# Corruption in Cities:
# Graft and politics in American cities at the turn of the Twentieth Century

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Version of September 30, 2001

Acknowledgments:
The author would like to thank Ed Glaeser, Claudia Goldin, Aaron Tornell and Naomi Lamoreaux for useful comments upon this paper. The author gratefully acknowledges fellowship support from the National Science Foundation, The Sloan Foundation, the Josephine de Karman Foundation, the Richard Irwin Foundation, the Joint Harvard-MIT Research Group in Positive Political Economy and the National Bureau of Economic Research. All errors remain the responsibility of the author.

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> "There's an honest graft, and I'm an example of how it works. I might sum up the whole thing by sayin': 'I seen my opportunities and I took'em'"
>
> George Washington Plunkitt[1]

## Introduction

Popular reports on machine politics have always featured tales of bribery, theft, graft, kickbacks, political influence peddling, insider trading and criminal cover-ups. Tales of official mis-deeds have sold newspapers from the *New York Times*' reports on Boss Tweed's "ring" in the early 1870s, through Lincoln  Steffen's essays on municipal corruption in *McClure's Magazine* in 1902 and William Riordan's interviews with Tammany District Captain George Washington Plunkitt published by the *New York Evening Post* in 1904, to the "Mirage" series in *Chicago Daily Herald* in the 1970s.[2] Academic scholars, however, have shied away from the more sensational aspects of urban politics, concentrating instead on the power relationships, especially on the relationship between political machines and the voters. It is assumed (with some justification) that machine politicians were not obviously more corrupt or self-serving than other politicians and therefore (with less justification) that there is little to be learned by studying the economics of political graft in American cities during the Progressive era.

However, since economists and political scientists identify corruption as a cause of slow economic growth in the developing world, machine politics in American cities at the turn of the

[1] Plunkitt was a local boss in New York City's Democratic "machine," Tammany Hall. He was unusually willing to talk about his activities as a member of the New York machine. In the early years of the twentieth century he gave a series of interviews to William Riordan, a reporter for the *New York Evening Post*, which were republished in book form in 1905. Though it is sometimes difficult to separate writer and subject, the <u>Series of Very Plain Talks on Very Practical Politics</u> is almost the only written source in which the machine politician is allowed to defend himself. (Riordon 1905, p.3)

[2] For a history of the New York Times' role in fall of Boss Tweed, see Mandelbaum (1965). The other series' popularity led to book versions: Riordan [1905] 1991, Steffens [1904] 1957, Smith and Zeckman 1979.

century presents the modern political economist with a quandary. Rent seeking activity on the part of government is generally believed to be bad for growth. The social cost of rent seeking activities is higher than the amount redistributed. Rent seeking activity, it is often claimed, is particularly damaging to innovative entrepreneurial activity, as new and rapidly growing firms are particularly susceptible to rent-expropriation. (Murphy, Shleifer and Vishny 1993) Machine politicians are generally agreed to be rent seekers and clientelist systems are cited as one of the causes of poor economic performance in southern Italy, India, and Mexico in the post-World War II period. But American cities between 1890 and 1920 were among the most rapidly growing and economically vital communities the world has known. And U.S. cities are not the only corrupt yet successful polities – both Korea and Japan have notoriously corrupt political systems. The question therefore is why does rent-seeking activity appear to cripple economic growth in some communities, while in others the damage is much less? The relationship between rent-seeking and growth deserves more study and American cities during the Progressive era is a good place to start.

The study of graft in U.S. cities may help explain when and how political systems change in response to graft and corruption. The nature of graft in 1900 sheds light on the motivations and identities of "Reformers" who were to restructure city government in the years between 1890 and 1920. The analysis also helps explain the timing of the rise and fall of political machines in American cities – why they emerge as the dominant political structure in the 1890s, and why they are fading (in most, although not all) cities by the 1930s.

Graft and corruption alter the incentives facing politicians, businessmen, workers, and voters. Recent work on corruption and graft in developing and post-Soviet countries suggests that the social costs of corruption are a function of the structure of the “market” for influence and favors. The structure of the “market” is the result of both economic and political constraints. (Shleifer and Vishny 1993) Following the framework suggested by the development literature, this essay is a qualitative report on the urban graft which developed in machine run cities in the first decade of the twentieth century, based on the examples reported by contemporary observers. I want to know which sectors of the city economy were susceptible to revenue extraction, what was the incidence of the revenue extraction, and what were the political and economic consequences of revenue extraction.

In the first section following this introduction I develop an intellectual framework for thinking about kleptocratic government. The framework, although developed with the behavior of Progressive era machine bosses in mind, should have wider application for thinking about government rent-seeking. In the second section I apply the theoretical framework to the record of Progressive Era urban graft. Although it is impossible to carry out a quantitative cross-city analysis of urban graft during the Progressive era (the Bureau of the Census does not provide a survey of graft by city department, as it does annually for taxes, fees, and expenditures) it is possible to construct a thorough qualitative picture of the pattern of graft in large American cities from the numerous accounts of misdeeds and shady doings revealed in court proceedings and reported by investigative journalists. The examples of graft reported here are drawn from a number of sources. The most important source is Lincoln Steffens’ essay series, *The Shame of the Cities*, in which he chronicles at least 90 separate instances of graft in six cities. From these examples I deduce the pattern of graft and collusion that determines the burden of graft and the identity of the winners and losers. In the final section I develop the implications of urban graft. I consider how the kinds of graft practiced (and not practiced) encouraged city growth, how it encouraged local manufacturers to oppose political machines, and how the dependence on certain kinds of graft explain why political machines emerged in the 1890s, dominated local politics in the biggest cities for nearly forty years, and then disappeared.

