

“ THE NORTHWEST ORDINANCE IN HISTORICAL PERSPECTIVE ”

By

**Douglass C. North
& Andrew R. Rutten**

FOREWORD

By

**Douglas A. Hedin
Editor, MLHP**

The Northwest Territory, later called The Old Northwest, included the modern states of Ohio, Indiana, Illinois, Michigan, Wisconsin and the northeastern part of Minnesota. The law governing the new territory was the Northwest Ordinance.

The political and legal components of the Northwest Ordinance are well known. It provided for freedom of religion, made available writs of habeas corpus and jury trials, and recognized other rights that later appeared in the Bill of Rights; it encouraged the development of schools, prohibited slavery while requiring fugitive slaves to be returned to their owners, and laid out a process by which the territory would be divided into states which could then enter the union.

It was also, in the words of Professors Douglass North and Andrew Rutten, “a landmark in American economic history.” It required that the land of anyone who died intestate would be divided equally between all heirs and it established a system of fee simple ownership of real property that eased transfer by sale or lease. Significantly, it affected land policy by providing for the political development of the Territory, the distribution of benefits from the public lands, and the conditions of the sales of those lands. When states within the Territory were admitted to the union, they brought preferences over land policy that differed from those held by factions in older states, and the “result was that the policy equilibrium was continually being shifted towards the policies favored by frontier states.”¹ Over time, the distribution of the benefits of public lands also

¹ The Northwest Territory produced the following states: Ohio (admitted in 1803); Indiana (1816); Illinois (1818); Michigan (1837); and Wisconsin (1848). Minnesota Territory, established on March 3, 1849, was carved out of Wisconsin.

changed, from going directly to the federal government to be used for national purposes, to increased grants to public land states and to nonpublic land states such as Maryland and Rhode Island which had few public lands of their own. The policy on land sales, encountering unexpected competition from many sources, also changed until a general preemption act was enacted in 1830 and made permanent in 1841.

Professors North and Rutten give “high marks” to the Northwest Ordinance’s adaptive efficiency—that is, how well the structures it fostered adapted to new conditions to achieve allocative efficiency. They write:

The two aspects of institutions, their ability to restrict choices and their responsiveness to changing situations, are illustrated by the history of the development and implementation of the Northwest Ordinance. The development of the ordinance was a process of changing existing land policy in response to changes in incentives brought on by the War of Independence. In the nineteenth century, land policy continued to evolve in response to changes in incentives. However, the path of evolution was largely determined by the structure provided by the Northwest Ordinance.

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² *The Economic Growth of the United States 1790-1860* is a textbook for the first half of “American Economic History,” a well-known course taught for many years by Dr. George Green at the University of Minnesota.

Their article appeared first on pages 19-35 of *Essays on the Economy of the Old Northwest*, published by Ohio University Press in 1987. It is posted on the Minnesota Legal History Project with the consent of Professors North and Rutten. It is complete, though reformatted. Pages breaks have been added.

It is also posted with the approval of David C. Klingaman and Richard K. Vedder, professors in the Economics Department of Ohio University, who contributed articles to *Essays on the Economy of the Old Northwest* besides editing it. They also edited *Essays in Nineteenth Century Economic History: The Old Northwest* (Ohio Univ. Press, 1975).

“The Northwest Ordinance in Historical Perspective” complements “The Great Land Ordinances” by the late Jonathan Hughes which also appeared in *Essays on the Economy of the Old Northwest*. That article is posted separately on the MLHP, as is the Northwest Ordinance itself. Also posted are the Resolutions on Public Land (1780), the Ordinances of 1784 and 1785, and the Southwest Ordinance, also known as the Ordinance of 1790. □

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IN

Essays on

THE ECONOMY OF
THE OLD NORTHWEST

Edited by

David C. Klingaman

and

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p

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THE NORTHWEST ORDINANCE IN HISTORICAL PERSPECTIVE

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A MAJOR TASK OF economic history is explaining the path of economic change through time. Doing so requires understanding the constraints that cause the economy to follow the particular path it does. Thus the role of the economic historian is not only to examine the economic consequences of each particular step along the path, but also to examine the determinants of the particular path the economy followed. In this essay we attempt to explain the factors involved in the passage of a landmark in American economic history, the Northwest Ordinance, and we explore its role in the evolution of the American economy. In section 1 we lay out the logical connections between institutions and economic performance. Section 2 outlines the Northwest Ordinance and its relationship to earlier land policy. Section 3 explores the major issues of the 1780s that led to the passage of the ordinance and shaped its specific provisions. Section 4 looks at the downstream consequences, that is, how the structure provided in the ordinance affected decisions about land policy in the early nineteenth century, and how that structure was itself modified. Section 5 summarizes the ordinance's implications for the institutional issues laid out in section 1.

