Public Choice Interpretations of American Economic History

Public Choice Interpretations of American Economic History

Edited by

Jac C. Heckelman, Wake Forest University
John C. Moorhouse, Wake Forest University
Robert M. Whaples, Wake Forest University

SPRINGER SCIENCE+BUSINESS MEDIA, LLC

Library of Congress Cataloging-in-Publication Data
Public choice interpretations of American economic history / edited by Jac C. Heckelman, John C. Moorhouse, Robert Whaples.
p.cm.
"Revisions of papers that were presented at a conference held by Wake Forest University's Department of Economics on April 9-10, 1999"--P..
Includes bibliographical references and index.
ISBN 978-1-4613-7065-9 ISBN 978-1-4615-4573-6 (eBook)
DOI 10.1007/978-1-4615-4573-6
1. Social Choice--United States--History. 2. Public goods--History.
3. United States--Economic conditions. I. Heckelman, Jac C. II. Moorhouse, John C., 1943- III. Whaples, Robert.

HB846.8 .P8324 1999
330.973--dc21 99-048310

Printed on acid-free paper.

Table of Contents

List of Contributors

Barbara J. Alexander is a Senior Associate at Charles River Associates, an economics, litigation support, and business consulting firm. She is the author of articles published in the *Journal of Economic History*, *Public Choice*, the *Journal of Law and Economics*, and the *Review of Economics and Statistics.*

Terry L. Anderson is executive director of the Political Economy Research Center in Bozeman, Montana and senior fellow at the Hoover Institution. He has published widely in the fields of environmental history and free-market environmentalism. His work has appeared in the *Journal of Law and Economics*, *Economic Inquiry*, the *Southern Economic Journal*, *Explorations in Economic History*, the *Journal of Economic History* and other journals and collections. His latest book, (co-authored with Donald Leal) is *Enviro-Capitalists, Doing Good While Doing Well.*

Jim F. Couch is an Associate Professor of Economics at the University of North Alabama. His research interests include public choice and public policy and have been published in *Public Choice*, the *Cato Journal*, and *Economics and Politics*. He is co-author (with William F. Shughart II) of *The Political Economy of the New Deal.*

Keith L. Dougherty is an Assistant Professor of Political Science at Florida International University. His research interests include American political development, federalism, and constitutional design. His related work includes a book on the Articles of Confederation (forthcoming from Cambridge University Press), as well as articles in *Public Choice* and the *Journal of Theoretical Politics.*

Jac C. Heckelman is an Assistant Professor of Economics at Wake Forest University. His research interests are in the areas of political economy and applied economic history, focusing primarily on secret ballot elections and political business cycles. He has published in *Public Choice, Economics and Politics, American Politics Quarterly, Explorations in Economic History,* the *Southern Economic Journal* and other journals.

Peter J. Hill is George F. Bennett Professor of Economics at Wheaton College and Senior Associate at the Political Economy Research Center. His research focuses on the evolution of property rights in the American West. He has published articles in the *Southern Economic Journal*, the *Journal of Law and Economics*, *Economic Inquiry*, the *Independent Review* and other journals. Among his books is *Eco-Sanity: A Common Sense Approach to Environmentalism* (with Joseph L. Bast and Richard C. Rue).

Gary D. Libecap is Karl Eller Professor of Economics at the University of Arizona. His research has focused on relational contracting in unitization agreements in oil and gas production; the development of regulatory policy regarding agriculture; and property rights arrangements and rain forest harvest practices. His work has been published in the *Journal of Political Economy*, the *American Economic Review*, *Explorations in Economic History*, *Economic Inquiry* and other journals. He is editor of the *Journal of Economic History.*

John C. Moorhouse is Carroll Professor in the Department of Economics at Wake Forest University. His research interests are in the field of law and economics. He is author of articles in the *Journal of Urban Economics*, *Public Choice*, the *Cato Journal*, the *Southern Economic Journal* and other journals and collections.