## 1. Definitions and Theory

### 1.1 Kleptocracy and Graft

A <u>kleptocracy</u> is a government with the objective function of maximizing the profits the politicians take home. A kleptocrat is not interested in graft *per se* but in revenue extraction. <u>Revenue extraction</u> by a government is exactly what it sounds like, the extraction of material wealth from citizens. <u>Graft</u> is revenue extraction by illegal means. Not all revenue extraction is graft. But graft is necessary when the revenue extracting official is constrained by stronger powers or subject to the rule of law. In a democratic city, with power divided among different branches within the city and shared between the city, state, and federal levels, even politically powerful kleptocrats cannot legally expropriate city funds without explanation. Therefore in this essay I will use the two terms essentially interchangeably. Graft is not the only corrupt act. Corrupt acts may be (loosely) defined as acts by which a government official, elected or appointed, abuses his power by using it for purposes for which it is not legally intended. Vote buying, for instance, is a corrupt act but it is not graft, because no revenue is extracted.

### 1.2 City politics

At the end of the nineteenth century the governments of many (though not all) large American cities came to be dominated by what was known at the time as “machine” politics,–patronage based political systems where the government dispensed private favors in exchange for votes and governed not through the legislative process but through back-room deals between the "boss" and interested parties. By the term "political machine" I do not mean simply a city government dominated by working class Irish politicians, but a particular political institution with the three characteristics 1) private deals between government and citizens, especially the exchange of government provided tangible favors for votes; 2) a large hierarchy of local politicians who carry out the exchange of favors for votes; and 3) a boss who organizes the work of the local politicians, centralizing the collection of votes and of revenue and paying the local politicians by sponsoring them for elective office or employing them in municipal jobs. Machine politics can be understood as a political technology which, under certain conditions, will maximize the extraction of revenue from a democratic city (or state, or nation.) The machine's advantage over alternative political structures is the ability to deal individually with each voter/taxpayer. Information is the key to this power. The machine politicians know how much to pay for votes, and how much extortion firms can bear before leaving. The drawback to machine politics is the cost of organizing the "machine" to gather information, deliver votes, and collect bribes. (Menes 1997)

This essay is largely an analysis of graft as practiced by politicians in machine dominated cities. There were also non-machine run cities in America between 1900 and 1920.[3] Some of these non-machine regimes were certainly corrupt. San Francisco under the political control of Abraham Ruef, or Minneapolis during the tenure of Doc Ames were probably two of the most corrupt urban regimes ever to disgrace American cities, but neither organized a true machine.

[3]In a previous survey of the secondary literature, of the 47 cities for which I have found political histories covering the years between 1900 and 1920, 24 had important machine organizations which controlled city government for at least ten of the twenty years. (Menes 1997)

(Bean 1968; Steffens [1904] 1957) Likewise there were relatively honest machine governments, such as Boss Speer's rule in Denver. Even when the Boss was personally honest, however, the machine system remained kleptocratic. The political lieutenants on which the Boss depended demanded access to graft as the payment for their loyalty, and their loyalty was for sale to the highest bidder. A political machine also had advantages over a non-machine kleptocrat in collecting graft. The information advantage enjoyed by the machine gave the system advantages in graft collection, as already pointed out. A political machine also may have had an advantage in dealing with the legal system. The legal structure of the city was set up to insulate the courts from political influence, but the shadow government of machine hierarchy gave the boss control over political appointees on the bench and in the D.A.'s office. Even elected officials were beholden to the machine because the machine controlled the nomination process. The most corrupt machine governments may not have been absolutely more corrupt than the worst non-machine cities, but the famously corrupt, long-lasting regimes, such as Omaha under Boss Dennison or Jersey City under Boss Hague, were machines. Greedy non-machine kleptocrats, such as Ruef and Ames, were usually caught and prosecuted relatively soon after taking power, and were also often betrayed by close associates who turned states evidence. The machine politician may not have been inherently greedier, but the qualitative evidence suggests he was more effective.

### 1.3 The City Economy

The real wealth of a city grows either because the urban quality of life improves or because the economic return to location in the city rises. Economic returns, wages and return on capital and a large proportion of the returns on city real estate, are dependent largely on trade with other cities. The “base” or “export” industries are a fundamental source of economic growth and economic wealth in the city. At the turn of the century the export manufacturing sectors in most cities were growing rapidly, fueling population growth and increasing the size and profitability of domestic industries and the demand for public infrastructure. At the same time technological advances in the provision of public goods (clean water, sewerage, generally better understanding of public health, advances in police and fire protection, etc.) and in public transportation increased the quality of life in the large cities, compared to farms, small towns, and suburbs.[4] Rapid industrial growth and rapid improvement in the quality of life in cities encouraged city growth and an explosion in the value of city property.

City growth does not increase the pecuniary return to political control unless the city government can expropriate at least some of the increased wealth. The government of a city can only expropriate profits if the firms and individuals cannot relocate inexpensively to good alternative locations. If cities compete for firms and workers then the increases in social surplus will go to the owners of capital and labor. A city competes both with other cities and with the adjacent suburbs for population and for industry. Advantages which tie a firm to a particular urban location include access to specialized city labor markets and access to transportation networks and hence to both inputs and markets for output. Several conditions unique to the years between 1890 and 1930 undoubtedly increased the power the city government had over the city economy. Cities could control access to the labor market not only because cities contained large numbers of workers, but also because the city government controlled the local transportation

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[4]It is around the first decade of the twentieth century that city life expectancy surpasses rural life expectancy in most parts of the industrialized world.

system, the street railroads. Street railroads concentrated commuters in the central city, encouraging firms to locate in the city and not in the suburbs. Cities could also, to a large extent, control access to the national railroad network through their control of the firm's right to connect over city streets to rail yards or the main-line. Port cities, such as New York, exerted similar control over access to the docks. Innovations in public infrastructure, energy, and communications technologies also increased the value of city locations for firms and consumers alike. Many of these new technologies, such as water distribution, sewerage handling and electrical generating systems, had large fixed costs and were provided at first only by large cities and not by the surrounding suburbs. In fact, access to public infrastructure was one of the reasons that many cities were able to annex suburbs before the Depression.