I

Institutions define and narrow the choice set that exists at any moment, in contrast to the standard approach of economists, who, typically take a tabula rasa approach, assuming that institutions impose no constraints on choice. Institutions are, as well, the connecting links in the sequential pattern of economic history. They not only define the alternatives at any moment, but as they evolve they connect previous choices with subsequent choices. Institutions are altered in light of new problems and issues, but they are altered at the margin, with the margin determined by the previous choices.

Thus the role that institutions play in an economy is to define the manmade constraints on choices that in turn affect economic performance. The cost of producing a good or service is usually taken as the cost of the land, labor, capital, and entrepreneurial talent that when combined through a production function produce output. Recently it has been recognized that [20] this simple neoclassical approach needs to be radically altered, since the costs of transacting appear nowhere in this formula. It is as though all of the 'gains

from trade' could be realized with no resources going into organizing and integrating production, devising markets, maintaining the political structure. The costs of production are actually the sum of production costs, here called transformation costs, and transactions costs, which are those costs incurred in carrying out exchange. Because the extent of specialization and division of labor depends on transaction costs, they have played a critical role in determining how well economies have realized their productive potential throughout history.

Transaction costs in turn depend on the institutional structure, which ultimately is shaped by the political decisions that define and enforce the rules of the game. This is why political and economic institutions play a critical role in the performance of an economy. They define the opportunities, which in turn determine the cost of transforming and transacting, and, hence, what is produced and how it is distributed. It is for these reasons that the decisions that produced the institutional structure of early America are important.

It is not just the rules themselves that are important, but also the degree to which the rules are enforced, the way they are enforced, and the preferences of the players. These three aspects interact to determine the choices actually made in the economy. The second and third are important because it is costly to measure performance of agents or the attributes of the goods and services being traded.¹ The more costly measurement is, the more likely it is that enforcement will be imperfect, particularly since third parties enforce rules and are themselves agents of principals. Accordingly, the contracts that embody economic decisions will be structured to attempt to take into account the effectiveness of enforcement by minimizing the dissipation of rent at the margins where compliance is difficult to determine. In addition, however, the attitudes of the parties to the rules in terms of their fairness or justice will (given the costliness of measuring performance) influence the costs of contracting. The price of ideological convictions is the premium individuals are willing to incur not to free ride. Although the strength of convictions varies with the issues and the individual, the premium is surely negatively sloped. That is, the higher the costs one incurs, the less ideological conviction matters.

The preference structure that affects the costs of contracting derives from the broad ideological constructs 'that everyone possesses as an essential part of the decision-making process. We know little about norms of behavior dearly, however, they are an important determinant of the choice set at a particular moment; even more important is their role in determining the path of institutional evolution. Without anything as elegant as a theory, we can say they are transmitted intergenerationally by family, schooling, and [21] religion, and that they change slowly (although the rate of change is surely related to the cost of information). Changes in relative prices surely play a major role in changing individual perceptions of reality and hence norms of behavior. Differences in norms of behavior can dramatically modify the consequences of formal rules. For example, the adoption of the United States Constitution by some Latin

American countries has led to very different results than in the United States. Since norms appear to change more slowly than formal rules, their interaction with rules can result in radically contrasting paths of institutional evolution.

It is one thing to understand the role of institutions, measurement costs, enforcement characteristics, and ideology in determining choices at any moment. It is much more difficult to understand the role institutions play in determining the path of economic development over time. We know very little about this subject, so the framework we suggest is not only tentative but far from complete. At any moment, there is an institutional framework that reflects decisions made in the past. This framework will change when participants are confronted with a new set of issues that makes them feel they can improve on the old forms of contracting based on the existing institutional structure (to put it in an economist's terms, there must be a change in some critical relative price). The participants will not change all the rules, but only those that, given the relative bargaining strength of the parties, appear to them to affect the new problem. In other words, institutional evolution occurs at the margin in response to new situations. The new institution will be a complex of inherited, old rules with modifications or new parts added to them to solve the new problems that are faced.

