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# The Significance of the Founding Choices
## Editors' Introduction

Douglas A. Irwin and Richard Sylla

Bookstores today are awash with titles that celebrate America's Founding Fathers as courageous and far-sighted leaders who not only guided the nation through the difficult period of achieving independence from Britain, but also established a system of government that has survived relatively unchanged for more than two centuries. Almost completely ignored in this outpouring of works, however, is a sense for the economic policy achievements of the founders. The neglect of economic policy is surprising. The United States in 1790 was a relatively small economy compared to the leading nations of Europe and Asia. Within a century it would become the world's largest economy. In two centuries it would become an economic and political colossus with a larger population than any other country except China and India. The post-1790 developments were rooted to a greater extent than is generally appreciated in the economic policy decisions made in the 1790s.

This book redresses the neglect of the founders' economic choices by bringing together leading scholars to examine the early economic policies adopted by the new government under the Constitution. Ratification of the Constitution broke the gridlock that afflicted decision making about economic policy under the Articles of Confederation prior to 1789. The chapters that follow study the economic policy options that were opened up by the new framework of government, and which choices were implemented. They focus on the *choices* made by U.S. economic policymakers in the years

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immediately after 1789: what the policy alternatives were, what the political debates were about, how the new Constitution made a difference to the policy choices, how the policy decisions were made, which paths were ruled out, and how the policies were either continued, modified, or abandoned in later years. In doing so, we hope that the volume contributes to our understanding of the foundations of U.S. economic success.

## A Brief Sketch of the Founding Era

By the late colonial period, the economic position of Britain's thirteen North American colonies seemed promising. Up to that time the colonies had been secure under the protection of the British army and navy, and could trade within the markets of the British Empire. Representative government generated domestic political stability and legal institutions that protected property rights and facilitated investment and exchange. The colonies experienced steady economic expansion, growing wealth, and flourishing trade that made them attractive enough to draw a steady stream of immigrants from abroad. But the colonial expansion reflected mostly high rates of population growth, as there is no evidence of modern economic growth in the sense of sustained increases of per capita product and incomes at rates approaching or exceeding 1 percent per year over extended periods.

When Britain's government, in the wake of the Seven Years' War (1756 to 1763), began to threaten the rights, institutions, and freedoms the colonists had come to expect, they began to contemplate political independence. In July 1776, after more than a year of armed conflict with Britain, the Continental Congress proclaimed American independence. Warfare in America continued for five more years, ending with the combined American-French victory at Yorktown in October 1781, although some British forces remained in the country and others continued to menace American ships. The Treaty of Paris, in which Britain formally recognized American independence, was signed two years later, in 1783.

The United States of America had gained independence, but the 1780s was a very difficult decade for the American people and the U.S. economy.[1] The War of Independence had been costly in terms of human lives and resources expended. Trade had been severely disrupted, and domestic currencies had depreciated as a consequence of excessive issuances. The transition to peace proved difficult as well. The United States found its goods and ships excluded from the markets of the British Empire. The national government was broke, unable to raise money or pay off loans it had obtained during the war from patriotic Americans and sympathetic foreign nations. Under the Articles of Confederation, the national government proved unable to take actions that would rectify this dire situation.

1. See Bjork (1964) for a discussion of the U.S. economy during this period.

The economic difficulties that the United States faced after independence were a critical factor in the decision to replace the Articles of Confederation with a new Constitution. The Constitution of 1787 marked a new political beginning for the United States. It also opened up new possibilities for economic policy. Under the Constitution, the federal government had a vast set of new powers, including the ability "To lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States . . . ; To borrow money on the credit of the United States; To regulate commerce with foreign nations, and among the several states,..; To establish a uniform rule of naturalization, and uniform laws on the subject of bankruptcies throughout the United States; To coin money, regulate the value thereof . . . ; To establish post offices and post roads; [and] To promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries." And, perhaps most controversially, the Constitution also empowered Congress "To make all laws which shall be necessary and proper for carrying into execution the foregoing powers." These powers—all in Article I, Section 8, of the Constitution—constituted much of the economic policy agenda for the new government.

President George Washington, widely admired and respected for his command of American forces during the War of Independence, provided a smooth and stable transition to the new political system. Equally important, the Washington administration undertook a series of steps to address the daunting economic challenges of the day. In the first years of the new U.S. government, America's political leaders at both the federal and state levels had a unique opportunity to lay a fresh groundwork for the nation's economic policy. They confronted a series of choices about the direction of economic policy with respect to public finance and debt management, currency and monetary policy, trade and revenue policy, land and western settlement policy, inventions and innovations, policies toward labor and business, and so forth. Many of the choices that they made would be precedent-setting and have lasting consequences.

Under the direction and guidance of Treasury Secretary Alexander Hamilton, the first Congresses enacted legislation that consolidated and funded the national debt, created a national bank, established a sound national currency, imposed import duties to collect government revenue, and protected intellectual property rights. Both the federal and state governments encouraged the formation of corporations. Some of these policy measures were uncontroversial, while others were subjects of contentious debates. In almost every case, there were many options and alternative paths that could have been taken. Some of the steps taken were altered or undone later, while others have persisted in one form or another to this day. The economic policy choices of the 1790s not only established conditions for (and removed constraints on) modern economic growth, but also provided a long-term policy framework that continued to encourage growth, the territorial expansion of the United States, and the country's influence on world affairs for decades and centuries.