Therefore we expect an important political difference between the domestic and export sectors which determines, in large measure, their relationships with a kleptocratic government in a city with open borders. The government can manipulate domestic markets, such as the markets for liquor or real estate, but it can do little to alter the markets in which export firms sell. If the borders are open the government can also do little to protect domestic markets in tradeable goods. There is little that the city government can do to improve the market position of most manufacturing firms, apart from running an efficient, low cost city. When the kleptocrat looks for allies amongst city businessmen, therefore, he will find them in the ranks of "domestic" interests, such as street railway and real estate development firms, not among the makers of cash registers or steel. Not that these business interests were above rent-seeking political alliances, but it was the national government, not the city governments, that could protect manufacturers from foreign competition in the domestic (U.S.) market, through quotas or tariffs on foreign goods.

For most of the nineteenth century manufacturers were politically active at the Federal level in support of high import tariffs.

### 1.4 A Taxonomy of Graft

Acts of graft may be categorized legally, by their economic nature, or by the identity of the government activity or responsibility which is compromised. The legal categories are traditional: embezzlement, patronage, bribe, payoff and kickbacks (or boodle). Scholars most commonly use legal categories when discussing corruption. (V.O. Key 1936) When considering the economic and political effects, however, categorizing graft by the type of economic transaction is more illuminating, as it allows us to (informally, in this essay) model the kind of "market" and the economic distortions involved. When investigating the actual graft it will be most useful to start with the nature of the government responsibility thus compromised, then map the government activities to their respective economic categories in order to predict the economic costs. Therefore in this section I define the economic categories of revenue extraction. Revenue extraction by a government can be divided into four economically distinct categories: 1) coercion (including taxation), 2) sale of government goods and services, 3) manipulation of markets, and 4) trading on insider information. These methods can be legal, or illegal, depending on local law, but the economic impact of the actions will in general be independent of the legality. The categorization is also independent of the type of polity, city, state, or country, or the nature of the regime, democracy, autocracy, aristocracy, theocracy, or other. The categorization can be used to compare the options available to machine bosses in 1902 to the range of options that they might, given other circumstances, have been able to exercise.

The social cost of a given level of government extraction, the dead weight loss, depends in part on which of the four kinds of revenue extraction the government is using. It is not possible in here to review the entire literature on taxation, trade regulation, and government monopoly, but a few observations can be made. First, the simplest version of coercion is taxation. Taxation of economic activity, in the absence of negative externalities such as pollution, incurs dead weight loss by discouraging socially optimal economic activities, such as trades or investment. The higher the taxes, the higher the distortion. If the tax rate is too high then the government will discourage enough activity that government revenue would rise if the government could credibly promise to lower tax rates.[5] Lump sum taxes, levied independent of behavior, do not distort economically (but are impossible to enact.) Second, governments can also generate revenue by manipulating markets. Governments can sell monopoly rights, or agree to ban imports in exchange for a payoff by import substituting firms. Manipulating markets to collect revenue also lowers total social welfare. The social cost of revenue raised through market manipulation may be considerably higher per dollar collected by the government than the social cost of taxation. In the case of taxation the distortion to markets is only an unintended side effect, but in cases of overt market manipulation the manipulation is the point.[6] Raising revenue via the third technique, by selling government produced output, on the other hand, may lead to an overall increase in social welfare. The production of public goods (such as maintenance of the

[5]Governments limit their own activity ex ante by agreeing to fixed tax rates in order to encourage taxable activity. Corruption can, in such an instance, lower overall revenue if private individuals expect that corrupt officials, ex post, will ignore the posted tax rate and attempt to expropriate most or all of the economic profits an individual has earned through his labor or investments. (Shleifer and Vishny 1993, DeLong and Shleifer 1992)

[6]Much of the literature on the political economy of trade policy deals with revenue extraction through market manipulation.

legal system), goods with significant positive externalities (education), and the regulation of natural monopolies (water and mass transit), are often argued to be the purpose of government. Of course, the kleptocratic government may not produce the socially optimal quantities or charge the socially optimal prices for these goods. The socially optimal prices on government produced goods will, in general, not be the revenue maximizing prices (they may not even cover the costs of production.) The government may, however, be able to function as a price discriminating monopolist and thereby achieve the socially optimal outcome while raising the maximum revenue. Finally, many government actions, especially those that involve the production of public services, can alter the value of private property in the city. Officials who know of city plans in advance can enrich themselves through insider trading. Redistribution of windfall gains is not economically distorting (it may be "unfair" or have undesirable effects on income distribution.) The opportunity to enjoy windfall profits, however, may encourage a corrupt government to manipulate markets in order to increase opportunities for lucrative trading.

The political costs of revenue extraction depend in part on the level of extraction and the dead weight loss and in part on the incidence of the graft or extraction. In general, the more diffused the incidence, with a large number of individuals each paying a small amount, the less likely it is that the group will organize for effective collective opposition. On the other hand, in a democracy, the more widespread the costs the larger a fraction of the population may be willing to vote against the grafting government if they have the opportunity. Reform support, therefore, may be quite widespread but reform leaders are likely to emerge from sectors where incidence of graft is concentrated. In a world of "optimal" graft the political opponents to the machine will be those who benefit the most from location in the city. City residents with a lot to lose may include manufacturers, but will also include owners of city real estate and franchises, contractors and builders, and any others who might otherwise benefit from the rapid growth of the city. In the "real" world the machine can buy the political loyalty of some of these groups, those active in local markets, by colluding with them to manipulate markets and share the revenue from graft.

## 2. Analysis of Progressive Era Urban Graft

To understand the reasons for, and the political and economic impact of, real graft it is necessary to analyze graft as it was practiced in 1900 in America's machine cities. Both market manipulation and insider trading are observed, as well as non-optimal (from the machine's point of view) taxation and non-optimal (from societies point of view) pricing of government produced goods.