Thus, as institutions evolve, new rules will become embedded in the institutional structure and provide the basis for subsequent policymaking. This very simple view of institutional change is incomplete. To understand institutional evolution, we also need to know which rules will get thrown aside. The tentative answer is that it is those rules that, as a consequence of changing relative prices, become controversial given the bargaining power of the players. Although it is easy *ex post* to observe a pattern in the evolution of institutions, it is very difficult to forecast beforehand which will be adopted. History provides many examples of decisions that in retrospect appear inevitable but in fact were very close. We are far from being able to predict which institution will be chosen, even though we may be able to make sense out of history by looking at the paths that were chosen and observing which alternatives were foregone.

The two aspects of institutions, their ability to restrict choices and their responsiveness to changing situations, are illustrated by the history of the development and implementation of the Northwest Ordinance. The development of the ordinance was a process of changing existing land policy in response to changes in incentives brought on by the War of Independence. [22]

In the nineteenth century, land policy continued to evolve in response to changes in incentives. However, the path of evolution was largely determined by the structure provided by the Northwest Ordinance. Before examining this process, we will examine the ordinance and how it resembled colonial land policies and how it differed from them.

II

The Northwest Ordinance was passed “by the United States in Congress assembled” on 13 July, 1787. Like the Constitution, which was devised and structured at the same time, it is simple and quite brief. There are three sections. The first established “the law of descent and conveyance of estates” for the territories. It provided that the estate of one who died without a will would be divided equally among all heirs, and explicitly established fee simple ownership of real property for the first time, so that property could be easily transferred by sale or lease. The second established “the territorial government. It provided the basic provisions of a territorial government and established the timetable by which the territories would eventually become self-governing. The final section established “the compact between the original States and the people and States. Its six articles effectively gave the territories a bill of rights, which provided for: (1) freedom of religion; (2) the use of writs of *habeas corpus*, jury trials, the common law, and bail (except in capital cases); and prohibitions against cruel and unusual punishment, the seizure of property without due process or compensation, or laws interfering with contracts; (3) encouragement of schools and the means of education because of the importance of religion, morality, and knowledge to good government and happiness; and encouragement of the utmost good faith towards the Indians; (4) the obligations of the territories to the United States, including remaining in the United States, sharing in the payment of federal debt, not interfering with federal land sales, not taxing nonresident owners higher than residents, and not interfering with shipments on the Mississippi or St. Lawrence; (5) the division of the territories into states, which were to have republican governments and to be admitted as full members of the United States after reaching specified populations; and finally, (6) a prohibition on slavery or involuntary servitude, with the proviso that fugitive slaves could be returned.

The land policy embodied in the ordinance included more than these provisions since the ordinance implicitly accepted many aspects of existing policy. The most important of these were established by the 1780 Resolution on Public Land and the 1785 land ordinances. The first established that the unsettled lands ceded by the states to the national government would be disposed of for the common benefit, and that the territories formed from them would become distinct republican states fully participating in the union.² The 1785 ordinance provided the mechanism for actually disposing of [23] the public lands by specifying that presurveyed contiguous parcels would be sold at auction.

As several generations of historians have documented, there are antecedents for almost every provision of the Northwest Ordinance and its sister ordinances. Many were taken directly from colonial or state practices. These include not only such mechanical details as the method of sale, but also the clauses dealing with governance issues.³ Those dealing with personal freedoms and rights came preponderantly from the Massachusetts and Virginia Constitutions. For

example, the article on religious freedom comes from sections 2 and 12 of the Declaration of Rights in the Massachusetts Constitution of 1780. The articles on inheritance, fee simple ownership of land, and education were authored by Nathan Dane of Massachusetts and were based on his understanding of Massachusetts law.⁴ The clauses guaranteeing access to the protections of the common law can be traced to colonial charters.⁵ Those provisions that cannot be traced to actual practices, such as the antislave clause or the ultimate incorporation of the colonies as full fledged states, can be traced to earlier policy proposals.⁶ In turn, almost all of the American roots of these practices can themselves be traced to English practices.⁷

But simply finding these precedents does not constitute an explanation of the Northwest Ordinance. After all, land policies varied widely among the colonies and states, and many aspects of these policies were not embodied in the ordinance. Furthermore, there is little precedent in colonial practices for the emphasis on land sales as a source of revenue, and none for the promise of eventual statehood for the territories or the antislavery clause. Indeed, the antislavery clause even conflicted with the Constitution, which sanctioned slavery through the three-fifths rule. We believe that the explanation for this particular mixture of the old and familiar practices with the radically new lies in the changes in incentives facing policy makers from 1776 to 1787.

