CONGRESS AND THE ECONOMY:  1790 - 2008

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ABSTRACT

To what extent has the federal government been responsible for the remarkable performance of the American economy? What we attempt to do in this essay is to consider the relative contributions of political events and economic innovations to American economic growth. Our essay is a political-economic historical survey coupled with an analysis of the prevailing political beliefs of the elites. Government is never unimportant; indeed, it is a necessary condition for robust economic growth. However, it is not sufficient. It is in this sense that we argue for the relative weights of economic innovators and political actors in our analysis below.
1. Introduction

To what extent has the federal government been responsible for the remarkable performance of the American economy? From the beginning of the Republic until just before the 2007-08 financial panic real per-capita GDP increased by a factor of 32. Indeed, as remarkable as this increase is it almost certainly underestimates how much better off Americans have become in terms of the real cost of living because of the rapid pace of innovation.

What we attempt to do in this essay is to consider the relative contributions of political events and economic innovations to the growth of the economy. Our essay is a political-economic historical survey coupled with an analysis of the prevailing political beliefs of the elites. Government is never unimportant; indeed, it is a necessary condition for robust economic growth. However, it is not sufficient. It is in this sense that we argue for the relative weights of economic innovators and political actors in our analysis below.

First, some preliminaries. In our view, what the evolution of the economy shows is the “Liberal Tradition in America” (Hartz, 1955; Hofstadter, 1948) in action. Representative democracy and capitalism in North America evolved together in an
environment of almost unlimited natural resources. The democratic capitalist system of the United States is unique because of the way that the British North American colonies were established and allowed to develop by the English crown. From the very beginning private property rights in land were the norm and the colonies were pretty much unfettered in their internal development until the 1760s. Hofstadter (1948/1973, p. xxx) states it this way: “The sanctity of private property, the right of the individual to dispose of and invest it, the value of opportunity, and the natural evolution of self-interest and self-assertion, within broad legal limits, into a beneficent social order have been staple tenets of the central faith in American political ideologies…”

Private property rights and the primacy of the common law and the courts that enforce it, have never been seriously challenged in American history. The importance of the common law lies in its English origins. “Medieval common law was principally land law......for several centuries every family fortune in England has been protected and regulated by intricate rules of common law......Thanks to the rise of Parliament in the Middle Ages and to the medieval evolution of the House of Commons, English property owners thereafter had a channel for the expression of alarm and opposition to sudden, revolutionary
changes in the law of Property” (Hogue, 1966, p. 246-247). The colonists took it for granted that they could move inland to the west and settle there. The form of land tenure in the British colonies was much freer than in England because of the simple necessity of attracting colonists. By the time of the Revolution the prevailing form of land tenure was free and common socage or what is referred to in more modern language as title in fee simple. This was, in effect, the modern form of land ownership free of the old feudal burdens. The land owner could freely sell his land, pass it to his heirs, cut down the trees or dig up the minerals on the land, and so on. Land quickly became a commodity that was bought and sold for profit rather than a family estate that was preserved for one's heirs (Carstensen, 1963; Harris, 1970).

The North American British colonies inherited a system of private property rights not only in land but in physical possessions and ideas that meant that creative inventors and entrepreneurs could engage in socially desirable activities and reap personal rewards for doing so (North and Thomas, 1973; North and Weingast, 1989; North, Summerhill and Weingast, 2000). “Economic Growth ... requires both political order and a range of positive incentives for productive and entrepreneurial activity” (North, Summerhill, and Weingast, 2000, p. 21). The political
order was provided by the shared English belief in representative democracy and the common law and the positive incentives by private property rights and (again) the common law.

Given government enforced private property rights in which inventors and entrepreneurs can make money from their creations, these creations—the railroad, the telegraph, radio, automobiles, etc.—have unpredictable economic, social, and political effects. Government tends to act with a lag to these spill-over effects. Politicians—who typically have a short-run perspective—react to what people believe is true and often, with the best of intentions, over-regulate the targeted economic activity thereby distorting the flow of capital in the economy as a whole. However, political institutions are not simply reactive. Wars, depressions, and social movements can drastically change taxes and the extent of economic regulation. The causal arrow points in both directions. Not only do shocks in the form of new technologies in the economic system affect the political system, but shocks in the political system affect the economic system.

Figure 1 shows real per capita GDP from 1790 to 2010. From 1790 to 1900 real per capita GDP increased from about $1000 to $4000 in 1996 dollars. During the 20th century it increased by a factor of 8 from about $4000 to about $32,000.
Figure 2 compares the United States with Argentina over the 1870 - 2001 period. The figure demonstrates the thesis of North, Summerhill, and Weingast (2000) that the economies of North and South America evolved differently because of their differing inheritances of their colonial parents. For example, the nature of land tenure differed dramatically between the Spanish colonies and the North American British colonies. “The Spanish empire lodged these rights in a system of privilege based on personal and corporate connection to the Crown. In contrast, the British system lodged rights in what became a system of transferable titles enforced by the judiciary.” (p. 52). Argentina did well in the early 20th Century but has never overcome Peronism.
Figure 2. Per Capita GDP of Argentina and the United States (1990 international Geary-Khamis dollars)


Figure 3 adds Canada and Brazil to the mix. Clearly British North America is different from Spanish/Portuguese South America. The graph ends at 2001 so it does not capture the recent success of Brazil which appears to have finally achieved permanent self-sustaining growth.
Innovation plays a key role in our analysis below. Indeed, it is the source of the remarkable growth of the American economy. The "Liberal Tradition" -- the political culture -- individual liberty, private property rights, the rule of law, independent courts -- has produced a system where private innovation has been encouraged and rewarded directly and indirectly by government. Innovation can be good, it can be bad. Arguably the Cotton Gin was one of the most fateful mechanical inventions in history. It made slavery profitable and changed the American economy.