### 2.1 Sources

The empirical analysis of graft is based largely on *The Shame of the Cities*, seven essays originally written by Lincoln Steffens in 1902 and 1903 for *McClure's Magazine* and arguably the finest survey of urban graft ever written. The examples from Steffens' essays are augmented by examples from William Riordan's book of interviews with machine politician George Washington Plunkitt and with examples taken from the secondary literature. (Riordan [1905] 1963) I use Steffens' essays as they were intended, as a chronicle of municipal corruption. Lincoln Steffens, though he made no pretense of impartiality, considered the essays to be reports from the field on the state of government and graft in American cities, not a treatise on the theory of good government. (Steffens [1904] 1957, p. 1) The essays report on government corruption in six cities, St. Louis (two essays), Minneapolis, Pittsburgh, Philadelphia, Chicago, and New

York, and chronicles approximately ninety separate examples of graft, kickbacks, vote buying, and other forms of corruption. Some of the examples are mentioned only briefly, but others are complete descriptions of complicated criminal conspiracies. Some of the reports of crimes are based on hearsay, but many reports are based on the results of criminal investigations and prosecutions of city officials. Steffens was not an unbiased observer, but his biases led him to report on rent-seeking and revenue-extracting corruption. Steffens believed business was the source of political corruption. He downplayed the sorts of corruption--vote buying and favors to the poor--that so infuriated other reformers, such as the English observer Lord Bryce. (Bryce 1888) There is no evidence that Steffens played favorites among businessmen. He does not excuse any sector from scrutiny or from censure.

Five of the six cities are controlled largely or in part by a political structure with the three requisite features of a machine: boss, patronage hierarchy, and vote buying, though in two of the cities, New York and Chicago, reform politicians have (briefly) gained significant power in 1902. The sixth city, Minneapolis, is a stunning example of corruption without a machine. The administration of mayor "Doc" Ames and his henchmen was certainly corrupt, interested in extracting could be had through their control of the police and the courts, but Ames never built the rest of the machine organization. According to Steffens Ames never intended to run for reelection, but was apparently trying to steal what he could before he lost office. (p.47) The corruption in Minneapolis suggests that control of a machine gave a boss control of much more of the government and hence access to a much wider array of revenue raising techniques than simple control of the mayor's office could yield. Corruption in the Ames' regime was limited almost entirely to kickbacks from vice and property crime sanctioned by the police. Ames controlled only a small part of the government, the mayor's office and the police, but not the legislature, and during his relatively brief tenure he did not use his political popularity and political connections to bargain for more power within the city system. As I am largely interested in corruption in machine cities most of the evidence on graft is drawn from the essays on the other five cities.[7]

I have organized Steffens' reported deals by the type government activity involved, and then mapped the graft to the taxonomy of revenue extraction defined above. Local government at the turn of the century levied taxes, enforced the criminal code, provided both public and private goods and services to citizens, and contracted out to private firms to provide goods and services. All four activities could be and were turned to pecuniary advantage by machine governments. A government official could steal directly from the government, either cash or goods that have been purchased for some other purpose. The police or other law enforcement agencies could sell lax or differential enforcement of the criminal code, especially lucrative for selling protection to "vice" interests--drugs and alcohol, gambling, and prostitution. Most governments contracted with private firms for various functions, such as paving streets and operating transit systems and these contracts and franchises could be let on favorable terms for a consideration, or could be awarded to firms owned by city government officials. The government charged directly (not just implicitly through taxes) for goods provided to citizens or for access to the city infrastructure. Not officially part of any government activity, but also a source of graft – Any of these activities

[7]It should not be assumed that only machine politicians could build political coalitions within the government. In 1906 Abraham Ruef in San Francisco, for example, builds a "ring" and manipulates street car franchises for kickbacks. However the evidence suggests that the machine's abilities, especially the ability to deliver votes for almost any candidate, gave machine politicians unusual clout when assembling coalitions of kleptocratic city officials.

could also alter the returns to private property, and hence produce opportunities for insider trading.

The first observation, before turning to the economic and political ramifications of different kinds of graft, is that despite the relatively circumscribed responsibilities and limited sovereignty of city government the machine had at its disposal a wide array of graft opportunities which made it possible to extract revenue from a large number of important sectors of the city economy[8]. As previously noted, it is necessary for the government to have the techniques to extract revenue from all sectors of the city economy in order for the government to be the effective residual claimant and therefore have an incentive to protect and perhaps even promote growth.

### 2.2 Direct extraction from the city treasury

Although direct theft from the city was the theoretically simplest technique employed to extract revenue and place it in the private pockets of politicians and bureaucrats, by 1902 independent oversight of city accounts made outright embezzlement risky and politicians reacted rationally. As George Washington Plunkitt explains, in New York City under Tammany "The books are always all right. The money in the city treasury is all right. Everything is all right. All they [the reformers] can show is that the Tammany heads of departments looked after their friends, within the law, and gave them what opportunities they could to make honest graft." (Riordan [1905] 1991 p. 5) Steffens does report a single example. In Pittsburgh the City Attorney, W.C. Moreland, and his assistant, L.H. House, were convicted of embezzlement of

[8]Modern national governments have much broader powers and hence the kleptocratic official has an even greater array of potential revenue raising activities.

nearly $300,000 in public funds. Both of the men went to prison without revealing what they had done with the money, but later check stubs were found which indicated that checks for at least $118,000 had been made out to the Pittsburgh boss, William Flinn. (Steffens [1904] 1957, pp.120-121) One example among ninety descriptions of graft indicates rather the rarity of this form of revenue extraction. But although it was risky for politicians to take tax dollars home, the structure of the political machine, especially the reliance on patronage, did allow the machine to access the city budget to fund political operating expenses. The city budget was used to pay the internal expenses of the machine. Patronage hires to reward political supporters used tax dollars to pay for the machine. Though Steffens was less interested in patronage, he did report the selling of positions in the police department in Minneapolis (p.48) and of teaching positions in Philadelphia (p.155) I have also found the costs of machine patronage in my own analysis of municipal budgets and wages. The wage premium on municipal wages compared to similar private sector wages was 8% higher in machine cities than in non-machine cities in 1909. The overall budgets in machine cities, controlling for size and region, are about 15% larger in the machine cities. Tax dollars were used to pay for the political support of the local politicians, the precinct captains and ward heelers, who staffed the machine. (Menes 1997) This increased cost undoubtedly slowed growth slightly, but the burden is relatively modest and the distortion likewise would have been.