III

Independence dramatically changed the incentives guiding decisions about American land policy. These decisions were no longer made by English politicians running an empire, but by American politicians running a nation. Since their interests were very different, it is not surprising that Americans did not simply adopt British policies wholesale. Their choice of policies reflected not only the difference between American and English control, but also the American political structure. Under the Articles of Confederation control over land policy lay with the states. Agreement among the states on land policy was complicated by the unequal distribution of its costs and benefits across the states. The attempt by each state to get a favorable land policy led to a protracted political war.⁸ To understand the particular provisions of the Northwest Ordinance, it would be necessary to examine this fight in detail. Since this obviously cannot be done briefly, we will focus on how three issues that emerged with American independence shaped land policy from 1776 to 1787. These issues are: the need to finance the war, the commitment to representative government, and the antislavery sentiment of the northern states.

Land policy became a national issue because of the need to finance the war against the British. Since the Articles of Confederation left the power of taxation with the states, the unsettled lands were the major asset of the new nation. Americans could not raise revenue from land in the same way as the British because British policies relied on the manipulation of the imperial

economy to generate revenue from the colonies. Because the British wanted large settlements, their land policy made use of such inducements to settlement as the promise of such English institutions as the common law⁹ and representation in local government,¹⁰ as well as marketing strategies such as settlement ahead of surveying and the granting of preemption rights to actual settlers.¹¹ These policies were unsuitable for Americans, who needed a policy that would generate revenue directly from the land.

The first method used to finance the war with the unsettled lands involved the use of land bounties, certificates for specified amounts of unsettled land, as a means of paying the army. This began with the states providing for their share of the troops out of their claims on unsettled land. Since the states differed in the extent of their claims on unsettled lands, this policy resulted in dramatic differences among the states. For example, Virginia, which had the largest endowment of unsettled land, offered ten times as much land to officers as the national government.¹² This led Maryland, which had no claims to either western land or land within its own border, to argue “that the back lands acquired from the Crown of Great Britain in the present war, should be a common stock for the benefit of the United States”¹³ The threat by Maryland not to join the confederation unless its proposal was accepted led to the resolution of 10 October, 1780. Among other things, the resolution provided that “the unappropriated lands that may be ceded or relinquished to the United States would be disposed of for the common benefit of the United States.”¹⁴ Despite this agreement on principles of land policy, the final cession of Virginia lands was not accepted until 1784.

The signing of the peace treaty did not end the search for a method of paying for the war. If anything, it intensified the search. Not only did the debt incurred during the war have to be paid, but land bounties could no longer be used. In addition, the army was threatening rebellion if its claims were not satisfied. Indeed, one of the proposals that was considered was to settle former soldiers directly on the western lands. The national government decided on a dramatic new method of generating revenue—selling land to settlers (or to land companies). [25]

This decision was a break not only with British policy, but also with the policies followed by the states during the early confederation period.¹⁵ Paying for the war was such a pressing problem that previous policies were never given serious consideration by the national government. Perhaps nothing illustrates this shift better than the changing attitude of Jefferson. In 1776 he argued that “the idea of Congress selling out unlocated lands has sometimes dropped, but we have always met the hint with such determined opposition that I believe it will never be proposed. I am against selling the lands at all”; by 1780 he was referring to them as a “precious resource” for financing the war.¹⁶

If the need to finance the war led to agreement that the western ‘lands should be sold, the different landholdings of the states led to disagreement about how to actually sell the lands. Those states that managed to preserve claims to western lands, such as Virginia, New York, and Connecticut,¹⁷ favored a land policy that increased the value of their western lands. They wanted to encourage western settlement, but with federal lands priced high enough to make their lands attractive. Those states that had unsold lands within their own borders, such as Pennsylvania and Massachusetts, favored a land policy that would diminish the value of this land as little as possible. They wanted to encourage western settlement, but at a far slower rate than states such as Virginia. Finally, those states that had no claims over unsettled lands favored policies that maximized national revenue from land sales.

