

# Opening Access in Early America

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One of the central questions in American history in general is why economic growth has been so robust and persisted for so long. The question is *the central* question in American economic history. Much of the material we cover this week concerns how the economy works and how the American economy in particular developed.

One of the key elements in the growth of the American economy is the government's relationship with the economy. On one hand, governments in wealthy societies tend to do a good job at providing certain services and functions:

- Legal system: secure property rights, unbiased enforcement of laws
- Infrastructure: roads, water, sewage, power
- Education
- Social welfare services: public health, old age assistance, assistance for poor
- Police, fire, and public safety
- Military

Providing these functions requires a strong and capable government. The other thing that governments in wealthy countries tend to do is allow their citizens a considerable range of personal freedom and security.

That is, governments in wealthy countries have a good bit of capacity and ability to provide valuable public services, but somehow manage to avoid using their capacity and power to infringe on the rights of individual citizens.

How does that happen that governments simultaneously get stronger and manage to use less coercion against their own citizens?

Douglass North, Barry Weingast, and I have developed a framework for answering these types of questions.

The framework begins by asking how is it that societies solve the problem of violence. That is, how do societies not only how do societies provide physical order through policing violence, but how do societies prevent powerful individuals from using violence as a means of coercion?

There appear to be three fundamental ways that societies solve the problem of violence. We call these solutions *social orders*.

The first social order dominates most of human history. In *primitive social orders*, societies are organized in very small groups, somewhere between 25 and 100 people. Face to face repeated interaction with the same individuals enables these societies to control violence somewhat, but the level of violence, both between and within groups, is high.

The second social order emerged about 10,000 years ago. In *limited access social orders* a group of powerful individuals agree to recognize each other's rights to valuable functions and assets within the society. These rights are *privileges* that generate rents to individual members of the elite group.

Elite privileges include the control of assets like land, labor, and capital as well as functions like prayer, trade, and education.

Members of the elite include the militarily powerful as well as religious, economic, political, and educational elites. Military power is typically dispersed through the dominant coalition, that is there are multiple sources of potential violence, and individual elites are allied with one another through extensive patron/client networks.

Because the rents generate by elite privileges are more valuable if there is peace, elites have a strong incentive to maintain order. This does not mean that everyone enjoys rights, only the elites (at least in a stark, ideal type of limited access order).

This is called a limited access order because elite rents are created by limiting access, and then the rents are used to stabilize the political and social system.

One of the most valuable source of elite rents is the ability to form organizations

that the society will enforce. In a limited access order only elites have the rights to form organizations.

In a limited access order, the political system systematically manipulates the economy. We call this form of political and economic organization the *natural state*.

The third type of social order first appeared about 200 years ago. In *open access social orders* control of violence is accomplished by consolidating control of military power in a political organization (military power takes the form of both armies and police forces), giving the political organization a monopoly on the use of violence, and then constraining the use of violence by the government through political and economic competition.

The point of the *limited access order* is to limit political and economic competition as a way to provide incentives for powerful individual to refrain from using violence. In an *open access order*, control of the government and economic functions is open to competition.

The essence of an open access order is that people can form organizations at will, and use those organizations to pursue whatever ends they want: political, economic, religious, etc. The one constraint on the formation of organizations is that they cannot use violence to pursue their goals. As Max Weber said: the state is the organization in society with a monopoly on the legitimate use of violence. Weber's definition applies only to open access orders.

When governments in open access order overstep their bounds, they are disciplined by electoral, political, and economic competition.

Because access to organizations is open, whenever a group is harmed by the actions of the government, they can organize politically to defend their *rights*.

The equilibrium of social forces in a open access order is provided by competition, the equilibrium of social forces in a limited access order is provided by rent creation.

When did the United States become an open access order?

We usually tell the story of American history beginning in the revolution and continuing through the constitution. But it is not clear that the American society was completely open access even in 1787.

Open access requires open political competition, and in every developed society today that involves some type of political parties. Political parties were an anathema to the founding fathers. Remember the “dangers of faction” in Federalist paper #10.

No state had free adult male suffrage by 1787, all of them had some form of property, wealth, or tax paying restriction.

Open access requires open economic competition. In every state obtaining a corporate charter required an act of the state legislature. In New York, granting of bank charters was limited to political friends of the Albany Regency, headed by Governor Martin Van Buren. In Pennsylvania, the number of bank charters was limited in order that the sale of bank charters would generate revenues for the state treasury. In New Jersey, one company, the Camden and Amboy railroad had a monopoly on northeast/southwest rail traffic. Again, as with the Pennsylvania banks, the state was selling limited economic privileges in return for revenues. But, as in New York, the creation of valuable economic privileges also generate political returns as well.

Americans in the early 19<sup>th</sup> century, were legitimately concerned that their democracy would founder. Their deepest concerns would be that a political faction would use the creation of economic privileges to generate economic rents, and then use those rents to solidify control over the political system. They were concerned, in short, that their democracy would operate like a limited access order.

In the 1830s and 1840s, state governments began changing their institutional and constitutional structures to mandate open access.

On the political side, this occurred through the development of competitive political parties and the extension of the suffrage. On the economic side, it came through the adoption of general incorporation acts that allowed any one who

wanted to form a corporation to do so simply by filing the appropriate paperwork at a state administrative office. In banking, general incorporation acts were called “free banking” acts, where the free referred to entry, not to regulation.

Interestingly, the first general incorporation act was for churches in New York in 1783.

By the 1850s, Americans had transformed their political and economic institutions at the state level in a manner that insured open access to political, economic, and religious organizations. That access guaranteed that ongoing political and economic competition would enable the American society to effectively control violence through the operation of its governments. Open competition also insured that those governments could be effectively prevented from limiting access or using violence against its own citizens in an unconstitutional manner.