### 2.3 Vice: Unofficial regulation of a market

Another method for raising revenue commonly employed by city government officials between 1890 and 1920 was collecting payoffs for tolerating establishments offering gambling, illegal alcohol, or sex.[9] All six cities, according to Steffens, generated revenue from "vice," though the methods of collection varied from city to city. In some cities, such as New York and Minneapolis (even before Ames) city officials and the police were directly involved and collected the payoffs in person. (pp. 47-65, pp. 206, 211) In some cities the relationship was more discreet, as in Philadelphia where "vice graft" was the business of "syndicates." (Steffens [1904]1957, pp.116-117.) The protection of vice is both production and market manipulation. The machine allows the production of goods and services that some voters want (even if the majority have voted to make them illegal.) The machine also limits production and extracts at least part of the resulting monopoly profits. The number of disorderly houses, gambling establishments, and saloons (legal and illegal) was regulated and the proprietors paid kickbacks in order to remain among the fortunate few to be selected to operate.[10] Opposition to implicit official tolerance of vice was rising during the Progressive Era, driven both by religious revivals and by growing intolerance for the foreign born (among whom the public consumption of alcohol was more common.) Rising intolerance meant rising pecuniary returns, but also rising political costs, for vice protection. There is no reason to believe that the provision of vice, however, had any particular impact on growth.

### 2.4 Insider trading

Insider trading is among the simplest to understand, and the hardest to chronicle, of all forms of graft, but there is evidence that insider trading was widespread in U.S. cities c. 1900.

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[9]All cities taxed and regulated the sale of alcohol in some manner. Some cities were in states that had already adopted complete prohibition of alcoholic beverages.

[10]Whether vice increases or decreases utility overall depends on normative as well as positive judgements which I am unwilling to make. The social and cultural ramifications of implicitly sanctioned vice are not the subject of the essay.

Steffens lists the Philadelphia “brokers who deal in ring securities and speculation on ring tips” (p.147) and “real estate dealers who like to know in advance about public improvements.” (p.148) George Washington Plunkitt apparently did very well from insider trading, largely by buying land he knew would be condemned and bought by the city. An evaluation of the economic cost of redistribution depends on normative considerations of fairness, but insider trading also probably encouraged socially costly market manipulation. For example, the politician who owned the land for the bridge approach might also see to it that he was paid above market value for his property.

### 2.5 Sale of franchises and contracts

Payments for contracts and franchises were the classic Progressive Era graft. Unlike insider trading (which was often not even clearly illegal), there is a wealth of qualitative accounts of bribes, kickbacks, crooked contracts, and lucrative franchises let at low or no cost. The records of graft on city contracts and city franchises, therefore, reveals from whom the government was extracting riches, and with whom they were colluding. In economic terms graft on franchises and on contracts are similar; both involve selling goods to the public and manipulating markets to limit competition and extract consumer surplus. In practice what in one city was done by the city under contract might in another city be done by a private firm under franchise. However there is enough separation between contract and to franchise to make it useful to separate the analysis. In general, contracts involved the provisioning of government departments and the building of roads and sewers. Many other forms of infrastructure, such as water systems and electrical utilities, we built under contract to the city in some cities, and by franchise in others. In all cities the street railways were franchises, with the lines built and operated by private firms (until after

World War I, when the firms began to lose money and the owners suddenly lost their ideological opposition to “socialistic” government ownership.) In general, it appears that franchises were the preferred organization when the fundamental source of revenue extraction was to be insider trading and market manipulation, whereas contracts yielded largely straight up bribes and were therefore a method of moving city money off the books and into private pockets.

**A. Boodle on contracts**[11]

City contracts were a valuable source of graft. Contracts to provide city services, and especially to build city infrastructure, are reported by Steffens in all cities save non-machine Minneapolis. Not all contracts involved large infrastructure projects, such as roads and bridges. Local governments, the largest government sector in the U.S. in 1900, purchased a wide array of goods. City money was deposited in favored banks (St. Louis, p.23; Philadelphia, p.147; New York, p.207). City hospitals bought drugs and city poorhouses bought groceries from favored suppliers (St. Louis, p.23-24) and some cities hired out for services such as street sweeping and garbage collection. Colonel Butler, the boss of St. Louis, after successfully dodging several investigations into the distribution of street railroads, is caught paying a $2,500 bribe to two members of the Board of Health in exchange for their approval of a contract for garbage collection. (St. Louis, p.40.) However, the value of contracts to purchase goods and services from private contractors pales before the value of payoffs on contracts for building public infrastructure. Steffens reports that, according a report made by a local reformer to the National Municipal League, the total value of paving contracts alone awarded by the city Philadelphia

[11]Boodle - the contemporary term for graft, originally a New York term, it is derived from the Dutch word boedel, which means a lot or estate.

between 1890 and 1900 to the firm owned by boss Flinn was 3.5 million dollars. The politicians could extract revenue by awarding contracts and franchises to themselves, as Steffens reports occurred in Pittsburgh (p. 117) or they could accept bribes and kickbacks from private entrepreneurs, as in New York where Steffens reports "there are public works for Tammany contractors" (p.209).

**B. Boodle and more on Franchises**

Pay-offs were also common in the award of city franchises, especially street rail road franchises. Demand for electric street railways had exploded after the first successful overhead electric system was installed in Richmond, Virginia in 1888. In St. Louis Steffens reports in detail on the results of the criminal investigation of the Suburban Railway Company. The President of the firm, a Mr. Charles Turner, testified to paying $144,000 in bribes to legislators in the upper and lower houses of the St. Louis Assembly for franchise rights purportedly worth three million dollars. (p.28-34) As is clear in *The Shame of the Cities*, however, the bribe to the politician for his vote on the franchise was only the beginning of the money to be made on street rail roads. Street railway companies could be "maced" by issuing new, competing franchises to new firms and forcing the old companies to buy out, or be bought out, to maintain the valuable monopoly rights.[12] Steffens describes, in some detail, three separate instances in which street railway franchises are sold to firms whose only interest was in selling out to, or buying up, competitors, including the above mentioned Suburban Railway Company franchise deal in St. Louis (pp. 28-34), an earlier deal, the Central Traction franchise grants, also in St. Louis (p.35-

[12]The verb "to mace" was, according to Steffens a Philadelphia term. It may relate to the noun "mace," one of whose meanings is the ornamental staff of authority carried before a public official or legislature.