It would seem that these widely divergent interests would prevent the states from reaching agreement about how to handle land sales. Although the scheme of the Ordinance of 1785, which was implicitly adopted by the Northwest Ordinance, seems to imply that an acceptable sales scheme existed, this was not the case. As we shall see in the next section, the fight over who was to benefit, both directly and indirectly, from land sales continued into the nineteenth century

The politics of the revolution also played an important role in determining land policy. The fundamental political issue of the American revolution was the representation of colonists in central government. Until the early 1770s, Americans had accepted the British theory of ‘virtual representation.’ It relied on the interest of British politicians in the common good to justify the denial of direct representation of the colonies in Parliament. This theory was abandoned by 1776. It was replaced by theories that justified government by the use of some form of actual representation.¹⁸ The universal acceptance of this idea meant that any politically feasible plan for the government of the territories (the American colonies) would have to include their eventual incorporation into the national government as states. This meant that the political structure of the British colonial system was as attractive to Americans as its economic policies.

Since incorporating the new states into the Union would inevitably [26] change the balance of power among the states, there was disagreement as to how the states should be incorporated. Each faction sought to ensure that the new states would not shift the balance of power in a manner that would overwhelm it. Among the factions were the northern and southern states, large and small states, and agricultural and industrial states. Among the issues that were raised were the number of states, the size at which territories would become eligible for statehood, and the manner in which the new states would be represented in the national government. From 1776 to 1787, a variety of different positions were adopted on these issues. For example, the number of states in the Northwest went from ten in Jefferson’s original proposal to five in the Northwest Ordinance. Unlike the economic aspects of land policy controversy

over the political mechanisms provided by the Northwest Ordinance ceased with the passage of the ordinance.

One political issue that deserves separate treatment is the effect of the Northwest Ordinance on the balance between slave and free states. The antislavery proviso in the ordinance appears to be in direct conflict with the Constitution, and has been the subject of immense controversy. In the Constitution slavery was sanctioned by counting slaves as three-fifths of a person for the purpose of determining representation in Congress; the ordinance explicitly prohibits slavery. The most likely explanation for these contradictory actions is that they resulted from a vote trade, in which northern states agreed to the three-fifths rule at the Constitutional Convention in return for southern states agreeing to the Northwest Ordinance's antislavery proviso at the Old Congress.¹⁹ Despite the lack of direct evidence, such a trade is plausible. There was a substantial amount of communication between the convention and the congress, and the final votes on the three-fifths rule and the Northwest Ordinance occurred within two days of each other. Certainly the trade makes sense. The size of states, in terms of representation, was a major issue in both the Constitution and the Northwest Ordinance. The three-fifths rule increased the representation of southern states, making slavery more secure. On the other hand, southerners may not have feared the increasing political power of the free Northwest states because of their view that these states would share interests (such as navigation of the Mississippi) with southern states.

These examples show how American independence allowed new issues to determine American land policy. To be truly satisfactory, analysis would have to be extended to include more detail about how exactly these issues affected land policy as well as examine other important issues. For example, we assumed that each state's position on land policy depended on how that state would be affected by those policies. However, this assumption ignores the possibility that the preferences of the actual representatives might reflect peculiarities of internal state politics. We have also ignored some of the most divisive issues of the period, such as free navigation on the Missis-[27]-sippi. Southern states favored it, since they believed it would not only encourage settlement of the Southwest, but also give a 'southern' tilt to states in the Northwest. It was opposed by northern states, since without free navigations freight would be shipped east, and by those states that wanted to discourage rapid settlement of the west.

IV

The Northwest Ordinance (together with its companion, the Act of 1785) did not settle policy on the disposal of the public lands. Indeed, the next fifty years were marked by almost constant controversy over who would benefit, and by how much, from the disposal of the public lands, with almost every aspect of land

policy undergoing several major changes.²⁰ This does not mean that the Northwest Ordinance was unimportant. Each new policy reflected what was politically and economically feasible at any moment; but feasibility, particularly political feasibility, depended crucially on what had been done in the past. To see how the passage of the Northwest Ordinance shaped subsequent policy, we will look at the evolution of three different aspects of land policy: the political development of the territories, the distribution of benefits from the public lands, and the terms of sale.