## Some Key Ingredients of Economic Growth

Economists usually consider growth to be increases in total economic output per person that are sustained for long periods of time. They measure it by "real"—that is, inflation-adjusted—Gross Domestic Product (GDP) per capita. They consider growth to be "modern" if real GDP per capita increases at rates of 1 percent or more per year for extended periods. For the United States and other nations, the data to measure real GDP per capita with any precision are not available for periods before the middle of the nineteenth century. In the American case, from that time to the present, all measures of economic growth are decidedly modern; they indicate annual average rates of growth of 1.5 percent per year or more.

For periods before the mid-nineteenth century, economic historians have used economic theory and models in conjunction with the more limited historical data available to make rough estimates of economic growth. Historians of the colonial era think that at best growth was modest—per capita gains of 0.3 to 0.5 percent per year (McCusker and Menard 1985)—and at worst about zero (Mancall and Weiss 1999). Around 1790, however, a different story emerges. As Richard Sylla notes in chapter 2 in this volume, the lowest estimates of U.S. economic growth for the 1790s are in the vicinity of 1 percent a year, although there remains uncertainty about how much growth there was in the first two decades of the nineteenth century.

It thus seems possible that economic growth became "modern" virtually at the start of the United States as a political entity. A recently compiled index of the output of one modern economic sector, industrial production, points to a reason why economic growth may have jumped to a higher level in the 1790s. It indicates that total U.S. industrial production grew at rates of about 5 percent per year from the 1790s to 1915, without much variation over extended subperiods of the long nineteenth century (Davis 2004). Adjusting the industrial production estimates for population growth, which was high but declining over the long century, industrial production per capita grew at approximately 1.5 to 2 percent per year in the early decades of U.S. history, and at more than 2 percent per year in later decades. The industrial or manufacturing sector, of course, was a small component of the U.S. economy in the 1790s, but its apparently high rate of growth from that time onward must have been among the reasons why real GDP per capita grew at rates substantially above those of the colonial era. As rapidly growing manufacturing and other modern economic sectors became larger and larger components of the U.S. economy, we would expect to observe a gradual acceleration in the overall rate of economic growth. Imperfect as estimates of real GDP remain for the 1790 to 1840 period, they are not inconsistent with such a gradual acceleration of economic growth. Why might U.S. growth have become "modern" in the 1790s? Could the economic policy decisions studied in this volume have made a difference? The authors of the chapters here address these questions with specificity and detail. Before summarizing their contributions, however, we ought to address the issues in somewhat more general terms.

As the world moves into the twenty-first century, it exhibits huge differences in incomes, wealth, and welfare among nations. Some, mostly in Western Europe, North America, and Japan, are rich and have been rich relative to others for a century or more. Others, termed "emerging markets," were relatively poor not so long ago, but have made giant strides in their economic growth in recent decades. These include the world's two most populous nations, China and India, as well as others in East Asia, Latin America, Eastern Europe, and elsewhere. Still others, including many in Africa, have long been and continue to be relatively poor. Why at the end of the twentieth century did the richest nations have real GDPs per capita three to five times the world average (the United States, the richest large country, was close to the top at nearly five times the world average), while Latin America as a whole was at the world average, China and India were below average but rising rapidly, and Africa as a whole languished at about a quarter of the world average?[2] Why is the world economy so unequal in our time? And, since estimates for earlier eras show less inequality across nations—the richest countries two centuries ago had real GDPs per capita less than three times the world average then, while the poorer ones were closer to the world average than they are now—why has the world economy become more unequal in the modern era?

Economic historians tend to answer these questions by focusing on why some countries in the modern era became rich. The great inequalities across nations today are mostly the result of a relatively small number of countries (such as the United States) growing quite rapidly in GDP per person for a century or two while most of the others more or less marked time, growing slowly, if at all, in terms of per capita product and incomes, rather like the American colonies during the eighteenth century.

So just why, or how, did the rich countries grow rich? Economists and economic historians provide a wide range of answers to this question, and they often disagree about the relative importance of the various factors they identify as important. Four general factors, however, seem to be a part of many explanations.

First, before most other nations, the countries that grew rich put in place *governments* that allowed economic growth and development to occur, and in many cases even fostered it through institutions and organizations they

2. These conclusions are derived from the comprehensive data contained in Maddison (2001).

created and by the policies they implemented. Typically, these were constitutional governments with limits on the authority of rulers and political representation for citizens.[3]

Second, modern, developed, and prosperous nations have long had highly articulated *financial systems* featuring strong public finances and debt management; stable currencies; good banking systems and central banks to provide effective payment systems and stable flows of money and credit; financial markets (money, bond, and stock markets) to fund the needs of governments, business enterprises, and households; and business corporations, since economies of large-scale production appear to require the corporate form of organization for their realization. The earliest economic leaders—the city-states of Renaissance Italy, the Dutch Republic of the seventeenth century, and Great Britain after the Glorious Revolution of 1688—developed most of these elements of a modern financial system *before* they became leading economies. This appears to indicate a causal connection leading from financial modernization to economic development. As other nations emulated the Italian, Dutch, and British pioneers of financial development, they too became richer.[4]