Felix Oberholzer-Gee is an Assistant Professor of Public Policy and Management at the Wharton School of the University of Pennsylvania. He research interests are in international political economy, experimental economics and environmental economics. His work has been published in the *American Economic Review*, the *Journal of Political Economy*, *Public Choice*, and the *Journal of Policy Analysis and Management.*

William F. Shughart II is Frederick A. P. Barnard Distinguished Professor of Economics and holder of the Robert M. Hearin Chair in Business Administration at the University of Mississippi. His research interests include public choice and industrial organization. He has published more than one hundred journal articles and book chapters, and seven books, including most recently (with Jim F. Couch) *The Political Economy of the New Deal.* He is also the book review editor for *Public Choice* and the senior editor of the forthcoming *Elgar Companion to Public Choice.*

Koleman S. Strumpf is an Assistant Professor of Economics at the University of North Carolina-Chapel Hill. His research focuses on political economy, the formal study of politics, and the behavior of state and local governments. His articles have been published in the *Journal of Public Economics*, *Economics and Politics*, and the *Journal of Urban Economics.*

Werner Troesken is an Associate Professor of History and Economics at the University of Pittsburgh. His primary research interests are in late nineteenth and early twentieth-century public policy and economic institutions. He is author of *Why Regulate Utilities? The New Institutional Economics and the Chicago Gas Industry, 1849-1924* as well as articles in the *Journal of Economic History*, *Explorations in Economic History*, the *Journal of Law, Economics, and Organization* and other journals. He is an editor of the journal *Social Science History.*

John J. Wallis is an Associate Professor at the University of Maryland-College Park. His areas of interest are state and local government finances, the New Deal, and institutional change. Since 1984 he has been involved in a data collection project, funded by the National Science Foundation, to create financial accounts for state and local government from 1787 to 1980. He has published articles in the *Journal of Economic History*, *Explorations in Economic History*, *Economic Inquiry*, the *Review of Economics and Statistics*, the *Journal of Institutional and Theoretical Economics*, and other journals and collected volumes.

Robert Whaples is an Associate Professor of Economics at Wake Forest University. His research interests are in historical labor markets. He has published in *Economic Inquiry*, the *Journal of Economic History*, the *Southern Economic Journal*, *Social Science History*, the *Journal of Economic Education* and other journals. He is Associate Director and Book Review Editor of EH.NET.

John H. Wood is R. J. Reynolds Professor of Economics at Wake Forest University. His main research interests are money, banking, and monetary policy. Current projects are on the evolution of commercial bank reserve requirements. He is author of articles published in the *American Economic Review*, *Public Choice*, the *Journal of Monetary Economics*, the *Journal of Finance* and other journals. His forthcoming book is titled *"A Company of Merchants:" A History of the Theories and Ideas That Have Shaped Monetary Policy.*

Acknowledgements

This volume presents revisions of papers that were presented at a conference held by Wake Forest University's Department of Economics on April 9-10, 1999. Most of the credit for organizing the conference goes to Jac C. Heckelman. We are grateful to Dean Paul Escott and Provost David G. Brown for financial assistance and are especially indebted to the following scholars who commented on earlier versions of these papers at the conference: Michael J. G. Cain (Department of Political Science, University of Mississippi), Lee A. Craig (Department of Economics, North Carolina State University), Gary Durden (Department of Economics, Appalachian State University), Kenneth A. Snowden (Department of Economics, University of North Carolina-Greensboro), and Andrew J. Yates (Department of Economics, Tulane University). Students in Jac Heckelman's "Public Choice" course provided additional useful comments on the papers. Most of all, we thank all the contributors to this volume for their hard work, original ideas and willingness to revise their papers on our tight deadlines

INTRODUCTION

Jac C. Heckelman,
John C. Moorhouse
and
Robert Whaples

The eight chapters of this volume are revised versions of papers originally presented at the "Applications of Public Choice Theory to Economic History" conference held at Wake Forest University, April 9-10, 1999. They all apply the tools of public choice theory to the types of questions which economic historians have traditionally addressed. By adding the insights of public choice economics to the traditional tools used to understand economic actors and institutions, the authors are able to provide fresh insights about many important issues of American history.

1. DEVELOPMENTS IN PUBLIC CHOICE THEORY

Economists have historically sought to develop policies to improve social welfare by correcting perceived market failures due to monopoly power, externalities, and other departures from the textbook case of the purely competitive model. An underlying assumption is that the public sector, upon recognizing the market failure, will act to correct it. Applied work often develops the conditions under which these policies will be optimal.