The Northwest Ordinance's most direct impact was on policy regarding the political development of the territories. Subsequent law did little to alter the ordinance's provisions for the steps in the incorporation of the territories into national politics. The changes that occurred were all minor, mostly concerned with procedural details.²¹ By and large, they corrected problems that had occurred with the government of the earlier territories. Their relative unimportance suggests that the most important and enduring contribution of the Northwest Ordinance to subsequent institutional development was its underlying view "that the Territories are to be regarded as inchoate states, as future members of the Union."²² As we shall see below, it would only be a slight exaggeration to say that the most important change in the politics of public land policy after 1787 was the growing participation of westerners.

As the discussion of the politics of land policy in the previous section showed, there was no one land policy that was preferred by everyone.²³ Not only did different states have divergent preferences over land policy, but these preferences depended on their preferences on other policies, such as slavery or tariffs. A change in either the preferences of participants or the political structure would change policy. The incorporation of the frontier states was important because they preferred a different mix of policies than any of the existing factions. Furthermore, their interests on some issues changed over time, with divergences among them sometimes occurring, depending on the level of economic development.²⁴ The result was that the policy equilibrium was continually being shifted towards the policies favored by the frontier states. This process can be seen by looking at the evolution of policy concerning the distribution of benefits and the terms of sale.

All land policy implicitly distributes the benefits from public lands, so any change in land law can be considered as a change in distribution policy. However, there were a series of proposals that treated distribution directly. Each of these aimed at changing the status quo (set by the Act of 1784 and implicitly accepted in the Northwest Ordinance), which was (with some exceptions for the public land states) that the direct benefits from the public lands were to go to the federal government for national business. They fall naturally into two categories: increasing the grants to public land states and distributing land to nonpublic land states.

For the public land states, the status quo was fairly high. Not only did they get the land reserved for schools, but after the admission of Ohio in 1803, they received grants for the construction of roads to the state from the east. Beginning in 1817 they proposed a series of bills enlarging these grants to include more for public improvements. Although the original bills failed (actually, they were vetoed by President Madison), a coalition of western, northeastern, and mid-Atlantic congressmen emerged and was able to gradually increase internal improvement subsidies. It began with grants to improve the Cumberland Road (itself partially financed by land grants under the Ohio Enabling Act) and surveys for canals and roads, finally extending to support for new projects in 1830.²⁵ Although these included projects outside of the public land states, the bulk of the projects were in the public land states. These grants increased so much that Ohio, the first public land state, received only 10 percent of its land in grants, and Michigan and Wisconsin, the last of the Northwestern states settled, ultimately received grants totaling almost 30 percent of their land.²⁶

Attempts to change policy to distribute benefits directly to nonpublic land states were also successful. This issue was first raised seriously in the 1820s by Maryland and Rhode Island, states that had few public lands of their own, either in-state or in the West. ²⁷ They advocated giving the nonpublic land states grants for education, with each state's grant proportional to its share of the original land. These proposals failed because of opposition from the South and the West. Finally, in 1837 the combination of a budget surplus, a land boom, and congressional realignment led to the passage of a distribution bill, which gave 80 percent of the surplus to nonpublic land states.²⁸

An examination of the evolution of sales policy from the status quo implicit in the Northwest Ordinance also shows an increasing Western tilt to policy. However, this tilt cannot be attributed solely to the growing political power of the western states. Even without direct political participation, the settlers could restrict the federal government's options. They could do this because of the weakness of the federal government in the distant territories, [29] and because of the government's need to compete with other options available to settlers. These two factors often allowed the settlers to ignore federal land policies. For example, auctions were used to sell land in the hope that competitive bidding would drive the price of prime land above the minimum. However, claims dubs, which were locally more effective at enforcing their will than was the federal government, could prevent competitive bidding and ensure that their members got their choice of land.²⁹