Third, the most successful economies were ones that fostered a high degree of *entrepreneurship.* Italian, Dutch, and British merchants and trading companies moved around the world to arbitrage their opportunities, buying low and selling high, and thereby making themselves and their countries richer. British tinkerers, inventors, and entrepreneurs developed new industrial technologies on a revolutionary, mass-market scale in the eighteenth century, providing Britain's merchants with new goods that could be bought low and sold high. Wealth created by modern industry thus added to the mercantile wealth already present in Britain. New and improved transportation technologies—roads, canals, railroads, and steamships—also contributed to the expansion of markets. The new technologies raised the productivity of labor, creating economic incentives for workers to leave farms in the countryside for better paying jobs in factories concentrated in urban areas. Then, as the industrial revolution spread from Britain, other nations also able to create a healthy climate for entrepreneurial innovation grew progressively richer.[5]

Finally, since modern, rich economies have most of their goods and services produced by business enterprises ranging from quite small to very large ones, they had to develop *managerial capabilities* to make these organizations work effectively. Successful entrepreneurs may have started out small, but as their enterprises grew they had to learn how to manage them and their

3. Studies examining the historical roots of governments that enable or hinder economic growth include Olson (1982, 1993), and North, Wallis, and Weingast (2009).

4. See Ferguson (2001, 2008) and Demirgüç-Kunt and Levine (2001).

5. For a comprehensive history of entrepreneurship throughout history, see Landes, Mokyr, and Baumol (2010). For better and worse ways to elicit vibrant entrepreneurship, see Baumol, Litan, and Schramm (2007).

growth, or employ others who were able to do that. All business enterprises need to be managed, but the need for effective management is especially important for large and complex enterprises, the ones whose economies of scale and scope have been largely responsible for the productivity advances that made rich countries rich. Economists measure improvements in productive efficiency by changes in total factor productivity (TFP), the increment in output over time that cannot be explained by increases in the conventional economic inputs of labor, capital, and land or natural resources. The sources of TFP growth remain something of a mystery. Improved managerial capability in productive enterprises is probably one source of TFP growth over time, although it so far has defied measurement. Without effective management, large-scale enterprises could not exist for very long.[6] In many of the world's nations, for much of modern history, few such enterprises got started or lasted for long. Growing economies, in contrast, long have invested considerable resources in educating and training those who manage large-scale enterprises.

In short, on most lists of the key ingredients of economic success for any nation, one likely would find good government, effective financial systems, healthy entrepreneurship, and improved managerial capabilities, especially for the large and complex enterprises that generated so much of the productivity advances that made rich countries rich. How did the rich countries manage to create these ingredients? How did the United States do it? The chapters that follow indicate that in the American case, decisions made early in the country's history, including the economic policy choices of the 1790s, may have had a lot to do with the outcome.

## This Book in Summary

In chapter 1, "The Constitutional Choices of 1787 and Their Consequences," Sonia Mittal, Jack Rakove, and Barry Weingast explain how the founders in the 1780s sought by means of the Constitution to replace an ineffective national government with one that they hoped, but could not really know, would be much more effective. Later generations have known that the founders' hopes were realized, but success was far from certain in 1787, or even in 1800. The authors explain how the new Constitution provided ways of solving many problems that remained unsolved under its predecessor, the Articles of Confederation, as well as accommodating adaptations of policies and institutions. As far as economic growth and development are concerned, the Constitution contributed to market-preserving federalism, a concept explained in the chapter, by giving the new federal government the authority to solve a variety of national problems, while

6. Studies of the historical role of management include Chandler (1977, 1990) and Lamoreaux and Raff (1995).

allowing the states of the union to address in an experimental, even competitive way, other problems that were not of a national nature. In terms of our discussion here, as a result of the Constitution and the manner in which its provisions were implemented by the founding and later generations, the United States put in place a governmental system that proved to be highly compatible with, and in many ways supportive of, modern economic growth.

Chapter 2, "Financial Foundations: Public Credit, the National Bank, and Securities Markets," by Richard Sylla, explains how a second key ingredient of economic success—a modern, articulated financial system—quickly emerged in the Washington administration. As has long been understood by historians, Alexander Hamilton was the founder most responsible for the financial revolution of the early 1790s. But how could so much financial change happen so fast? Sylla shows that Hamilton, who became a student of financial history while an officer on General Washington's staff during the War of Independence, realized that financial modernization was needed both for effective government and economic growth. When President Washington named him to be the nation's first secretary of the treasury, Hamilton used his authority to implement a plan that had been developing and maturing in his mind for years. With the cooperation of Congress, Hamilton implemented the federal revenue system the Constitution authorized, restructured the national debt and placed it on a sound financial footing, argued for and obtained a national banking corporation, and defined the new U.S. dollar and provided for its coinage by calling for a federal mint. Hamilton's policies prompted the states to charter many more banks and other corporations. And all the new federal bonds and national bank stock that resulted from his plan induced investors, brokers, and dealers to create active markets for the new securities. As Hamilton had predicted, the new and modern financial system almost immediately increased the power of the federal government and helped to raise the rate of economic growth toward modern levels. Effective government and modernized finances, two key ingredients of economic success, were realized in very short order in the 1790s. That was quite an achievement.