37), and a “mace” of the Widener and Elkins street railway monopoly in Philadelphia (pp. 156-158) Not recorded by Steffens, but amply chronicled in the histories of successful real-estate developers such as Huntington and his political allies in Los Angeles (not a machine city), was the money to be made on insider trading on real estate which the new street cars and inter-urbans made accessible to development. In this case the “fairness” of the distribution of the windfall profits may be argued, but it is clear that the accessibility of the profits encouraged the city governments to franchise extensive systems of commuter rail. (In part, it can be argued, setting up a suburban pattern of development already better suited to the car than the street car.) Again, the technologically provided opportunities motivated corrupt governments to encourage growth.

The economic cost to the public of manipulating the market for street railroads does not result from the mace, but from the monopoly power being assembled in the first place. The first best solution might have been to prevent the development of the street railway monopolies, though given the state of the technology of mass transit competition may not have been a sustainable.[13] The cities were undoubtedly better off with street railways, even monopolies, then they would have been without them. The street railway made the huge population expansions of the late nineteenth and early twentieth century possible.

Politically, neither variety of boodle was not likely to produce leaders for the reform movement. Success depended on political access. A prospective contractor or street railroad owner might oppose any particular machine boss, and back his own man, but he was unlikely to want to fundamentally alter a system through which he could hope to control the market for his

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[13]Municipal ownership was proposed by some reformers, especially those with more “socialist” ideas. But was opposed by business interests. Few reform movements, dependent on coalitions including the businessmen, openly embraced the option of municipal ownership of traction.

products.[14] There was political opposition amongst riders to street railroad and other franchise abuse. “Traction” problems, insufficient trains and overpriced service, were issues in local elections in both machine and in non-machine cities.

However the political machine may have had a political advantages over non-machine governments in mitigating the political impact of corrupt franchise deals. The street railroad could not differentiate between machine supporters and opponents. A franchise holder made his money by overcharging all his customers. The machine, however, could make up the difference to selected voters through private favors. As the social reformer Jane Addams reports in her essay “Why the Ward Boss Rules:”

> Even when they are intelligent enough to complete the circle, and to see that the money comes not from the pockets of the companies' agents, but from the street-car fares of people like themselves, it almost seems as if they would rather pay two cents more each time they ride than give up the consciousness that they have a big, warm-hearted friend at court who will stand by them in an emergency.[15] (Reprinted in Stave 1972. pp. xx)

The machine may have found it easier to expropriate funds through crooked contracts than through straight-up embezzlement, and not just because it was easier to conceal the transactions. Crooked contracts to provide true public goods did not offer the government the opportunity to manipulate the (consumer) market for the public goods provided by the new infrastructure. The money to pay the contracts was raised, usually, through general taxation.

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[14]The unsuccessful contractor or franchisee could inadvertently precipitate reform. Steffens reports how the reform D.A. in St. Louis was able to crack the Suburban Railway case when the Railway owner, impatient that his franchise extension was being held up in the courts, leaked a rumor of the payoff he had made to the St. Louis press in hopes of spooking the boodling legislature into some sort of action.

[15]Jane Addams, "Why the Ward Boss Rules," reprinted in Bruce Stave, ed., Urban Bosses, Machines, and Progressive Reformers Lexington: DC Heath, 1972.

However, as Steffens reports with some disgust, inflated government contracts were apparently understood as a sale, at inflated prices, of real goods. “The people had been taught to expect little from their rulers: good water, good light, clean streets, well paved, fair transportation, the decent repression of vice, public order and public safety, and no scandalous or open corruption, would more than satisfy them. It would be good business and good politics to give them these things... --not full value, but a good percentage.” (pp. 144-145)

It is possible that individuals put up with inflated costs not only because they preferred the devil they knew (the competent but corrupt machine) to an unknown government, but also because the machine was actually better at producing government goods. It has even been suggested that the machine structure, because it centralized power in cities where the legal distribution of power was decentralized, was more effective at getting things done than even an honest non-machine government would have been, and that the voters valued the ability of the machine to make and carry out decisions. As Steffens explains:

> In still another direction [the reformers] found that the financial and political support of the great steam railroads and largest manufacturing corporations [in Pittsburg]...were thrown against [the reformers], for the simple reason, as was frankly explained by one of them, that it was much easier to deal with a boss in promoting their corporate interests than to deal directly with the people’s representatives in the municipal legislature. (p.126)

**2.6. Paying for city goods and services**

The city government could also extract revenue by selling goods and services directly to individuals. At the turn of the century real estate zoning did not exist and regulation and inspection of businesses had only just begun, but the nature of transportation technology gave the city government an effective method for extracting graft, especially from manufacturers--control of access to the transportation network of the city. Common law guarantees abutters access to the roads, but does not guarantee a firm access to an adjoining railroad or wharf. The city government, in general, controlled the access to rail and water. Embezzlement, patronage, protection of vice, insider trading, and boodling extracted revenues largely from and through the domestic sectors of the city economy. To the extent that the graft raised the cost of production in the export sector the burden also fell on manufacturers who sold their output outside the city. Such roundabout extraction of revenue, however, did not take advantage of the machine's greatest asset, the ability to tailor the taxes and graft to exactly what the market would bear. The power over access, however, gave the city government power over almost every commercial and industrial establishment in the city. Steffens gives examples for all of the cities (except, of course, Minneapolis). In St. Louis, in a Grand Jury report presented by Steffens, an investigator reported that for at least the previous ten year, "There was a price for a grain elevator, a price for a short switch; side tracks were charged for by the linear foot, but at rates which varied according to the nature of the ground taken; a street improvement cost so much; wharf space was classified and precisely rated." (p.22-23) While in Pittsburgh similar privileges were used as both a carrot and a stick, "The manufacturers and the merchants were kept well in hand by many little municipal grants and privileges, such as switches, wharf rights, and street and alley vacations [the right to build on or over a city street]." (p.109) Though in some cases the additional tracks or easements did cost the city, in many cases the firms were being charged for access to infrastructure that already existed. The city government was extracting revenue directly from the export firms (and, to the extent that those firms were enjoying monopoly rents, they were expropriating rents extracted from non-city residents).