The public choice movement has questioned the false dichotomy established by welfare economists. Economists of all persuasions assume traditional private market actors, such as entrepreneurs, managers, and consumers, are self-interested rational maximizers. Why should this not hold for all economic agents? The innovation of public choice analysis is to show what happens when public sector actors, such as politicians, bureaucrats, and voters, also behave as rational self-interested maximizers. The welfare implications of establishing governmental monopolies to regulate private transactions are vastly different under this scenario.

Public choice (which goes by different names depending upon the audience, including Rational Choice, Formal Political Theory, and the New Political Economy) is often considered simply as the application of economic tools to traditional political science lines of inquiry, but has evolved past that point. It often employs new tools from outside the discipline but always retains a definitive economic flavor. Public choice analysts formally model the government sector, thereby making policy endogenous, rather than assuming economic agents respond passively to exogenously determined governmental rules and institutions.

Public choice scholars have both reinvestigated established ideas and also moved the economics and political science professions into new directions. This allows us to better understand the implications of government regulation. It provides a stronger contrast between private market failure and government regulatory failure when policy is endogenized to benefit well-formed special interest groups or the government officials themselves (just another special interest group) over the general interest of unorganized common citizens.

As a field, public choice can trace its origins to scattered writings in various publications, but Anthony Downs' seminal book, *An Economic Theory of Democracy* (1957), was the first well-read example of positive public choice analysis. Downs presented the first integrated axiomatic treatment of the government sector and the election process, and showed how economic tools can be applied to non-market decision processes. The field grew during the 1970s, mainly as a reaction to the active promotion of interventionist economics and the Keynesian tradition. One definitive trait running through most public choice models is that of rent-seeking. Although the phrase "rent-seeking" was coined by Anne Krueger in her (1974) study of India's tariff structure from a macroeconomic perspective, public choice work in this area was begun earlier by Gordon Tullock (1967), focusing on the social losses accruing from monopoly creation under patent policy, using microeconomic analysis. Rent-seeking, which in general refers to the inclination to devote resources toward promoting redistribution through government policy rather than new production, has powerful implications for welfare analysis. As Mancur Olson has shown from a microeconomic perspective in *The Logic of Collective Action* (1965), individuals and small groups may expect greater net benefits from using their resources to lobby for benefits for themselves. The harmful consequences will be spread out among society overall. So while there are net losses to society, those expected to achieve the concentrated benefits will fight harder for the policy than the majority who bear the diffuse costs. The implications of collective action comprise an important component in several of the contributed chapters to this volume. Olson later extended his work to examine the macroeconomic consequences in *The Rise and Decline of Nations* (1982). It takes time for special interest groups to form and overcome the initial inclination for free-riding, but once they do, they will be more likely to channel resources toward unproductive rent-seeking. As these groups continue to form, more and more resources will be diverted away from new production, thereby harming growth possibilities.

Here we see both positive and normative public choice analysis. Without a strong government sector actively involved in regulating the economy, private actors would not be enticed into wasting resources for policy manipulation. On the other hand, private market outcomes which deviate from the perfectly competitive non-externality model may also yield undesirable consequences. Furthermore, Olson argues that the special interest groups will lose their stranglehold on policy after a government collapses, such as after a coup or invasion, and thus stable democracies will be prone to continually shrinking growth. Olson is quick to point out, however, that there are other positives associated with living in a stable democracy and does not argue that governments should be periodically overthrown simply to spur new growth.

Although many economists were initially reluctant to apply neoclassical economic analysis to areas outside of formal markets, the public choice paradigm was formally recognized by the economics profession with the awarding of the Nobel Prize to James M. Buchanan in 1986. At present, the paradigm can be, and often is, applied to any field within economics (often without explicit recognition of the public choice approach) but many economics programs still do not offer separate field courses in public choice at either the graduate or undergraduate level.

2. DEVELOPMENTS IN ECONOMIC HISTORY

Economic historians have always dealt with questions about how government makes decisions. Like political historians, they have long looked at the role of economic interest groups in making public policy. One early and noted example is Charles Beard's (1913) *An Economic Interpretation of the Constitution*, which detailed the economic interests of the representatives at the U.S. Constitutional Convention and argued that these interests were crucial in the shaping of that document. However, this early research rarely incorporated formal models and could not test for the marginal influences of competing interest groups as they moved toward political equilibrium.