In chapter 3, "Revenue or Reciprocity? Founding Feuds over Early U.S. Trade Policy," Douglas Irwin looks at import duties as the key method by which the new federal government raised revenue to fund its operations and pay the national debt. As noted earlier, the national government was essentially broke under the Articles of Confederation. In addition, the national government had no authority over trade policy so it could not retaliate against other countries for discriminating against U.S. exports. Marking a huge break from the Articles, the Constitution gave Congress the power to levy import tariffs, giving the government an independent source of revenue and the potential to strike back at Britain's restrictions on U.S. commerce. In the debate over which objective deserved emphasis, Hamilton insisted upon revenue. In Irwin's view, Hamilton was aware that the American public would resist many domestic excise taxes, so he had to rely on import taxes as the principal revenue-raising device of the government. Import duties were a critical part of his funding scheme. By funding the debt, Hamilton improved the country's creditworthiness (which might be needed in times of war); by nationalizing the debt, Hamilton allowed states to reduce the burden of their local taxes, thus increasing support for the Constitution. But imports could be easily disrupted, making it a fragile base on which to depend for supporting the nation's finances. Keenly aware of the country's financial fragility, Hamilton desperately wanted the United States to remain neutral in any European conflict. For this reason, he strongly opposed efforts by Thomas Jefferson and James Madison, who wanted to use tariffs to retaliate against Britain in the hope of forcing open the markets of the British Empire to U.S. commerce. Hamilton feared that British reprisals would severely diminish the steady flow of revenue from import duties, on which his financial plans hinged.

Peter Rousseau in chapter 4, "Monetary Policy and the Dollar," argues that the United States gained considerably in the early 1790s after the Constitution ended the colonial and 1780s monetary system that allowed provincial and then state governments to issue their own fiat paper currencies, and replaced that system with the new specie dollar and currency union of all the states. Under this new system, banks, not governments, would provide most of the nation's money stock by issuing deposits and bank notes convertible into the specie-dollar base. The founders' motivation for the change was the sad experience during the War of Independence, when both the Continental Congress and the states financed their military forces by overissuing fiat paper currencies to the point where they lost much of their value and risked a hyperinflation. The "Continental Currency" issued by Congress essentially collapsed by 1779 or 1780 because Congress lacked the authority to levy taxes to be paid in Continentals. Holders of depreciating Continentals were instead taxed by inflation as their dollars depreciated in value. States did have powers of taxation, and their currencies during and after the war fared better than Continentals, but not well, because states were reluctant to levy unpopular taxes. The Constitutional solution to these problems, implemented as a part of Hamilton's financial revolution, was to ban the states from issuing fiat moneys, and to place the United States on the specie-based dollar defined in terms of gold and silver. Under the new system, money was created not by government officials printing it to finance public spending, but by banks issuing it to finance trade, investment, and entrepreneurial innovation. The new system, unlike the old, gave Americans more confidence in the long-term value of their currency holdings, anchored as they were in silver and gold dollars, and it allowed the money stock to expand in accordance with requirements of a growing economy.

Howard Bodenhorn's chapter 5, "Splendid Associations of Favored Individuals: Federal and State Commercial Banking Policy in the Federalist Era and Beyond," deals with the founding choices about the banking system in the United States. There were two main options: one in which banks were to be loosely regulated in their operations, accountability, and governance, or one in which regulations embodied in bank charters were more restrictive in these areas. Bodenhorn shows that Robert Morris's Bank of North America, the nation's first bank when chartered in 1781 to 1782 (by Congress and also several states) exemplified the first approach. The loose regulation of Morris's bank, and its behavior in attempting to stifle competition, produced a backlash by the mid-1780s; the bank lost its Pennsylvania charter temporarily and only regained a new one by extensive politicking and accepting more restrictions on its operations.

Hamilton was a keen observer of these events. Therefore, when as treasury secretary he crafted the charter of the Bank of the United States in 1791, its operational latitude was more carefully delimited. It was made accountable to the federal government which, in a Hamiltonian innovation, owned 20 percent of the Bank's stock, and its governance provisions balanced the interests of large and small stockholders. At the same time, Hamilton's charter allowed the Bank to open branches throughout the United States. Both the first and second Banks did that, providing the country with nationwide branch banking in its early decades. After the second Bank lost its federal charter in the 1836, nationwide branch banking would not return until the 1990s. Despite that setback, Bodenhorn demonstrates that Hamilton's charter, with its many restrictions on bank operations, became the model for most American banks and, he notes, most Canadian banks. Canada's banks operated branch systems throughout the country, but U.S. state laws and federal regulatory deference to those laws until late in the twentieth century restricted banks to operate from one office (unit banking), one city, or at most one state.

Founding choices about the sort of banking Americans should have seem eerily relevant in the aftermath of the banking and financial crises of the early twenty-first century. Once again, regulatory laxities are thought to have led to bad outcomes. Reforms embodying stricter regulation of U.S. banking and financial services are therefore at the top of legislative agendas.

