The Economics of Multiple Governments: New Jersey Corporate Chartermongering 1875-1929

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Three of the four firms Alfred Chandler investigated in *Strategy and Structure* [3] (DuPont, General Motors, and Standard Oil) incorporated in New Jersey. DuPont and General Motors both reincorporated in Delaware in 1916. Appendix A of *The Visible Hand* [4] lists 278 American industrial enterprises with assets in excess of $20 million as of 1917. Of the 271 listed in *Moody's Manual* [10], 32% held New Jersey charters at some point. New Jersey charters represented 42% of the fifty largest firms (by asset size) in 1917.

The large representation of New Jersey in Chandler's studies reflects that state's dominance in the incorporation of large industrial enterprises at the turn of the century-- particularly during the merger wave between 1895 and 1904. Ralph Nelson [11, p. 67] notes that New Jersey charters represented half of the mergers over $1,000,000, sixty percent of firm disappearances, and almost eighty percent of the capitalization of merged firms. New Jersey's dominance in the merger wave provided the impetus for this dissertation's examination of the legal and economic history of this chapter in American federalism [5].

In the first of three methodological perspectives on New Jersey chartermongering, the dissertation explored the fiscal history of the state's strategy. The New Jersey state budget relied primarily on railroads for tax revenue for the first three-quarters of the nineteenth century [6]. As the state's demand for revenue grew, this source dwindled and property taxes rose. The attempt to find a less politically sensitive source of revenue led state officials to adopt the chartermongering strategy-- the conscious relaxation of the state's corporation statutes to attract the legal domicile of firms. The strategy's success in raising revenue enticed several states to imitate New Jersey-- most notably Delaware, which copied New Jersey's statute almost verbatim [8, pp. 14-15]. However, not until New Jersey passed seven strict antitrust laws under Governor Woodrow Wilson, thereby reneging on the implicit contract with the firms, did Delaware replace New Jersey as the "Mother of Trusts".

The second methodological perspective documented the course of New Jersey corporate statutory law from 1875 through 1929. To this extent the chapter sought to extend John Cadman's work [2]. First appearing in 1888 and 1889, the core of the chartermongering strategy relied on general

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authority for corporations to merge and hold stock in other corporations. The state devised a number of enabling clauses in the 1890s that permitted structurally diverse firms to incorporate under the same general act. However, after the turn of the century, even while retaining its liberal general incorporation statute, New Jersey increasingly inserted regulatory provisions in the laws affecting firms operating *within* the state. Such legislation coincided with development of the state's economy generally-- a phenomenon that indirectly undermined the state's chartermongering strategy.

The final perspective utilized the historical results of the preceding chapters to develop a theoretical model of the chartermongering phenomenon in a game-theoretic context. The model supposes that firms seek to merge in order to acquire market share and exercise market power. States of differing budgetary size presumptively maximize the sum of consumer and producer surplus. With these hypotheses, and using arguments partially based upon Romano [12], the analysis suggests that firms seeking to exercise market power incorporate in states with small, rather than large, budgets. Small states charter large firms and encourage them to operate outside their borders, thereby imposing a legal externality on large states. Competition among small states implies that the law of the smallest state prevails. Although extremely stylized, this model seems to capture much of the qualitative results of the historical and legal analysis.

Business historians should see this dissertation as a complement to their work on individual firms and groups of firms. The corporate chartermongering episode in these years reflects the dual function of law in the economy: both rationalizing economic behavior through constraints and adapting to changing technological and economic forces. As Chandler [4] has documented, the changing technological and organizational requirements of industrial enterprise implied increases in the size of these firms. New Jersey's holding company and merger laws in the late 1880s and early 1890s helped provide the legal basis for that change. Where Naomi Lamoreaux [7] examined the merger wave between 1895 and 1904 from the firm or industry perspective, this work provides a partial view of that phenomenon from the perspective of the state. After the turn of the century, the challenge other states posed to New Jersey's title as the "Mother of Trusts"-- most prominently, by Delaware-- suggests that the organizations we call state and local government have their own strategies and structures which interact in economically important ways with those of private firms.

The structure and evolution of the law resulting from this interaction has far-reaching effects. U.S. corporations continue to incorporate on the state, rather than national, level of government. At the turn of the century critics argued that New Jersey's chartermongering strategy undermined the antitrust and security laws of other states. As part of a larger work on these issues, a paper in progress argues that as these external effects of state incorporation law passed to the national level, state law became less of a social issue. Increasingly, state incorporation law concerned only the internal relationships of the firm: those between shareholders, management, and creditors. Because of this division of corporate law between the national and state governments, state incorporation law became "trivial" [1]. If, as William

Lazonick [9] recently argued, effective control of corporations has begun to shift from managers to shareholders, thereby undermining traditional incentives for long-term investment, the existing division of corporation law between the national and state levels may play a prominent role in that shift. While trivial from the perspective of the issues of 1900, the anomalous mismatch between spheres of regulatory and economic activity inherent in our system of state incorporation law may impose significant social costs on a different dimension today.

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