Economic historians could only begin to use public choice theory after the field was transformed by its own revolution—the cliometric revolution. Cliometrics is the explicit use of economic theory, models and measurement in answering questions about the history of the economy. The birth of this cliometric approach is often traced to the publication of an article by Alfred Conrad and John Meyer (1958) which applied the capital asset pricing model to the decisions of southern slave owners and computed the rate of return from owning slaves. Cliometrics swept through the economic history profession during the 1960s and early 1970s (Whaples 1991). Almost all economic historians in the U.S. today are cliometricians and the 1993 Nobel Prize in Economics went to two pioneers of cliometrics, Robert W. Fogel and Douglass C. North, "for having renewed research in economic history by applying economic theory and quantitative methods in order to explain economic and institutional change."

As the cliometric revolution progressed, it was inevitable that the formal modeling and measurement of economic behavior would expand to bring in the public choice theories that had been developed by other economists. Among the earliest efforts to do this was an article by Gavin Wright (1974) which modeled Franklin Roosevelt as a rational maximizer, attempting to distribute federal New Deal expenditures in a manner which would maximize his and the Democratic Party's chances of reelection. Wright's results showed the powerful impact of politics on this facet of the economy and spawned several rounds of additional studies—one of which is included in this volume. Another milestone in the marriage between public choice theory and cliometrics was Robert McGuire and Robert Ohsfeldt's (1986) reanalysis of Charles Beard's contentions about economic interests and voting at the Constitutional Convention—using logit analysis to examine the impact of personal and constituent interests on votes over specific issues at the convention.

Still, until recently, most economic historians have preferred to answer questions about the functioning of markets and the impact of government policies, rather than probing the impact of interest groups and existing institutional arrangements on the form of government regulation and other policies. Only recently has there been an upsurge in research dedicated to examining how coalition formation has transformed the structure of regulation and legislation—such as Shawn Kantor's (1998) examination of the messy coalition building needed to enact stock laws in late nineteenth-century Georgia. The most notable example of this recent work is a collection of papers edited by Claudia Goldin and Gary Libecap (1994). Its primary goal was to provide case studies of the origins of government intervention into the economy. About half the papers focused on how well constituency interests were reflected in legislation. The other half explored how preexisting policies, institutions, and economic market structures shaped legislation and regulatory activity. The volume included chapters on railroad regulation, utility regulation, banking regulation and insurance, New Deal marketing regulations, immigration restrictions, and workers' compensation regulation.

A review of the Goldin and Libecap volume (Childs 1995) concluded that more such projects need to be done and that they need to be more long-range in their scope. We believe that our volume can help fill these needs. This volume covers many of the same issues and uses many of the same approaches that are used in the Goldin and Libecap volume. Although each is narrowly focused, the papers in this volume collectively cast their nets even more broadly. Most deal with the legislative process and regulatory activity, but others broaden the focus to include the bases of government finance, the evolution of property rights, and the inner workings of agencies over a broader period of time—from the colonial era to the present.

3. FINDINGS OF THIS VOLUME

The studies making up this volume cover the period 1777-1970. Each analyzes an episode in American economic history within a public choice framework of rational maximization. Agents or interest groups are interpreted as either responding in predictable ways to economic incentives put in play by government policy or attempting to influence government policy. In Chapter 1, Keith L. Dougherty offers an explanation of state compliance with the system of requisition under the Articles of Confederation. The central issue of the time for the federal government was the prosecution of the war for independence. Because the central government had no power under the Articles to force states to meet their war time obligations, one would expect a state to free-ride on the payments of men, money, and materiel made by other states. Dougherty argues that a state's requisition payments depended on the degree to which federal services represented private, rather than public, goods to a state. Requisitions of men during the period 1777-1783, and of funds to repay the national debt during the period 1784-1789, are modeled empirically. Dougherty's proxy variables, for the degree to which military services during the war and repayment of the debt in the years immediately following the war are private goods to the individual states, are statistically significant and consistent with his hypothesis. Not only does Dougherty analyze an interesting historical question; he does so in a way that tests the free-rider implication from public choice theory.