In chapter 6, "The Other Foundings: Federalism and the Constitutional Structure of American Government," John Wallis notes that after the Constitution provided a stable and accommodative government at the national level during the 1790s (as established by Mittal, Rakove, and Weingast in chapter 1 of this volume), most of the interactions between political and economic development took place at the level of the states. Wallis explains that it was difficult politically for the federal government to maintain a presence in banking (the two Banks of the United States were discontinued) or to play much of a role in the development of the nation's economic infrastructure; for example, improvements in internal transportation. That left the states to become the laboratories in which the important experiments in banking, corporations, and infrastructure development were made.

Initially, states strove to keep taxes low by investing in banks and other corporations, and by borrowing extensively for transportation improvements in the expectation that they would, in one way or another, pay for themselves. But such policy choices also provided incentives for state governments to restrict these developments. Dividends and other revenues states obtained from investment in banks and corporations as well as toll revenues on state-owned canals would be greater if there were not so many banks, corporations, and canals. Less competition meant greater earnings on state investments. At the same time, extensions of the political franchise and the rise of mass political parties created pressures to provide more access to banking and the corporate form, as well as more infrastructure investment. The economic and financial crises of the late 1830s and early 1840s brought these conflicts between economic and political development to a head. Banks, other corporations, and state transportation projects failed. State revenues declined precipitously everywhere, and eight states and one territory defaulted on their debts.

Citizens were outraged by these embarrassing outcomes, and reacted by calling for constitutional changes at the state level to ensure that they would not happen again. And so, within a stable framework of national government, many states rewrote their own constitutions to disentangle their governments from banks and corporations, and to provide more open access to both by enacting free banking and general incorporation laws. These laws allowed citizens to start banks and corporations without the specific sanction of state legislatures. They also placed restrictions on state borrowing for public purposes—henceforth, such borrowings, if proposed by public officials, could be made only after a public vote approved tax increases to service the debts to be incurred. Wallis explains how these developments represented a major shift in American political economy. The founders had worried about the democratic excesses, particularly in state legislatures, and wrote the Constitution to curb them by diminishing state authority, and even national authority, through an intricate system of political checks and balances. In the ensuing decades, American politics nonetheless became more democratic. By rewriting their constitutions, Wallis argues, states reconciled greater democracy with more responsible political decision making and more open access to financial and other corporate institutions that fostered economic growth.

Robert Wright's chapter 7, "Rise of the Corporation Nation," continuing Wallis's discussion of corporations, draws attention to a dramatic rise in the chartering of business corporations during the 1790s. Only eight such corporations had been chartered in the long colonial era, and another twenty-one during the 1780s. During the 1790s, 290 more corporations, ten times as many as in all previous colonial and U.S. history, appeared. Wright attributes this to the implementation of the new Constitution, which gave entrepreneurs the encouragement they needed to invest their efforts and funds in new, large-scale enterprises. But the appearance of a "corporation nation" in the 1790s was just a beginning; Wright notes that by 1860 the country would have some 20,000 corporations, far more than any other nation. Still, Americans had to overcome a great deal of suspicion about corporations, which many believed were privileged institutions with too much market and political power. An obvious solution to this problem, or at least part of it, was to make the corporate form available to almost anyone or any group of Americans who desired it—to turn the corporation from a privileged monopoly for the few into a competitive form of enterprise for the many.

Why were corporations important? In Wright's view, the increased availability of the corporate form of business organization stimulated entrepreneurship by broadening the menu of organizational-form choices available to entrepreneurs. Most corporations had limited liability, which encouraged shareholders to pool their capital to achieve economies of scale and scope. That led to innovative primary markets for the new issuance of shares, and to active secondary or trading markets that provided shares with liquidity. Finally, the appearance of so many corporations so early in U.S. history meant that Americans more or less had to learn how to govern and manage complex corporate entities. The training and experience in management that Americans gained in the early corporations no doubt came in handy later, when even more and larger corporations appeared to take advantage of technologies of mass production and distribution. Via its impact on corporate development, the Constitution thus contributed to vibrant entrepreneurship and managerial capabilities.

In chapter 8, "Land Policy: Founding Choices and Outcomes, 1781–1802," Farley Grubb argues that the U.S. government became "land rich" even before the Constitution when the original states with claims to land between them and the then-western border of the country, the Mississippi River, began to cede those claims to the national government. The problem, as Grubb notes, was that the land would not have been worth very much had the national government tried to sell it quickly to pay its debts, although that idea, as well as the thought of exchanging land for public debt, was considered. Instead, under the Constitution, Congress opted to survey the lands and sell them gradually as the nation expanded and population grew, and to pledge the revenue from future land sales to debt retirement via the sinking fund that Hamilton had created as a part of his financial reforms. Grubb estimates that at prevailing land prices, the federal government's holdings of land in the 1790s had a value well in excess of the national debt. Even if that value could not have been realized had the land been sold quickly, it served to give domestic and foreign creditors of the government confidence in its ability to honor its obligations in later years and decades. Thus, the land policy choices of the 1790s supported public credit. That credit, as Grubb notes at the end of his chapter, had an early payoff when the United States in 1803 doubled its size by obtaining the Louisiana Territory from France "on relatively cheap and easy terms."

