morris,[31] lodges with Mr. Hazard.[32] Mr. Hazard has followed buying certificates for some time past. He told me he had made a business of it; it is easy to guess for whom. I told him, 'You are, then, among the happy few who have been let into the secret.' He seemed abashed, and I checked by my forwardness much more information, which he seemed disposed to give."

"The Speaker gives me this day his opinion, that Mr. Fitzsimons[33] was concerned in this business as well as Mr. Morris, and that they stayed away [from Congress] for the double purpose of pursuing their speculation and remaining unsuspected."[34]

Again, on January 18, Maclay wrote:

"[Senator] Hawkins of North Carolina said as he came up he passed two expresses with very large sums of money on their way to North Carolina for purposes of speculation in certificates. Wadsworth[35] has sent off two small vessels for the Southern States, on the errand of buying up certificates. I really fear the members of Congress are deeper in this business than any others.

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[30] John Langdon, Senator from New Hampshire.

[31] Robert Morris, Senator from Pennsylvania. As Superintendent of Finance for the Continental government, Morris had proposed redeeming the Revolutionary War debt at par value.

[32] Jonathan J. Hazard, Rhode Island's Delegate to the Continental Congress in 1788.

[33] Thomas Fitzsimons, Congressman from Pennsylvania.

[34] *Journal of William Maclay, United States Senator from Pennsylvania 1789-1791* at 173-74 (Frederick Ungar Publishing, 1965) (1890).

[35] Jeremiah Wadsworth, Congressman from Connecticut.

> Nobody doubts but all commotion originated from the Treasury. . . "[36]

Speculators pumped Members of Congress and the Administration for details about Hamilton's plan and its chances for adoption (Federal Hall was conveniently located near Wall Street in New York). How much Hamilton and his associates leaked inside information to friends who in turn traded is still a subject of debate. One economic historian observes that "the evidentiary record points toward the conclusion that the first market for government securities was created by interested parties with special information."[37]

Meanwhile, Congressman James Madison, a Democrat, suggested a compromise of paying the speculators the highest market price to date for the certificates with the balance going to the original note holders. Hamilton countered that such "discrimination" in favor of the original debt holders was unworkable, and that the certificates were negotiable, creating a moral obligation to pay the holder in full. He had the votes and Congress passed his plan to pay the certificate holders the entirety of the debt.

There was even more resistance to Hamilton's plan for federal assumption of state debts of about $25 million, but Hamilton struck a deal with Madison, Jefferson and other Virginians under which the Virginians would support assumption of state debts, and the Administration would support moving the capitol to a location on the Potomac River. The assumption proposal was thus approved, much to the dismay of some anti-federalists. Maclay lamented in his Journal on July 17th: "[T]he assumption was forced on us to favor the views of speculation. . . . The whole town almost has been busy at it; and, of course, all engaged in influencing the measures of Congress. Nor have the Members of Congress kept their hands clean of this dirty work; from Wadsworth, with his boat-load of money, down to the daily six dollars,

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[36] Maclay, *Journal* at 174-75 (cited in note 34).

[37] Howard M. Wachtel, *Alexander Hamilton and the Origins of Wall Street*, Report-no: HW-02-101096. Available at SSRN.

have they generally been at it."[38]

Congress, when it created the office of the Secretary of the Treasury in 1789 ironically told Hamilton that it would not stand for his own involvement with speculating in federal or state debt. Congress provided that the Secretary of the Treasury and the Treasurer may not "be concerned with buying or disposing of obligations of a State or the United States Government" while in office and that an officer who violates this provision "shall be fined $3,000, removed from office, and thereafter may not hold an office in the Government.[39] The provision was intended to prevent high ranking Treasury officials from "speculating in the public funds."[40] The First Congress, however, said nothing about the fact that Members of Congress were themselves speculating in the public funds.

The First Bank

Hamilton sought to conduct national finances through a national Bank modeled on the Bank of England. The Bank would be chartered for twenty years and have capital stock not to exceed $10 million: $8 million from private investors and $2 million from the federal government. The government would own one-fifth and private investors four-fifths of the Bank's stock. Private investors could pay for three-fourths of their purchased stock in public debt certificates. The Bank would have power to issue negotiable notes that would circulate. Maclay and the other anti-federalists complained that the argument in favor of the Bank "resolved itself into this: that the public should find the specie to support the bank while the speculators, who subscribe [for bank stock] almost wholly in certificates, receive the profits of the dividends."[41] Congress nonetheless passed the bill establishing the Bank

[38] Maclay, *Journal* at 323 (cited in note 34). Six dollars was the daily pay of a Member of Congress.