Next, John J. Wallis describes the major nineteenth-century transition in the source of revenue to the states and in the source of government finance of infrastructure from state to local government. From 1800 to 1840, the major sources of revenue to the states were fees from special legislative acts of incorporation and income from investments in railroads, canals, banks, and other private corporations. By 1835, over a third of the states had abolished their property tax. By 1900, the situation had changed dramatically. Almost every state prohibited incorporation by special act and state investment in private corporations. Over half of all state revenue was generated by property taxation. Moreover, local governments dominated investment in transportation and public utilities. Local government debt was eight times that of state debt in 1900. A simple public choice model explains this transition. Implicit cost-benefit calculations meant that the system of state and then local financing of infrastructure worked reasonably well. In the first four decades of the century, the beneficiaries of state acts of incorporation and direct investment paid the state fees, dividends, and tolls. Benefits and costs were linked. When state constitutional reforms in the middle decades of the century prohibited this system of functional finance, infrastructure investment devolved to local government and special (local) districts. This tended to reestablish the linkage between benefits and costs. Local taxpayers, the chief beneficiaries of local public infrastructure investment, realized that more benefits meant higher taxation. This nineteenth-century shift in the structure of government from state to local prominence has not played much of a role in the history of public finance. Wallis' study begins to remedy that omission.

The evolution of property rights is the story of how increasing resource values generate investment in new methods and technologies for defining and enforcing property rights in those resources. Absent complete property rights, open access resources are subject to excessive exploitation with the concomitant dissipation of rents. In Chapter 3, Terry L. Anderson and Peter J. Hill analyze three cases from the American West, involving the overgrazing of the northern plains, despoliation of the Yellowstone Basin, and low productivity of Indian communal lands. Each allegedly represents a tragedy of the commons justifying government invention. Building on their work on the evolution of property rights, Anderson and Hill go beneath this obvious interpretation of institutional failure to ask: Why did not property rights evolve to close the commons in these three cases? In short, the answer they provide is that federal land policy thwarted that evolution by imposing artificial transaction costs on closing the commons. After developing a model of individual and group actions for excluding outsiders, Anderson and Hill apply their model to the three cases. To take just one example, cattlemen's associations, cooperative roundups, control of access to water, and, later in the nineteenth century, the use of cost-effective barbed wire fencing closed the open range and mitigated overgrazing. Private institutions were closing the open range. But special interests pressured the federal government into adopting policies that countered these customary range rights by outlawing the use and forcing the removal of extra-legal fencing (1885) and the passage of a series of homestead acts (1862-1909) that privatized some of the open range but only by dividing it into economically unviable small parcels of 160 acres. These small homestead plots are not suited to agriculture in the semi-arid northern plains. Serving the politics of the time, the homestead acts significantly increased the transaction costs of enclosing the more efficient large-scale ranches. The same kind of analysis shows how private efforts to preserve the natural wonders of Yellowstone and how traditional Indian means of overcoming the tragedy of the commons were undermined by federal policies. The authors conclude that interest group politics led to a race to grab land with the resulting dissipation of land rents, open access to national parks causing subsequent overcrowding, and to the tragedy of federal trusteeship of Indian economic development and self-determination.

Controversy surrounds the interpretation of the Sherman Act. Did it decisively deal with the trusts or was it a mere sop to the populists? Did it protect small business against large-scale efficient competitors or did it help big business by forestalling the passage of more onerous state antitrust laws and easing the way for the passage of the McKinley Tariff? In Chapter 4, Werner Troesken employs an event study to analyze the previously untested weak and strong appeasement hypotheses about the Sherman Act. Troesken reasons that if the Sherman Act was merely a sop, it should have no effect on the financial returns of a set of firms making up national trusts. This is the weak appeasement hypothesis. The strong hypothesis is that the Sherman Act benefited the trusts and the author argues that, under that condition, passage of the act would be expected to increase the market value of trusts. Using weekly data from July 8, 1889 through September 2, 1890 on the market value of shares of the American Cotton Oil Trust, the National Lead Trust, and the Sugar Trust, Troesken finds some evidence that the Sherman Act increased the value of the average trust. Investors apparently did not perceive the Sherman Act as a significant threat to the trusts. By contrast, firm-specific estimates suggest that state antitrust statutes did pose a threat to the trusts. Both are consistent with the strong appeasement hypothesis since active state enforcement would be displaced by the new federal act. Troesken's study suggests that economic historians interested in the politics surrounding the passage of the Sherman Act should consider not only the lobbying of small businesses and farmers, but the politicking of the trusts, as well.