In chapter 9, "Free and Slave Labor," Stanley Engerman and Robert Margo review how the abundance of land in America implied, as the other side of the coin, a shortage of labor. This shortage was mitigated not only by rapid natural increase (births greater than deaths), but also by immigration of free labor, indentured labor, convict labor, and slave labor. The Constitution itself said little about the immigration of labor. The implicit default was free immigration since the land/labor ratio remained high, and that was made more explicit in Hamilton's prescient 1791 Report on Manufactures. Still, in the Constitutional era, in-migration of indentured labor began to decline and an independent United States rejected convict labor from Europe. But the Constitution did deal with slavery by stipulating that the slave trade—immigration of slave labor—could not be ended for at least twenty years (the slave trade was ended by law in 1808), and that slavery itself was left to the states as an issue to be resolved. Northern states had few slaves, and they enacted laws ending slavery, gradually in most cases. Southern states had most of the slaves, and they wanted slavery taken off the table as a matter of national debate. These compromises over slavery most likely were the price of having a unified country in the early decades, something very much in doubt at the time. Six decades later the slavery issue did divide the country, leading to a costly civil war.

The Constitution also said little about factors affecting the stock of human capital, such as education, training, health, and internal labor mobility. These were considered matters with which the states would properly deal, and the authors conclude that was likely a good thing because it promoted experimentation and competition between states.

Engerman and Margo discuss the effects of slave policy choices in comparison with options not adopted. The ban on slave imports, in comparison with no ban, raised the price of slaves, and especially of female slaves, the only remaining source for expansion of the slave labor stock. If slavery itself had been ended by the Constitution, the authors conclude that the U.S. economy would have had less output and a different structure than it did with slavery, and they point to the post-Civil War era after slavery ended as tending to confirm their analysis.

Finally, Zorina Khan's chapter 10, "Looking Backward: Founding Choices and Intellectual Property Protection," documents that the American system of patent and copyright protections authorized by the Constitution, as implemented by legislation in the 1790s and after, was a departure from European precedents in directions that were conducive to economic growth. American patents were for "first and true" inventors and for new and original inventions, not merely ones imported from another country or copied from another inventor. As of 1790, patents were subject to an examination system to enforce these strictures. Application fees for patents were lower than in Europe, and were intended to cover administrative expenses rather than enhance government revenues. Property rights were strong; those granted patents were not restricted in how they could exploit them. That encouraged an active market in licensing and assigning patents. The system was open and transparent; with an inventor's rights protected, knowledge of new inventions was made widely available, as was knowledge that patent protection had expired. Patents did not grant monopoly rights; that was not their purpose. The purpose, as stipulated in the Constitution, was "to promote the progress of science and useful arts" by means of granting temporary exclusive rights for novel and original inventions.

In contrast to inventors, the copyrights of American and foreign authors were less protected than in Europe. American copyright piracy may have been to the advantage of the public, and encouraged the widespread dissemination of learning and literature. But it was met by retaliation from foreign countries, which was not to the advantage of the most successful American authors. Over time, as the market for American cultural products expanded, the founding regime of strong patents and weak copyrights changed to one that was more balanced. Khan suggests, however, that further change may have gone too far, giving the United States a system of weak patents as well as strong copyrights. Today, the enforcement of copyrights seems to be more in the interests of their owners, which often are firms that can afford extensive lobbying of lawmakers, than in the public interest.

The chapters of this book, summarized here, indicate that the founding choices made in the Constitution and then implemented during the 1790s did indeed give the United States a governmental and financial system conducive to economic growth. They also gave rise to institutions such as the competitive business corporation and the patent system that encouraged innovation, vibrant entrepreneurship, and the development of managerial capabilities. Given that so many ingredients of long-term economic success were put in place by the founding choices, perhaps we should not be surprised that the higher rates of economic growth characteristic of modern economies began in the 1790s and continued for more than two centuries. The United States got many things right at the start of its national history. It went on to become perhaps history's most successful "emerging market" economy.

## Alternative Approaches and Explanations

Was America's economic success really a matter of the policy choices of the 1790s? Or might it have been preordained regardless of those choices? Some influential recent research appears to diminish the importance of policy choices in favor of more fundamental causes. This research on the underlying foundations of economic growth indicates that a country's underlying institutions matter more than policy choices, and are largely responsible for whether it becomes prosperous or not. These institutions include the protection of property, security against expropriation of private wealth, and the sanctity and enforcement of contracts. Such institutions are viewed as being essential to promote the entrepreneurship and investments that lead to economic growth and development.[7]

Where do these institutions come from? Searchers for the "deep roots" of America's and other countries' institutions contend that differences among them were endogenously based on factors such as geography, climate, and disease environments. Engerman and Sokoloff (2008, 124), for example, suggest that "the institutions that emerged across the colonies established by Europeans do seem to have varied systematically with aspects of the environment, such as climate, land types, and natural resources." According to this line of thinking, the mild climate and natural resources of North America favored certain types of economic activity and promoted European settlement, dispersed and smaller land holdings, and thus greater economic equality. These characteristics in turn fostered demands for political participation and the adoption of measures favorable to economic development such as a greater provision of educational opportunities. In contrast, the hotter climates and natural resources of the Caribbean and large parts of Central and South America were conducive to plantation agriculture and extractive mining activities. This led to fewer European settlers, larger land holdings, extensive use of slave labor, and greater economic inequality, all of which detracted from long-run economic development (Engerman and Sokoloff 1997).