[39] 1 Stat 65, 67 (1789), codified in 31 USC § 329 (2000).

[40] See 1 Annals of Congress 636 (1789) (statement of the bill sponsor, Representative Aedanus Burke).

[41] Maclay, *Journal* at 361 (cited in note 34).

in February 1791, and the First Bank of the United States received its charter.

It is debated whether, at least in its early years, the Bank helped stabilize the financial system. The initial stock offering for the Bank in July 1791 sparked speculative frenzy. Investors quickly bought $8 million in the Bank's stock, with Members of Congress among the purchasers. The stock price rose sharply and then fell sharply. In 1792, trading in new Treasury bonds fueled growth of a securities market near Federal Hall and brokers met to organize what became the New York Stock Exchange. Insider trading in the newly issued government bonds continued. William Duer used his connections with Hamilton to speculate in government bonds, but went bankrupt and helped precipitate a market crash in 1792. The Bank was hardly effective in controlling this speculation and ensuing panic.[42]

Hamilton's financial plan - and the establishment of the Bank - was also tied to a very unpopular idea: raising taxes. Hamilton's 1791 *Report on Manufactures* suggested protective tariffs. Congress raised tariffs on imports and imposed a tax on distillers. In Western Pennsylvania and elsewhere, the distillers' tax was a threat to farmers who used spirits as currency as well as drink. Some refused to pay. In 1794, a federal court ordered distillers to pay the tax, provoking the Whisky Rebellion. President Washington called in militia to put down the rioting.

The battle over Hamilton's economic plan thus pitched Northern commercial interests and speculators in depreciated federal and state debt against Southerners and farmers who believed the plan would enrich these vested interests at their expense. Banks were also by their nature suspect -- particularly a national bank modeled on the Bank of

[42] See generally Richard Sylla, *William Duer and the Stock Market Crash of 1792*, Friends of Financial History, No. 46 (1992); Robert E. Wright and David J. Cowen, *Financial Founding Fathers: The Men Who Made America Rich* (2006); David J. Cowen, *The Origins and Economic Impact of the First Bank of the United States*, 1791-1797 (2000) (blaming a sharp curtailment of credit by the Bank for the panic of 1792); David J. Cowen, *The First Bank of the United States and the Securities Market Crash of 1792*, 60 J of Econ Hist 1041 (2000).

England.

Thomas Jefferson was among those hostile to Hamilton's economic plan and to the Bank, the establishment of which he believed exceeded federal powers. When he became President in 1801, Jefferson abolished many of Hamilton's taxes, including the whisky tax, but he allowed the Bank to remain intact, in part to appease Federalists in Congress. After Jefferson left office in 1809 he continued his opposition to the Bank.

When the Bank's charter came before Congress for renewal in 1811, the Democrat-Republican party controlled Congress. Many state banks opposed renewal of the Bank's charter because they believed the Bank had unfair advantages. The House of Representatives defeated the re-charter bill by one vote.

The First Bank thus folded in 1811 when its charter expired. Merchant and financier Stephen Girard purchased most of the Bank's stock as well as the Bank's building in Philadelphia and founded the *Bank of Stephen Girard*, which loaned money to the government during the War of 1812 (Girard subscribed to 95% of the government's war loan of about $5 million). Thus began an American tradition of private financiers substituting for a national bank in times of financial emergency.

The Second Bank

The financial impact of the War of 1812, including inflation and unfunded debt, gave Congress and President James Madison second thoughts about the bank. Congress voted in 1816 to establish a new national bank, the Second Bank of the United States. Girard would become one of its principal stockholders.

The new Bank was allowed to control unregulated issuance of currency by demanding payment in specie for notes issued by state banks. Predictable opposition came from state banks as well as farmers and others in favor of expansionist monetary policy. The state of Maryland was persuaded by its banks to tax all banks not chartered by

the State. When the Bank challenged the tax, Maryland argued that the Bank was unconstitutional. The case went to the Supreme Court where Daniel Webster argued on behalf of the Bank. The Supreme Court, in *McCulloch v. Maryland,*[43] an opinion by Chief Justice John Marshall, held that creating the Bank was an exercise of legitimate fiscal powers by Congress.