The federal government's need to compete for sales with other sources of land led to the first major change in sales policy The Frontier Land Bill of 1800 proposed by William Henry Harrison, the (nonvoting) congressional delegate from the Indiana Territory and containing measures favored on the frontier, was passed before there were any western states. Before its passage sales policy

had been governed by the Act of 1784, as modified in 1796. It provided for sale of tracts larger than 640 acres for two dollars per acre, with payment in specie or government securities, due immediately. Sales under this regime were disappointing, largely because settlers could get land more easily either by buying it on better terms in existing states or in the nonfederal tracts in the public land states, or simply by squatting in the federal lands. To meet this competition, the new law not only allowed sale of smaller parcels, but offered four-year credit at 6 percent interest, with one quarter due in forty days, one quarter due in two years, and the balance in four years.³⁰

As had been predicted by foes, the credit system had serious problems from the beginning. Purchasers used all of their money for a down payment, hoping either that Congress would give them relief, or that they could avoid eviction and repossession. The result was a steady growth in the amount of money owed on land. The problem became intolerable after the land boom of 1816-18. In 1818 there was a total of \$7 million owed on land, but land revenues totaled only \$2½ million. The increase in outstanding debt was due to the fact that Congress granted relief, as purchasers had hoped, passing ten relief laws between 1800 and 1820.³¹

The Act of 1820 abolished credit but was not a complete defeat for the West. It reestablished cash sales, but on more generous terms than before, with the minimum plot reduced to forty acres and the price to \$1.25 per acre. In addition it was followed by a series of credit relief acts that not only extended the period of payment for purchases, but also allowed purchasers to relinquish some land in return for title to remaining portions.³²

These acts did not meet all of the demands of westerners, especially those in fairly well settled states. In these states the presence of large parcels of still unsold (and thus untaxable) public lands—30 percent of Indiana, 50 percent of Ohio, and 70 percent of Wisconsin³³—led to a series of proposals for graduation, so that the price of unsold land would gradually be reduced. The Graduation Act was passed in 1841.³⁴

Another modification of sales policy that remained controversial during [30J this period was preemption, which gave squatters the first chance to buy the land they occupied. Preemption had been commonly granted by states after the war, when it was motivated by the desire to settle the frontier.³⁵ However, the federal government had not followed this lead, going as far as having troops burn out squatters in the 1790s. This policy was made official in 1807 with the passage of the Intrusion Act, which provided that squatters could remain as long as they paid rent until the land was purchased. Those who failed to register or pay rent were subject to a fine or imprisonment. As with credit sales, this led to widespread abuse, and between 1799 and 1830 Congress passed twenty acts granting preemption rights to squatters in specific regions. Finally in 1830 these acts were replaced by a general preemption act, which was renewed several

times until in 1841 a permanent general preemption was passed.³⁶

The history of these three aspects of land policy illustrates the importance of the Northwest Ordinance. Since land policy changed, often dramatically, after 1787, the ordinance did not simply set the terms on which the western lands were settled. Instead, land policy continued to evolve in response to changing economic and political pressures. However, as we have shown, these political and economic changes were to a large extent due to the Northwest Ordinance.

V

What were the implications of the Northwest Ordinance for efficiency and the distribution of income? We are not aware of any studies that explore the second question (although some tentative work has been done on overall land policy), but both earlier research and our own essay allows us to provide some answers on the first issue.

First we should enter a caveat. The economic historian (and the economist for that matter) should be interested in efficiency in two distinct (if related) ways. The first is the traditional measure, allocative efficiency. It is concerned with the standard question of whether the existing institutional arrangements result in more output than any other conceivable arrangement. The second type is adaptive efficiency. It is concerned with how well the institutional structure adapts to new and unforeseen circumstances. An adaptively efficient institution must both maximize the alternatives available, so that in a world of uncertainty the chances of achieving an allocatively efficient solution in turn are maximized, and provide a competitive mechanism for eliminating less efficient solutions. Any evaluation of the efficiency of the Northwest Ordinance must consider both types.

The criterion of allocative efficiency has been at least provisionally examined.³⁷ Traditionally, historians have given land policy a bad press, complaining about too much land being made available, the evils of speculation, or sometimes, paradoxically enough, monopolization of land. [31]

Economists, on the other hand, have by and large given land policy higher marks. However, it is probably true that the early policy tended to lead to too many resources going into settlement. This policy was continued and even exacerbated by the Homestead Act. It is also probably true that the size requirements of later land policy led to an economically inefficient initial distribution. However, the historian's notions of speculation and monopoly do not hold up. Finally, it should be noted that these inefficiencies were due not to the Northwest Ordinance but to either the 1785 ordinance or its subsequent modifications.