Most of the time innovation is good and leads to a higher standard of living for ordinary Americans. Cheap steel and
kerosene, the moving assembly line and true interchangeable parts, the electric starter for automobiles, water treatment plants, and so on, have made life better and have lowered the real cost of living.

Measuring the impact of innovation is a thorny problem. It is widely recognized by economists that measures of consumer prices do not accurately account for quality improvements in existing goods and the impact of completely new things (Costa, 2001). This became an even more serious problem after World War II when the rapid pace of innovation encouraged by massive government investment in Universities and research institutes produced a wave of innovation (e.g., miniature vacuum tubes to transistors to integrated circuits to computers and radios on a silicon chip).

Figure 4 (from Costa [2001]) gives a hint at how innovation has affected the real cost of living. The figure shows the percentage of personal expenditures spent on food and recreation from 1900 to 1997.
At the turn of the 20th century about 35 percent of personal expenditures were spent on food and only about 3 percent on recreation (entertainment and reading). By the late 1990s food accounted for only about 12 percent and recreation had increased to above 8 percent. Costa (2001) argues that food and recreation (with suitable controls) can be used to correct consumer price measures so that they do fully take into account innovation. The important point about Figure 4 is that it shows that people were clearly getting better off through the 20th Century but especially after World War II.
Below we split American history up into seven periods -- the early Republic (1789 - 1824); the early railroads to the Civil War (1825 - 1861); bimetalism and industrialization (1866 - 1896); mass production and World War I (1897 - 1920); the automobile and Route 66 (1921 - 1930); the Great Depression and World War II (1931 - 1947); and government as Blind Venture Capitalist (1948 - 2008). In each period we survey government actions, innovation in the economy, financial shocks, and population changes. We use the analysis of the political ideology of members of Congress by Poole and Rosenthal (1997) and Gerring's (1998) analysis of the ideology of political parties to interpret the actions of Congress and political leaders.
2. The Early Republic: 1789-1824

**Political Shocks**

- Louisiana Purchase
- Land Act
- War of 1812
- Embargo Act
- Land Act
- Hamilton's Economic Program

**Inventions and Innovations**

- Steamboat
- Cotton Gin
- Power Loom

**Financial Shocks**

- First Bank Expires
- Panic of 1819
- Panic of 1797

**Labor Force**

- Agriculture
- Percent Labor Force Agriculture
- 30 M. Acres
- 40
- 50

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House: Embargo Act
All Voters, 21 December 1807

Yea = 82
Nay = 44
PRE = 0.77

Region
-0.5
-1.0
0.0
0.5
1.0
For Embargo
Against Embargo

Liberal - Conservative
R=Jeffersonian Republican, F=Federalist

Senate: Embargo Act
All Voters, 18 December 1807

Yea = 22
Nay = 6
PRE = 0.83

Region
-0.5
-1.0
0.0
0.5
1.0
For Embargo
Against Embargo

Liberal - Conservative
R=Jeffersonian Republican, F=Federalist

House: Embargo Act
Errors Only, 21 December 1807

Yea = 82
Nay = 44
Errors = 10
PRE = 0.77

Region
-0.5
-1.0
0.0
0.5
1.0
For Embargo
Against Embargo

Liberal - Conservative
R=Jeffersonian Republican, F=Federalist

Senate: Embargo Act
Errors Only, 18 December 1807

Yea = 22
Nay = 6
Errors = 1
PRE = 0.83

Region
-0.5
-1.0
0.0
0.5
1.0
For Embargo
Against Embargo

Liberal - Conservative
R=Jeffersonian Republican, F=Federalist

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MORE TO COME

9. Conclusion
References


Endnotes

1 Technically, *land tenure* refers to the manner in which and the period for which *rights in land are held*. In this regard, property is *rights*, not *things*. “The things are property objects, and tenure is concerned with rights in these things” (Harris, 1970, p.2). Tenure in land is a *bundle of rights* and rights in land held by a private party is an *estate in land*. See Harris (1970, pp.1-10) for a full discussion of these definitions.

2 In feudal England these were: 1) Homage; 2) Fealty; 3) Wardship; 4) Marriage; 5) Relief; 6) *primer seisin*; 7) Aids; 8) fines for Alienation; and 9) Escheat. See Harris, 1970, pp. 25-27 for a full discussion of these definitions.

3 Technically, the characteristics of *free and common socage* were: 1) it was perpetual; 2) it could be inherited; 3) it could be passed in a will; 4) obligations were fixed and certain (see note 3); 5) the owner had the right to waste; 6) it was freely alienable (you could sell it, etc.).