A related but different view is that of Acemoglu, Johnson, and Robinson (2001, 2002, 2005), who study European colonialism and see institutional differences among colonies less as developing from climate and resource differences and more as choices made, or imposed, by the European colonizers. Exploitative, extractive institutions were imposed in initially (circa 1500) more densely populated regions with higher mortality rates for Europeans, such as parts of Latin America, as compared with initially less densely populated and lower mortality regions such as North America, where private property institutions were adopted. The former were more prosperous at the time the European colonizers appeared, but in the long run the latter, including prominently the United States, in a reversal of fortunes became more prosperous than the former. Institutions matter for economic performance, but were chosen by colonizers rather than being dictated by geographical conditions.

Still another view of institutional origins suggests that different legal traditions transplanted by various European colonizers were important in shaping the economic futures of colonies.[8] This work begins with the observation that legal rules protecting investors and limiting the extent of expropriation

7. For a recent overview of work on good institutions, see Haggard, MacIntyre, and Tiede (2008).

8. This body of work is summarized in La Porta, Lopez-de-Silanes, and Shleifer (2008).

vary systematically across countries. In particular, common law countries of British origin appear to provide greater investor protections than civil law countries with legal codes originating from Roman and French traditions. Differences in legal origins, which were exogenously placed around the world as a result of colonization or other means, had implications not just for financial development, but also for government ownership and regulation. Common law countries tend to have less government intervention, greater contract enforcement, and greater protection of property rights. Simply put, in this view a country such as the United States simply had the good fortune to be a British colony and to inherit British institutions.

Such research has led to reconsiderations of the underlying roots of different economic outcomes. It might seem to suggest that the importance of government economic policy is overrated, and that there are deeper roots to a country's economic success (or failure) than simply implementing the right (or wrong) policies. In this view, initial conditions, not the policy choices made by a particular generation of leaders, were most responsible for a country's economic success or lack of it.

Yet to attribute all or most of U.S. economic success to its initial geographic and climatic conditions and its colonial inheritance perhaps goes too far in discounting the role of different institutional arrangements and different economic policy choices in affecting long-term outcomes. The United States may well have had the climatic and geographic endowments that were conducive to the importation of good institutions, and it may have inherited good institutions from its original colonizer, but that does not mean that success was predetermined. As Acemoglu, Johnson, and Robinson (2001, 1395) observe, there are "substantial economic gains from improving institutions, for example as in the case of Japan during the Meiji Restoration or South Korea during the 1960s." Japan's Meiji leaders, in a setting of limited natural resources, adopted modern institutions and policies that quickly catapulted it ahead of other Asian countries. South Korea and North Korea in the 1950s had virtually the same ethnic and cultural heritages and levels of income; half a century later South Korea's per capita income was ten times North Korea's. Barbados and Jamaica, two Caribbean island economies inhabited mainly by descendants of African slaves, as former British colonies inherited nearly identical political, legal, and economic institutions; yet in the latter half of the twentieth century Barbados, by making better economic policy choices, grew nearly three times faster than Jamaica in real per capita income.[9] Clearly, there are substantial variations in policies and outcomes within countries having the same or similar geographies, climates, and legal origins. There are also reasons for doubting that

9. See Henry and Miller (2009). Barbados and Jamaica are not entirely similar. Barbados, smaller and more densely populated, experienced out-migration, whereas Jamaica had more land so that people could leave the plantation sector for small farms. But in that sense Jamaica was more like the United States than was Barbados, which might reinforce the view that policy choices indeed matter as much or even more than inherited institutions.

protection of property is constant over time in countries of a given legal origin.[10]

Even within a given colonial inheritance, there can be a variety of political institutions. A pertinent example is, of course, the United States. The Articles of Confederation provided for one system of political rules, but those rules did not seem promising in ensuring the nation's economic success. Yet the American political system was flexible and adaptable enough to make adjustments by scrapping the Articles of Confederation in favor of the Constitution. If powerful vested interests had a stake in preserving the status quo under the Articles, as some historians suggest, they might have been able to prevent the political change, leaving the United States with a very different institutional mix. Instead, a consensus among the Founding Fathers flexibly adapted the political rules to creating market- and growth-promoting institutions. The alternative arrangements under the Articles could not survive without the political support of important, commercially engaged segments of society that favored a stronger national government. Fearful of excessive government power, however, the founders also ensured that the Constitution included the separation of powers and many checks on executive discretion, which helped to make more credible the promises of the government to respect property rights.[11]

Among the greatest contributions of the Constitution to the well-being of the nation was to preserve, even extend, a large and open market area. The economic benefits of an expanding free-trade area reduced the incentives of individual states or groups of states to break away and form independent countries. Not only would independent states potentially jeopardize the large and open national market of the American union, but as the history of Europe amply demonstrates, they could have been a source of political friction and even military conflict. The Constitution's failure to resolve the slavery issue, a failure that likely was the price of having a union of the original thirteen states, would lead to a costly Civil War eight decades later. But it is likely that other interstate conflicts were avoided because of the federal union and its commitment to free trade among states. Research by economists and political scientists amply documents the devastating and

10. See Haber, North, and Weingast (2008). As Haggard, MacIntyre, and Tiede (2008, 219) note: "Chile and Iraq are both civil law countries; Ireland and Sierra Leone common law countries. Yet does anyone believe that the performance of Sierra Leone or Iraq is likely to be explained to any significant degree by its legal system, however defined?"