This holding, however, was not free of the tinge of bias. Chief Justice Marshall had not fully divested his own stock in the Bank, and had instead transferred the stock to family members before deciding the case in 1819. Chief Justice Marshall's flimsy effort to minimize the appearance of conflict without fully divesting his Bank stock, fueled the fire of controversy surrounding both Chief Justice Marshall's Supreme Court and the history of the Bank.[44]

In the financial crisis of 1819, the Bank reigned in available credit, and received part of the blame - at least in the press - for the economic hardship that followed.

In 1823, Nicholas Biddle, of a prominent Philadelphia family, became President of the Bank, making it even more vulnerable to attack by populists. Biddle launched an aggressive publicity campaign on behalf of the Bank, allegedly paying newspaper editors Mordecai Manuel Noah and James Watson Webb, among others, to be advocates for the Bank. He also caused the Bank to grant low interest loans and consulting contracts to Members of Congress who would support the Bank. As Judge John Noonan recounts in his book on the history of bribes, Nicholas Biddle kept a handwritten list of "congressmen, federal officials and newspaper editors, liable to the Bank as borrowers or guarantors" including "James Monroe, down for $10,596; Henry Clay in the amount of $7,500 and Daniel Webster liable for $17,782".[45]

Corruption thus again gave ammunition to the Bank's political

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[43] 17 US 316 (1819).

[44] This issue apparently did not come up until later, in 1837, when Senator William Smith of South Carolina alleged that Chief Justice Marshall had decided the case without fully divesting. See John T. Noonan, Jr. and Kenneth I. Winston, *The Responsible Judge* at 280-85 (1993).

[45] John T. Noonan, Jr., *Bribes* at 444 (1984).

opponents, now led by President Andrew Jackson. The Second Bank, like the First Bank, had financial ties with members of Congress. The Bank also spent substantial sums of money supporting Jackson's opponents in political races.

Two Senators in particular were strong allies of Nicholas Biddle and the Bank, Daniel Webster and Henry Clay. Webster, who was originally elected to Congress as a Federalist opposed to the War of 1812, initially also opposed the formation of the Bank. Gradually, however, Webster grew closer to the Bank and to Nicholas Biddle.[46] Webster argued several cases for the Bank in addition to *McCullough v. Maryland*, including *Bank of the United States v. Dandridge* and *McGill v. Bank of the United States*. Webster agreed to be on the Board of directors of the Bank's Boston branch. Webster was paid for these services during his term in the Senate. Webster was thus the Bank's principal lobbyist and lawyer, at the same time as he was a Senator voting on, and speaking eloquently on behalf of, the Bank's future.[47] In 1833, when the Bank's charter renewal was before Congress, Senator Webster wrote Biddle:

> "Since I have arrived here, I have had an application to be concerned, professionally, against the Bank, which I have declined of course, although I believe my retainer has not been renewed, or refreshed, as usual. If it be wished that my relation to the Bank should be continued, it may be well to send me the usual retainers."

The implication was clear - if the retainers were not sent, the Bank might lose far more than Webster's services as an attorney at law.[48]

Henry Clay had his own ties to the Bank. He left Congress for

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[46] Webster constantly had financial difficulties. Professor Gordon aptly described the ethical fall of Webster in his review of Webster's papers. See Robert Gordon, *The Devil and Daniel Webster*, 94 Yale L J 445 (1984).

[47] See Charles M. Wiltse and Harold D. Moser, eds., 2 *The Papers of Daniel Webster* (1989) (correspondence with Biddle).

[48] Noonan, *Bribes* at 444 (cited in note 45) (quoting this correspondence).

two years in 1821, after incurring substantial personal debt, and served as general counsel of the Bank from 1820 to 1825. In 1823, he again became a Member of Congress and was elected Speaker.[49] In *Osborn v. United States*, Clay and Daniel Webster argued on behalf of the Bank challenging the constitutionality of a tax that Ohio levied upon the Bank.[50]

The Bank's charter came up for renewal in 1836, but Biddle and his allies in Congress decided to force the issue four years earlier in 1832, when President Jackson was up for reelection and was running against Henry Clay. The Bank was to become a key issue in the Presidential election and Daniel Webster spoke strongly in favor of the Bank in his speech on the Senate floor. Apparently there was no mention by him of his ties to the Bank. Congress passed a bill renewing the Bank's charter. Jackson vetoed the bill.

