Should Government Build the Railroads?

by Burton Folsom, Jr.

On July 12, 1831, President Andrew Jackson, who was no prankster, did something that made many people laugh, some curse, and others rub their eyes in disbelief. He appointed 19-year-old Stevens T. Mason to be secretary and acting governor of the Michigan Territory.

Granted, Mason was a very intelligent teenager and his family was nationally prominent. But surely, his critics wondered, this was the worst case of political patronage ever seen. During the next ten years, however, the youthful Mason would often vindicate Jackson's judgment. Mason went from acting governor to elected governor. He plotted the strategy that brought Michigan into the Union, and he made deals that defined Michigan's boundaries on two peninsulas. Unfortunately, he also launched a gigantic scheme of state-run railroads and canals that almost bankrupted the state. As a result, Michigan voters went to the polls en masse to make their state a haven for free enterprise for the rest of the century.

The Mason story begins not in Michigan, but in New York, along a remarkable ditch that was dug in the 1820s. The Erie Canal, an astonishing achievement in engineering, had a big impact on American thinking. Here we had a canal 364 miles long that connected the Great Lakes with the Atlantic coast—and it was built not by entrepreneurs but by the state of New York. Suddenly New York City could trade with farms and cities throughout the midwest. Profits from tolls flowed into the state, and the whole Great Lakes region was open to settlement and trade.

Shortly after 1825, tens of thousands of New Yorkers and New Englanders filtered into Michigan via the Erie Canal. Governor Mason himself used the Erie Canal eagerly when he had to go to Washington to see President Jackson. Almost everyone in Michigan gushed with praise for this new canal, which brought them immigrants and took their exports. The message seemed obvious: states that want to get ahead need active governments to tax their citizens to build a transportation network.

To compete with New York, for example, Pennsylvania spent $14.6 million on its Main Line Canal from Philadelphia to Pittsburgh. Maryland and Massachusetts joined in the rush with a variety of state-supported projects. Illinois and Indiana began elaborate canal networks in 1837, just when Michigan entered the Union. This was when railroads were being built, and some states began to lay track and buy locomotives.

The State as Creator

To Mason this was all exhilarating. Maybe the traditional theory of limited government was wrong. Maybe states could be creators, at least in the area of transportation. And after all, it was state governments, not the one in Washington, that were building these canals.

Even as territorial governor, Mason urged Michigan to lay the foundation for the state to build internal improvements. When delegates met in 1835 to write the Michigan constitution, they—with Mason's encouragement—wrote the following into law:

> Internal improvements shall be encouraged by the government of this state; and it shall be the duty of the legislature, as soon as may be, to make provisions by law for ascertaining the proper objects of improvement, in relation to [roads], Canals, and navigable waters. . . .

In other words, Michigan's constitution almost required the state to fund internal improvements.

After this constitution was adopted, Mason publicly supported an activist state government. "The spirit and enterprise which has arisen among our citizens, if fostered and encouraged by the State, cannot fail to lead to lasting prosperity," Mason said. By 1837, three weeks before Michigan entered the Union, Mason was more urgent: "The period has arrived when Michigan can no longer, without detriment to her standing and importance as a state, delay the action necessary for the development of her vast resources and wealth." He was also optimistic: "we cannot fail soon to reach that high destiny which awaits us. I . . . demand immediate legislative action."

With Mason leading the cheers, the legislature met and almost unanimously passed an elaborate internal improvements bill. Democrats and Whigs alike joined in the public support for it. When the alternate strategy of private ownership came up, Mason recommended that the canals and railroads "should never be beyond at least the partial control of the state." "Extortion from the public" was what Mason called one bill to charter a private railroad. Most Michiganians seemed to agree. The Detroit *Daily Advertiser* noted that "Dewitt Clinton . . . built the [Erie] Canal with the funds of the state. What would be thought of the policy of surrendering that great work to the control of a private corporation[?]"

The example of the Erie Canal had become the ace that trumped all opposing arguments. And if one state subsidy was good, two must be better, and three better yet. Michiganians were so confident that state projects would flourish that they promised to build two railroads from Lake Erie to Lake Michigan, and a couple of major canals across the state as well.

Bad Luck, Bad Judgment

Mason thought the state should spend $5 million to build these projects. Actually, that was just start-up money. As soon as the anticipated tolls started pouring in—as happened with the Erie Canal—the state could then build more. The legislature approved the $5 million. Then the legislature authorized the governor to negotiate a $5 million loan with the lender of his choice under the best terms he could get, as long as he didn't exceed 5¼ percent. The state, in this arrangement, would issue bonds for the $5 million and pay them back as tolls came in from the railroads and canals.

Bad luck was the first problem to strike. The national economy went into a tailspin—the Panic of 1837—and capital was hard to borrow. Then came distractions. While in New York to talk with investors and study the bond market, Mason became sidetracked by Julia Phelps, the daughter of a wealthy leather merchant, Thaddeus Phelps. Mason courted and married her in 1838.

Then came bad judgment. Businesses were failing because of the panic, and most sound investors wanted more than 5¼ percent for their money. Mason finally persuaded the officers of the Morris Canal and Banking Company, a reputable firm, to buy the Michigan bonds. They promised to pay him the $5 million in regular $250,000 installments over several years. Mason gave them the bonds and went back to Michigan with their promise. The Morris Company turned most of the bonds over to the Pennsylvania Bank of the United States, which then sent them to Europe

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