The Great Depression and the New Deal were watershed events in American economic history. Historians have explained the distribution of New Deal spending across states in terms of localized economic need, upgrading federally-owned assets (particularly those found in the West), the political self-interest of the national Democratic party, and the matching requirements of federal relief programs. Jim F. Couch and William F. Shughart II, employing disaggregated data on Works Progress Administration spending, re-examine the relative importance of these factors. In Chapter 5, they present estimates suggesting that the distribution of WPA spending was driven largely by political considerations and negatively (perversely) related to state matching funds. Moreover, they find that WPA spending was used to improve federal assets in sparsely populated western states. Finally, they reveal that WPA distributions were in part determined by the voting record of the states' senators in supporting or opposing other New Deal legislation. Political self-interest mattered hugely to New Deal policymakers in Washington.

The New Deal also represented large-scale federal assistance of anti-competitive behavior. Barbara J. Alexander and Gary D. Libecap trace the history of two major efforts at government sponsored cartels: for agriculture and for industry. The Agricultural Adjustment Acts of 1933 (struck down by the Supreme Court in 1936) and 1938 provided for price supports, acreage and marketing control, parity payments, export subsidies, crop insurance, and government purchase. Most of these policies have persisted until today. By contrast, little is left of the industrial codes of the National

Industrial Recovery Act (struck down by the Supreme Court in 1935). Chapter 6 explains the different experiences of these twin efforts at cartelization. New Deal agricultural policies had strong political support stemming from the close cooperation of the Department of Agriculture and the American Farm Bureau going back to the early 1920s farm crisis. A reasonably homogeneous cost structure, across farms by size, aligned interests and lowered the cost of organizing the farm lobby. Alexander and Libecap find that middle to large producers made up the core of the political constituency supporting New Deal agricultural policy. Because they tended to be the low cost producers, the pricing policies they supported were politically durable. No comparable cost homogeneity existed within the industrial sector. Moreover, it tended to be the high cost producers that were the most ardent supporters of National Recovery Administration codes. But intra and inter-industry cost and profit level differences undermined comprehensive political support. Collusive policies favoring high cost producers were not self-enforcing. They invited undercutting. By 1935, the U.S. Chamber of Commerce and the National Association of Manufacturers opposed extension of the NRA. The public choice theory of political coalitions explains much of the durable legacy of New Deal agricultural policies while simultaneously explaining the disappearance of NRA codes of fair competition.

Bankers, unlike most managers of regulated businesses, have a choice of regulators. They can choose incorporation under state charter, which subjects them to state regulation, or they can choose to become a national bank and be regulated by the Comptroller of the Currency. In addition, after 1913, state banks also had the choice of becoming members of the Federal Reserve System—national banks were required to join. The decision to become a member of the Federal Reserve System or remain outside hinged on the relative costs and benefits of joining. Chief among the benefits were access to the Fed discount window and subsidized check clearing and collection services. A major cost was the higher non-interest-bearing reserve requirements. This cost fluctuated with market rates of interest. Using the theory of clubs and voting with the feet, Jac C. Heckelman and John H. Wood model the decision of a state bank to join, remain in or outside, or relinquish membership in the Federal Reserve System. In Chapter 7, the authors argue that the decision was sensitive, among other factors, to interest rates, until 1980 when the Monetary Control Act required all banks to follow the Fed's reserve ratio requirements. Banks can be expected to lobby their regulators for more favorable regulations. The Banking Act of 1935 enhanced that opportunity for members of the Federal Reserve System because it gave the Fed authority to set reserve requirements and the interest rate payable on time deposits. Heckelman and Wood provide evidence that high interest rates provided an especially strong incentive for large banks, relative to small banks, to remain outside the Fed, but that after the passage of the Banking Act of 1935, larger banks tended to remain in the Fed system. The authors conjecture that large banks remained members because of the new opportunity to lobby the Fed and that small banks stayed out or dropped out to engage in free riding on the large banks' lobbying efforts, joining the system as the required ratios fell. Between 1935 and 1980, Fed required reserve ratios fell by half. This study highlights how regulatory incentives can sort firms into relatively homogeneous groups (clubs) and that homogeneity can facilitate more effective internal lobbying.