11. See Weingast (1995, 1997). One potential contributor to America's economic success is the abundance of natural resources. Yet it has also been argued that natural resources can be a curse to economic development because they create rents that can breed domestic conflicts over control of those resources. Several factors allowed the United States to avoid the problems associated with resource abundance. America's resource base was widespread and accessible to most individuals (for example, the Homesteading Act). Thus, free entry and widespread land holding prevented the creation of scarce and valuable rents that would generate domestic conflict. In addition, America's democratic political institutions were sufficiently entrenched and had legitimacy to push conflict over resource rights to political and legal institutions rather than to other forms of power grabbing. See Lederman and Maloney (2007).

destructive economic effects of civil conflict, which can even threaten a wider breakdown of law and order.[12]

## What Have We Missed?

Just as there were founding choices, there are choices to be made in making a collaborative study and putting together a book on founding choices. After the coeditors organized the project and secured the participation of the authors represented here, discussions with them and with others indicated topics that we might have included but did not.

One is national security, an area in which the founders had many concerns and choices to make. Important recent books have shed new light on national security concerns at the founding. Historian Max Edling (2003) argues that founders, traditionally thought to have written the Constitution to check the excessive democracy of state legislatures because they deemed it to be inconsistent with both the common good and minority rights, were as much if not more concerned about building a strong national state that could stand up to the predatory inclinations of larger, stronger European states. And well they might, since Britain, France, and Spain posed real threats to the fledgling American republic during the 1790s and early 1800s. Political scientist David Hendrickson (2003) amplifies the argument by contending that the Constitution was in effect a peace pact between sovereign but divided states and communities. These entities chose to make peace amongst themselves in 1787 and 1788 so that they could better put up a united front against the European predations they feared. We might remember that the United States founded a coast guard and a navy in the 1790s to complement its army, and that after his influential role as the first secretary of the treasury from 1789 to 1795, Alexander Hamilton was commissioned a major general and served in effect as chief of staff of the U.S. army from 1798 to 1800. The military policies of the United States were quite controversial during the 1790s. After that they became less controversial, and the military played no small role in the territorial and economic expansion of the country, as well as its increasing role in the world of empires and nations.

Another topic we have slighted, although not totally ignored, is the judiciary. The federal judiciary was to play an important role in the system of governmental checks and balances designed by the founders. The Supreme Court would pronounce the laws of Congress and state legislatures as well as the actions of the federal executive branch to be unconstitutional. The federal courts would settle disputes between states and between citizens of different states. The judiciary role in the 1790s was, however, less important than it became in subsequent decades as the country expanded. A number of landmark Supreme Court decisions under Chief Justice John Marshall who headed the Court from 1801 to 1835 proved instrumental in delineating fed-

12. See Collier (1999).

eral and state powers, in protecting private property rights, and in preserving the U.S. common market as a free trade area. In the case *Dartmouth College v. Woodward* (1819), the Marshall Court ruled that the contract clause of the Constitution limited the power of a state to overturn a corporate charter, thereby extending the protection of contracts between individuals to corporations. In *McCulloch v. Maryland* (also 1819), the Court affirmed the constitutionality of the Bank of the United States and more broadly the power of the federal government to pursue explicit or implicit constitutional ends by appropriate means to those ends. *Gibbons v. Ogden* (1824) upheld the constitutional authority of Congress, and not a state, to regulate interstate commerce. On the other hand, the decision of Chief Justice Roger Taney in *Dred Scott v. Sandford* (1857), which enhanced the rights of slaveholders, contributed to dividing the nation.

Finally, education receives little attention in this volume. As Engerman and Margo note in their chapter, the founders chose, perhaps wisely, to leave most decisions about education to the states and localities. The first state-sponsored universities were established in the 1790s, in North Carolina and Georgia. We might also have given more attention to the effects of founding choices on the distributions of political power and incomes. No doubt there are other omissions, but we hope that we have treated the most important founding choices.

What is evident in the pages that follow is that the economic policy choices of the founding era released a burst of energy that would persist for more than two centuries. In half a century the land area of the United States would triple in size, spreading from sea to sea. In a century, the American economy would be the largest of any of the world's nations, drawing to it large numbers of immigrants from around the world. In two centuries, a nation that in 1790 had less than half a percent of the world's population would become the world's third most populous nation, one in which 5 percent of the world's people would produce some 20 to 25 percent of world economic output, and enjoy a standard of living unimaginable a century or two ago. Such economic size and strength made the country politically what some would describe as the world's sole superpower and even a hyperpower. In 2010, Americans as usual, maybe even more than usual, worry about their own and their country's economic problems. The founders, we surmise, would have a different view. They would take a measure of pride in the long-term results of their economic policy choices.

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