In his veto message of July 10, 1832 Jackson pointed out his numerous objections: That the Bank enjoyed a monopoly on the Federal Government's banking; that one fourth of its stock was held by foreigners and the rest by a few hundred of the richest Americans; that these relatively few very wealthy private stockholders would elect 20 of the Bank's 25 directors, while the government chose only five directors, virtually assuring that incumbent management could remain in office and concentrating power in the hands of a few men "irresponsible to the people"; that the Bank was a threat to democratic government because any public functionary who sought to curtail its powers "would be made to feel its influence"; that the Supreme Court was wrong in deciding that the Bank was constitutional and that Congress and the Executive branch had a responsibility to decide this for themselves; and that "the rich and powerful too often bend the Acts of government to their selfish purpos-

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[49] See Maurice Baxter, *Henry Clay and the American System* (1995). See also, *The Henry Clay Family, a Register of Its Papers*, Library of Congress, Manuscript Division (2000) (containing correspondence between Clay and Biddle about the Bank).

[50] 34 US 573 (1824). Clay sought to force Ohio's auditor to return improperly seized taxes to the Bank. The Supreme Court sided with the Bank and ordered the auditor to return the money.

es" and it is wrong for the law to bestow "gratuities and exclusive privileges" on the rich, of which the Act for renewal of the Bank's charter was an example.[51]

The President's veto message did not reference specific examples of the Bank's corruption of Democratic process, but his condemnation of the corrupting influence of the Bank on government was clear. The bank was not just an economic threat, but a threat to democracy itself, and it had to go.

Senator Webster gave a point-by-point rebuttal of the President's veto message. The President, he said, had usurped the Supreme Court's role in passing on the Constitutionality of the Bank. Webster also argued that the Bank was chartered by Congress to serve the public interest, not simply in order to further private gain: "Congress passed the bill, not as a bounty or a favor to the present stockholders, not to comply with any demand of right on their part, but to promote great public interest, for great public objects."[52] This argument would have been more convincing if Webster himself had not had extensive financial dealings with the Bank.

Jackson appeared to have the moral high ground. Jackson won his battle largely because his political power overshadowed that of the patrician Nicholas Biddle. The Bank's corruption of Congress also helped give Jackson the moral upper hand. Webster may have been right that the Bank was in the public interest, but his characterization of Congressional motives was disingenuous when he himself, being both a Senator and a lawyer on retainer for the Bank, served public and private interests simultaneously.

After his 1832 reelection, Jackson undermined the Bank further, leading to its early demise. He redirected federal deposits from the Bank to state banks. He then demonstrated his hostility to all banks, and to paper money in general. Jackson's July 11, 1836 Specie Circular required the government to accept only gold and silver in payment for

[51] James D. Richardson, ed., 2 *A Compilation of the Messages and Papers of the Presidents, 1789-1908* at 576 (Government Printing Office, Washington, DC, 1908).

[52] 8 Reg Deb 1221 (Reply of Senator Daniel Webster, dated July 11, 1832).

sale of federal land. In 1837, immediately after the election of Jackson's successor Martin Van Buren, the country went into a financial crisis and deep depression, arguably because of Jackson's banking policies.

Allowing the Bank's charter to expire may have been a mistake for years to come. In 1907, for example, the absence of a central bank meant there was no lender of last resort to banks that got into trouble acting as underwriters and investors in securities markets. A credit crunch in the Spring of 1907 was triggered in part by financing demands abroad for the Boer and Russo-Japanese Wars. In March, the stock market fell precipitously. In October, a run on the Knickerbocker Trust Co. of New York caused the bank to close. Other banks failed. J.P. Morgan - like Stephen Girard in 1812 -- had to function much like a national bank, putting together a consortium of Wall Street financiers to bail the Country out of crisis. Morgan's consortium coordinated with the Treasury Department to rescue other banks, and Treasury provided them with about $30 million for this purpose. Morgan also provided funds for the New York Stock Exchange.[53] Morgan was rumored to have detained other New York bankers in a room where he would not let them out until they reached agreement on the bailout terms. He essentially acted as a national bank in the crisis.