When we turn to the question of adaptive efficiency, the Northwest Ordinance

gets high marks. By making land easily transferrable and inheritable, it widened the options of individuals and helped to resolve the allocative inefficiencies described above. The fact that individuals had clear title to land and could, after meeting the initial requirements for getting title, transfer it, lowered the cost of transacting downstream. This meant that despite the inappropriateness of the initial size of landholdings under the Homestead Act, it was possible to restructure landholdings to achieve allocative efficiency. Moreover, the governance provisions of the Northwest Ordinance provided for an assured and reasonably certain path from territory to statehood and thus involvement in the political system of the United States. The provisions of the Bill of Rights provided for the sort of safeguards that, however imperfectly enforced at times, nevertheless provided to settlers confidence in their ability to take up land and to utilize it, and more assurance about the outcome of decisions. In terms of adaptive efficiency, the Northwest Ordinance is a remarkable piece of legislation. □

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NOTES

1. See Lancaster (1969) and Becker (1965) for the origination of this consumer theory argument. It has been extended into the transaction cost framework by Cheung (1983), North (1981), and Barzel (1982).
2. Bestor (1973), 20-22.
3. The origins of such features of the land distribution system as rectangular surveys of townships, the 640-acre section, land bounties, and preemption are traced in detail in Ford (1910) and Harris (1953).
4. For details of the politics surrounding the Northwest Ordinance, see Barrett (1891). Dane's claims for authorship are advanced in Dane (1897).
5. For the history of grants of English "rights and privileges," including the common law, see Brown (1964). The origins of representative government are traced in Kammen (1969) and Wood (1969).
6. For a discussion of the policy proposals concerning land, see Bestor (1973). Dane understandably claims that Jefferson's influence has been overstated.
7. Examples of the adoption and adaptation of English institutions to colonial circumstances are found in Howard (1968), Allen (1982), and Hughes (1986).
8. Indeed, as we show in the next section, the controversy over land policy did not end with the passage of the Northwest Ordinance, but continued into the nineteenth century.
9. See Brown (1964).
10. See Kammen (1969), Pole (1969), and Wood (1969).
11. See Ford (1910) 112-42, and Tatter (1935).
12. Freund (1963), 19.
13. Freund (1963), 18.
14. Bestor (1973), 21.
15. See Tatter (1935) for a summary of early state policy.

16. **Ibid. p. 184.**
17. **Connecticut maintained control of a large parcel of land in what is now Ohio. Known as the “western reserve,” (as in Case Western Reserve) it included Cleveland.**
18. **The evolution of American thinking on representation is traced in Wood (1969).**
19. **Our analysis follows that of Staughton Lynd in his “Compromise of 1787,” reprinted in Lynd (1967), 185-213.**
20. **The details of the evolution of land policy can be found in Treat (1910), Hibbard (1965), or Gates (1979).**
21. **The changes in the laws regarding political development are cataloged in Farrand (1896).**
22. **Farrand (1896), 53.**
23. **Our discussion of the politics of land laws relies heavily on Feller (1984), which contains a thorough analysis of Congressional votes on land legislation during the period.**
24. **For example, in 1826 two Ohio “congressmen opposed additional frontier land surveys. . . arguing that a glutted market depressed property values and retarded the sale of Ohio’s remaining public domains.” Feller (1984), 79.**
25. **Feller (1984), 48-67, 83-85, 91-97, 136-42.**
26. **Gates (1979), 384.**
27. **Feller (1984), 40-48.**
28. **Feller (1984), 40-48.**
29. **Hibbard (1965), 198-208.**
30. **Treat (1910), 1-101.**
31. **The relief acts and their terms are listed in Treat, (1910), 143.**
32. **Feller (1984), 26-38.**

33. Calculated from General Land Office, Statement of Annual Land Sales, 1830-1840, Table D, Recapitulation, reprinted in New American State Papers, Public Lands, Vol. 1, General Administration, p. 111.
34. Feller (1984), 101-10, 125-36, 156-71.
35. Tatter (1935), 176-86.
36. Hibbard (1965), 144-70.
37. See Fogel and Rutner (1972) and Dennen (1977).



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