The granting of city easements and licenses to export firms can be compared to similar deals made with domestic interests, such as shopkeepers or local builders, where it was apparently common practice to split the value of the favor. In Philadelphia Steffens reports the machine made deals “with shopkeepers who don’t want to be bothered with strict inspections” and in New York “Architects and builders... [c]alled on the right man and they settled on a scale which was not fixed, but which generally was on the basis of the department’s estimate of a fair half of the value of the saving in time or bad material.” (p. 208)[16] Politically, manufacturing firms dependent on sales outside the city had more to gain and less to lose from political opposition to machine graft than did firms dependent on domestic markets. The city government could not alter conditions for good or ill in markets outside the city. The city government could both reward and punish a local manufacturer for political opposition by favoring a competitor. It was difficult for the city to reward a firm with export markets, and it was <u>also</u> more costly to effectively punish an export dependent firm. Defeating a “reform” supporting businessman by destroying his business would have been a Pyrrhic victory for the machine. Exporting firms, especially large and profitable ones, provided livelihoods to many workers and other domestic interests--raising the value of commercial real estate and hiring local construction firms and intermediate goods producers. If the firm was damaged or destroyed the city was likely to see the gain go to firms in other cities. Therefore the political relationship between machines and

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[16]It is interesting to note, from the point of view of the organization of a machine, that the appointed representative of the city machine in the Building Department had more leeway in setting bribe rates than the elected representative of the St. Louis’ legislator’s ring. Perhaps this is because the boss would also have more direct control over appointed than over elected officials.

manufacturers was a balance of power, in which opposition and accommodation both played a part.

### 3. Implications for Growth, for Reform, and for Rise and Fall of Machine Politics

The patterns of urban graft suggest solutions to three curious aspects of the Progressive Era: why American cities grew rapidly, despite the presence of corruption, why American businessmen were active in reforming urban government, and why the political machine rose so swiftly to national prominence in the last decades of the nineteenth century and then, after appearing unconquerable for nearly twenty years, declined in importance almost as swiftly as it had arisen.[17]

The nature of graft in Progressive Era American cities rewarded politicians for encouraging economic growth, especially real estate development. Given the opportunities open to corrupt politicians, the “take” rose as the city grew. Two thirds of city revenue were raised by taxes on real estate, which encouraged city government to support real estate development. Although opportunities for outright embezzlement of city funds were limited, there were ways of tapping into the city budgets, of which kickbacks on city contracts for infrastructure were among the most lucrative. As cities grew demand for infrastructure rose. Much of the money to be made from city franchises for gas, electricity, and street railways (and hence the value of the bribes and kickbacks to the politicians who assigned them) increased as cities grew. The street railway was a particularly powerful engine for growth, and many street car companies were owned and operated by real estate developers who made most of their money from the development of the new streetcar suburbs, rather than from the nickel fares paid by riders. (Bottles 1987) Likewise

[17]With a few notorious exceptions.

insider trading opportunities were the most lucrative where city real-estate values were increased by government activity. It is possible that some of these activities were not utility enhancing – cities grew rapidly and without much plan – but it is clear that the political machine had strong incentives to limit corruption that would have put a burden on growth. If highly market-distorting corruption had been the only kind available for revenue extraction, then the growth limiting aspects of the graft would not have stopped the kleptocrat, but as I hope this analysis of Progressive Era graft shows, the politician had many ways to benefit from growth without killing the golden goose. The most important domestic market which the machine could manipulate was the real-estate market, and that the available forms of corruption involved purloining some of the increase in the value of real-estate that resulted from growth-enhancing government policies. Counter-intuitively, it was the strength of American property rights that made the corruption work. The politician and land owner could collude precisely because the title to the land was secure. If the government had been able to confiscate the land at any price, or the land-owner had not had clear title, then the motivation for improvement would have decreased significantly.

Although urban political machines were able to use the relatively limited governmental powers available to American cities c.1900 to reach an impressively wide array of interests, if the list of types of graft is compared to the list of techniques available to a national governments it is obvious that an extremely important technique is missing: protecting local industries from competition of foreign firms. Import substitution has been a popular and yet apparently extremely costly strategy for many third world countries. The durability of import substitution as a policy, despite the burden laid on relatively poor economies, is that the policies produce a group of economically and politically powerful interests, manufacturers of import substituting goods, who then spend considerable resources insuring that the government continues to pursue an import substituting policy. (Krueger 1993) These are the same interests that historians such as Hays and Hofstadter have identified in American cities as supporting political reforms intended to limit corruption. (Hays 1964; Hofstadter 1962) In short, a small difference in the market for influence (a city government cannot be bribed to close the border) may have a large difference in the political economy of a city or nation.

The reform label was embraced by individuals with many different agenda: Socialists and businessmen, suffragettes and segregationists all claimed to be "reformers." I do not propose that graft explains the motivations of all the different individuals who wanted to change the *status quo*. However I do believe that identifying groups with a strong material interest in certain types of reforms may illuminate the political economy of reform--why some reforms were widely adopted, and others were not. The inability to manipulate goods markets and labor markets encouraged businessmen who owned manufacturing industries to become involved in political reform movements. The knowledge and interests of these businessmen (and occasionally women) not only strengthened the "Reform" movement, but also fundamentally altered the kinds of institutional solutions pursued by the reformers. Modern American local government emerged during the Progressive era, deeply influenced by the progressive "reformers" who came together to fight machine politics.