In the final chapter, Koleman S. Strumpf and Felix Oberholzer-Gee present an empirical test of a hypothesis developed within the public choice paradigm; namely, that in a democratic regime, heterogeneous policy preferences lead to decentralized decision-making. Adoption of the Twenty-first Amendment—repealing Prohibition—turned over authority to regulate the consumption of alcohol to the states. The states had three choices: permit alcohol sales and consumption throughout the state, ban sales and consumption throughout the state, or permit local option. Using a two-step procedure, Strumpf and Oberholzer-Gee first estimate local preferences based on local demographic and economic variables as regressors in a probit analysis across local jurisdictions in states with local option. Regressions are estimated for 1935, 1940, 1950, 1960, and 1970. These estimates of local preferences are then used in the second stage to predict a state's adoption of local option. The evidence is consistent with the hypothesis that states with a higher degree of preference heterogeneity are more likely to grant local governments the authority to regulate alcohol sales. This case study provides a test of the theory of fiscal federalism and a method for further testing the theory using other policy choices.

Ultimately, the purpose of this volume is to show how the public choice paradigm can be applied to areas of interest within economic history. We believe that the authors have succeeded in achieving this goal.

REFERENCES

Beard, Charles (1913). *An Economic Interpretation of the Constitution of the United States*. New York: Macmillan.

Childs, William R. (1995). "Review of The Regulated Economy; A Historical Approach to Political Economy," *Journal of Economic History* 55, 445-446.

Conrad, Alfred and John Meyer (1958). "The Economics of Slavery in the Antebellum South," *Journal of Political Economy* 66, 95-130.

Downs, Anthony (1957). *An Economic Theory of Democracy*. New York: Harper.

Goldin, Claudia and Gary D. Libecap, editors (1994). *The Regulated Economy: A Historical Approach to Political Economy*. Chicago: University of Chicago Press.

Kantor, Shawn Everett (1998). *Politics and Property Rights: The Closing of the Open Range in the Postbellum South*. Chicago: University of Chicago Press.

Krueger, Anne O. (1974). "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64, 291-303.

McGuire, Robert A. and Robert L. Ohsfeldt (1986). "An Economic Model of Voting Behavior over Specific Issues at the Constitutional Convention of 1787," *Journal of Economic History* 46, 79-112.

Olson, Mancur (1965). *The Logic of Collective Action*. Cambridge: Harvard University Press.

Olson, Mancur (1982). *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*. New Haven: Yale University Press.

Tullock, Gordon (1967). "The Welfare Costs of Tariffs, Monopolies, and Theft," *Western Economic Journal* 5, 224-232.

Whaples, Robert (1991). "A Quantitative History of the *Journal of Economic History* and the Cliometric Revolution," *Journal of Economic History* 51, 289-301.

Wright, Gavin (1974). "The Political Economy of New Deal Spending: An Econometric Analysis," *Review of Economics and Statistics* 56, 262-281.

PUBLIC GOODS AND PRIVATE INTERESTS: AN EXPLANATION FOR STATE COMPLIANCE WITH FEDERAL REQUISITIONS, 1777-1789*

Keith L. Dougherty

> It is too precarious of a dependence because the States will never be sufficiently impressed with our necessities. Each will make its own case a primary object, the supply of the army a secondary one.
>
> -Alexander Hamilton[1]

Since Mancur Olson's seminal work, *The Logic of Collective Action* (1965), political scientists, economists, and historians have recognized the problems of cooperation and group action. Research on the Articles of Confederation has been no exception. Scholars have described America's first federal republic as an exemplar of the collective action problem in need of reform (Cain and Dougherty 1999, Dougherty and Cain 1997, Jillson and Wilson 1994, McLaughlin 1935). The Articles of Confederation organized thirteen states around a system of unenforced taxation that contained no incentives for states to contribute men, money, or supplies to the national government. As a result, states should have withheld their resources. But if we take these claims seriously, we are left with a puzzle. States contributed 53% of the men levied for the Continental army from 1777 to 1783 and 30% of the money requisitioned for the federal treasury from 1784 to 1789. They won the War of Independence and were able

---

* I thank Kosali Ilayperuma, David Lalman, Joe Oppenheimer, Daniel Simon, and Piotr Swistak for their comments and statistical advice on one of several versions of this paper. Andrew Yates and other participants in the "Applications of Public Choice Theory to Economic History Conference" at Wake Forest University simplified the analysis, while Mary Beth Melchior offered some useful editorial suggestions. Finally, and most importantly, Jac Heckelman provided multiple reads and detailed statistical advice, worthy of special thanks.