The United States did not have a national bank again until the Federal Reserve was established in 1913, over two centuries after the founding of the Bank of England in 1694.

The Second Bank of the United States, like its predecessor, however, was partly to blame for its own failure. The Bank's actions reinforced Jackson's argument that having a national bank corrupted the political system. Webster, and the Bank's other supporters in Congress, by participating in the corruption or tolerating it, also shared in the blame.

III. Modern Parallels

In the beginning of this lecture, I mentioned the accounting

[53] See Jean Strouse, *Morgan: American Financier* (1999).

scandals of the 1990s. The Sarbanes-Oxley Act goes well beyond disclosure, the traditional subject matter of federal securities regulation, and deep into corporate governance. The auditing industry is now subject to extensive federal regulation. Some have argued that these restrictions make the United States less, rather than more, competitive in the global market for capital. Could this be our version of the Bubble Act?[54]

Looking beyond our borders, we also see examples of how corruption of government by business is not just bad for government. In the long run, it is bad for business. Russia's experiment with free market capitalism in the 1990's was fraught with corruption of both business and government - mostly by Russians, but even some American economic advisors invested in Russian securities despite a promise to the United States government that they would avoid conflicts of interest.[55] Russia has responded in a typically Russian way - reassertion of absolute authority over both the economy and the political system by a central government.[56] Parts of Latin America appear to be going in a similar direction.[57]

Non Governmental Organizations such as Transparency International have made fighting corruption globally a top priority. For the reasons I have discussed today, historical and contemporary evidence suggest that business interests ought to support these efforts vigorously.

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[54] See Ribstein, *Bubble Laws*, 40 Hous L Rev 77 (cited in note 15).

[55] See *United States v President and Fellows of Harvard College*, Civil Action No. 00CV 11977DPW at 2 (September 26, 2000) (settled in 2005 with payments by defendants totaling over $31 million) ("The United States alleges that Defendants' actions undercut the fundamental purpose of the United States program in Russia - the creation of trust and confidence in the emerging Russian financial markets and the promotion of openness, transparency, the rule of law, and fair play in the development of the Russian economy and laws.").

[56] See Marshall Goldman, *The Piratization of Russia: Russian Reform Goes Awry* (2003).

[57] See Paulo Prada, *Bolivian Nationalizes the Oil and Gas Sector*, New York Times (May 2, 2006).

Here in the United States, there is a lot of regulation aimed at corruption in government and business, and perhaps more soon to come. The nagging question is whether we fight corruption simply by adding another layer of regulation every time a scandal breaks, particularly if politicians are caught up in it.

After Watergate, federal ethics rules became complex in many areas including financial disclosure, financial conflicts of interest, employment relationships, negotiating for employment in the private sector, and so forth. Criminal and civil statutes apply, as well as rules promulgated by the Office of Government Ethics.

The ethics office that I supervise in the White House works with every Presidential nominee to a Senate confirmed position in the Executive Branch to assure that these rules will be complied with. Each Executive Branch agency has its own ethics office, headed up by its own Designated Ethics Officer. The amount of paper work is extensive.

The press and public, however, perceive that gaps remain. The lobbying industry has grown substantially in recent years, although lobbyists have for a long time been a fixture in Washington - the word came from the lobby of the Willard Hotel, near the White House, where influence peddlers would wait for members of President Grant's administration to come over to drink and smoke cigars. The lobbying industry is not regulated the same way as the legal profession. Disclosure of lobbying contacts is the regulatory norm for lobbyists, and substantive standards of conduct are relatively lax, whereas substantive standards of conduct are the norm for lawyers. More disclosure by lobbyists may help, but will it be sufficient?

Finally, the high cost of election campaigns enhances an avenue of influence that Nicholas Biddle experimented with when he funded the campaigns of President Jackson's political opponents. A senator today cannot represent private banks on the side, and collect a "retainer", as Senator Webster did from the Bank of the United States, but a senator can receive campaign contributions from banks. First Amendment concerns make the campaign finance avenue of influence far more difficult to constrain than the other methods that Biddle used

to influence Webster and his colleagues. Full disclosure of campaign contributions may be the only practical approach. How we will deal with this and other contemporary challenges to the integrity of government and business has yet to be determined.