For example, if we consider the motivation of businessmen then we can resurrect at least some of Hays' explanation of reform motivation. The machine government was responsive to demands for public goods because it was the residual claimant for the city. If the businessman-reformer were to succeed in insulating his business from the kleptocratic revenue extraction of the machine he would also have removed the incentive the machine government had to provide the public goods which he desired. Therefore the businessman-reformer did not want to simply destroy the machine, he wanted to replace it with a government that would provide government services without the graft. The solution that appealed to businessmen was, not surprisingly, an attempt to create a bureaucratic government similar in many ways to the corporate bureaucracies that were emerging to run the new, giant national firms. (Hays 1964; Rice 1977) Reform of the executive branch – centralizing control in the Mayor or in a small number of elected Commissioners, making the responsibilities of various officials more transparent, and introducing Civil Service to prevent politically motivated appointments – were, as Hays claimed, intended to insure that the new, reformed city governments could provide public goods efficiently. The problem, however, was not that the machine had failed to do so but that the cost had been more than the businessman had wanted to pay.

Many theories to explain the emergence and decline of the machine, but they can be grouped into theories of rising costs and theories of falling revenues. The cost theories generally argue that immigration kept costs low, because immigrant votes were cheap votes. Unfortunately the dominance of the machines starts too late and ends too early to suit this argument. The Irish (and to a lesser extent German) immigrants, whose ranks swell the machine begin to arrive in large number in the late 1840s, while with the essential end of immigration in 1917 the source of cheap voters dried up. The only problem is the timing, as the strongest machine support came not from new immigrants, but from established immigrants and (even more) from their American born offspring. (Menes 1997) Therefore we would expect the rise to begin in the 1870s and 1880s (which is only ten or twenty years to early), and the decline to begin roughly a one generation after the end of immigration, which is about thirty years to late to fit the historical evidence.[18]

I am not arguing that cheap votes were not important, but that they were only a necessary, not a sufficient condition. Even the cheapest votes required a large, expensive political organization to mobilize. Therefore even with available votes, political machines can be expected to arise only when there is plenty to steal, and to decline when revenues drop and they can no longer sustain the organization. The evidence from the patterns of graft suggest that revenues may have risen and declined sharply at about the right time to explain the rise and decline.

Three technological changes clustered around 1890 tied firms and residents to the city and hence increased what could potentially be extracted from a city: public infrastructure, the national market in manufactured goods, and the street car. The development of better public services (piped water, sewers, electricity and gas power grids) encouraged residents and firms to remain or move to the political city, as these goods exhibited significant returns to scale and were, at first, only available in large cities. The emergence of a true national market in many intermediate products and consumer goods created plants and firms dependent on large scale, consistent access to the rail network. Small firms, selling locally, could move goods without rail, but the new, big firms selling from New York to California could not. The invention of the street car, although it made the first true suburbs possible, also increased dependence on the central city. The street car brings people to the center, and so the firms that employ those people must

[18] It is clear that ethnic change in a city often doomed a machine (Boulay and DiGaetano 1985) And that many machines survived into the 1950s, 1960s, or even 1980s But after 1920 it appears that the source of new machines had dried up. When organizations died they were not replaced (with the exception of Czermak’s machine in Chicago).

locate in the city, even if the people live outside. Graft is the link which ties the economic value of the city to the political profits that may be extracted. As I have shown, the types of urban graft common in 1900 took advantage of government control over all three of these innovations: the distribution of street rail road franchises, the building of infrastructure, and the access to rail and water.

After World War I four technological changes reversed the trends that concentrated wealth in central cities. First, the suburbs and smaller cities installed the sewers, water systems, public lighting, professional fire departments, and high schools which had first been introduced in the large cities. Second, the car ended the tyranny of the street car franchise. And third and fourth, two changes – the truck and the electric motor – relaxed the dependence of manufacturing firms on access to rail. The truck brought in raw materials and took away finished goods. The switch to electric motors freed the firm from the necessity of receiving large, heavy shipments of coal (which even today are most efficiently moved by rail.) As I have shown, much of the graft was extracted directly from street car companies or from firms who wished to access the rail roads or docks, and a good deal of the remainder resulted from pay-offs in construction and real-estate development, all sources which must have declined following the above technological innovations. More important, however, these same changes would also block the development of new forms of graft because, although cities did not become poorer, the locational rents accruing to a particular city (compared to location in a nearby city or suburb) did decline. Firms and residents did not instantly flee, but the threat to leave was far more credible and the revenue that could be extracted by a rent seeking politician must also have fallen.

Therefore, due to the unique state of technology the value of controlling a city government was unusually high between 1890 and 1920. As already noted, the machine was an expensive political technology. One explanation for the timing of the rise and fall of the machine, therefore, is that before 1890 and after 1920 the maximum sustainable graft that could be extracted from the city was not sufficient to support a machine. I am not suggesting that there is no corruption in local government today, but simply that there is not enough to sustain a full-fledged political machine. If I am correct, the relationship between corruption and the machine is the reverse of the usual, the machine did not create corruption, but rather the increasing opportunities for corruption increase the likelihood that a durable machine will emerge. If the city government is small and poor that poverty will eliminate many forms of corruption, including patronage based machine politics. However, if we are trying to eliminate corruption, attacking the clientelist political system may not be the most effective way of limiting governmental rent-extraction. Without institutional or technological changes in the rents up for grabs, re-writing the rules may simply change the identity of the kleptocrats. Or even, conceivably, simply change the method by which the incumbents hold office. I have seen some evidence that in several cities incumbent machine politicians support reforms that weakened machines, but that strengthened the advantages to incumbency.

Graft mattered and graft still matters. Material rewards, bribes, protection, patronage, and boodle, were an important factor in the evolution of American local politics and in the development of American cities and are important in the political and economic development of developing and developed nations worldwide. However there is no simple calculus, where a certain level of graft imposes a proportional cost on growth or development. The institutional structure of government, and the nature of the economy and of technology, all interact to alter the options open to the self-seeking politician or bureaucrat, and hence to the impact that he (or she) has on society. Because both the patterns of graft and the political and economic history of American cities at the turn of the century are (relatively) well documented, they may also help us understand the more general rules governing the role of corruption in economic and political development around the world.

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