Why Statehood? A Note on Interpreting Jurisdictional Competition in U.S. History

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Abstract: Stephanie Moussalli's *The Fiscal Case Against Statehood* is an institutionally rich and genuinely interdisciplinary contribution to understanding the incentives faced by political actors in the states and territories of the 19th century United States. One of Moussalli's key findings is that local governments exercise less fiscal restraint after achieving statehood than they had as federally managed territories. There are two ways to interpret this result. Moussalli's preferred interpretation is that competition between politically decentralized states was not an effective mechanism for constraining local political actors. In this note, I suggest the alternative interpretation that due to the significant gains associated with statehood and the fact that attracting population was an important part of the quest for statehood, territorial politicians may actually have been more susceptible to the influence of jurisdictional competition than state politicians. Consequently, admission to the union removed a source of competitive pressure that had previously constrained fiscal behavior.

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Introduction

The Fiscal Case Against Statehood (Moussalli 2012) is a work in two parts, both of which are impressive examples of interdisciplinary research. Moussalli's findings and the record created in their pursuit are a trove of valuable information for the scholar interested in the political economy of early American federalism or 19th century state government.

In the first part, Moussalli attempts to adjudicate the historically contentious debate over the fiscal consequences of the transition from territorial to state government. She finds that statehood did encourage the growth of government in newly formed states. In the second part, she argues for conceiving of accounting as a technology of government that enables politicians to more efficiently expand their domain. Consequently the greater availability of rents associated with statehood incentivized local governments to develop more advanced accounting practices.

The focus of this note will be on the first section of *The Fiscal Case Against Statehood*, the objective of which is to resolve a contentious historical debate over the fiscal burden of state versus territorial governments. Through a careful study of the reports of state and territory financial officers and other historical data, Moussalli finds that statehood does result in an increase in the relative size of government. She interprets these results as finding against the theory of jurisdictional competition in this context, postulating that if jurisdictional competition were at work the decrease in federal oversight and subsequent transfer of authority from federal to state government would result in the newly decentralized government experiencing greater competitive pressures (Moussalli 2012, 10-12).

I wish to propose an alternative conception of jurisdictional competition, and therefore an alternative interpretation of Moussalli's findings. Jurisdictional competition can take many forms depending on institutional context. In the case of 19th century states and territories, territorial politicians stood to benefit from statehood in many ways. If statehood was one of the rewards of treating the local population well, then territorial politicians would have been more subject to competitive pressures than politicians in a post-statehood environment. In this conception, rather than statehood being expected to constrain the growth of government, statehood is expected to relax the constraints faced by territorial legislators. Interpreted in this way, Moussalli's results are consistent with the theory of jurisdictional competition.

Jurisdictional Competition in *The Fiscal Case Against Statehood*

The residents of territories in the 19th century United States took one of two positions on statehood. Those in favor of statehood believed that stronger local control would result in more fiscally responsible government. Those opposed to statehood feared exile from the federal system of subsidization of territories or believed that creating a new government would only place additional burdens on local residents (Moussalli 2012, 8).

Moussalli frames this debate in the context of two competing public choice theories. The first of these is the theory of Leviathan as articulated by Brennan and Buchanan (1980). In the theory of Leviathan, government is a predatory creature that only behaves itself to the extent that it is forced. Leviathan is not benevolent; he must be chained in order to prevent him from consuming his master. Moussalli (2012, 11) predicts that statehood loosens the chains around Leviathan by reducing federal oversight. This relaxation of the constraints on governmental power is essentially equivalent to a reduction in the costs of expropriation. Consequently, the theory of Leviathan predicts that statehood will result in more expropriation by the state (Moussalli 2012, 11).

The theory of jurisdictional competition is advanced as an alternative theory generating an alternative prediction. Moussalli (2012,12) describes the theory of jurisdictional competition as predicting that decentralization—i.e. the transfer of control over the jurisdiction from federal to state authority—will serve as a constraint on the behavior of the government. Consequently, the theory of jurisdictional competition is described as predicting that statehood will result in less expropriation by the newly formed state.

In order to adjudicate between these theories, Moussalli conducts an event study around the 1912 transition of New Mexico and Arizona from territory to statehood. Using two measures, locally sourced government revenue as a fraction of the assessed value of property within the jurisdiction and locally sourced government revenue as a fraction of gross national product, she finds that the relative size of government does increase after statehood. The government of New Mexico in particular nearly doubles in size. In contrast, Nevada, which remained a territory through the period, did not experience a spike in size (Moussalli 2012, 49-53).

Jurisdictional Competition and "the Prizes of Statehood"[2]

Competition is not inherently good. The effects of competition depend on what prize is being sought, and how the game is played. Competition is valued in a market context because the structure of competition is such that entrepreneurs are rewarded for coming up with a preferred allocation of scarce resources. The prize is profit, and the rules of the game state that the only way to win is to improve the welfare of both yourself and another by engaging in mutually beneficial exchange.

[2] Credit for this excellent phrase goes to Kenneth Owens (1987).

Theories of jurisdictional competition propose that it is possible for political systems to mimic some of the beneficial properties of market systems. Tiebout (1956) shows that under conditions of perfect information and costless entry and exit of both jurisdictions and individual residents, competition between local governments will result in an efficient allocation of public goods. Ostrom, Tiebout, and Warren (1961) propose the more general polycentric framework within which networks of autonomous organizations interact within the same system of rules to provide a complex array and variety of public goods, each at its optimal level of provision. One of the proposed benefits of such a framework is that the multiplicity of organizations enables consumer choice, forcing government agencies and public service providers to satisfy citizens' preferences or else risk losing their budgets.

Jurisdictional competition can be viewed as an imperfect analog of market competition rather than as an example of a perfectly competitive market at work. In this conception, interjurisdictional competition generates tendencies towards more responsible principle-agent behavior on the part of political principles rather than issuing any kind of guarantee of efficiency. So long as the resident of a jurisdiction is able to inflict some punishment upon political agents for predatory activity—or reward political agents for engaging in desired activities—the local government will be less likely to undertake the marginal expropriation. Jurisdictional competition then becomes something that exists in different degrees in different institutional contexts, with higher levels of competitive pressure more effectively constraining legislators.

As such when Moussalli (2012, 57) interprets the theory of jurisdictional competition as predicting greater constraints on legislators and her results as suggesting that "…the Leviathan dynamic trumps the effects of decentralization in this context," she presumes that state governments faced greater competitive pressure than territories. But like states, territories were already entities operating with some degree of autonomy in an environment where they faced some degree of competitive pressure. Both organizational structures allow the jurisdiction some degree of autonomy over a defined range of powers while reserving other authorities to the federal government or to the people. If there were competitive forces at work, why should they affect one jurisdictional classification and not the other? In the absence of further institutional context there is no apriori reason to believe that a state would face any more or less competitive pressure than a territory.

Theories of jurisdictional competition often presume that tax revenue is usually the prize won by the successful participant in a jurisdictional competition, but tax payments are not necessarily the only rewards an individual has to offer a local government. For example, statehood itself could be a prize. If territorial politicians stood to gain from statehood, and if the actions they had to take to procure statehood generally required satisfying the local population, then a model of jurisdictional competition where statehood is the prize could be expected to constrain territorial politicians.

The Pursuit of the Prize

Moussalli (2012) suggests several reasons why politicians would value the prize of statehood. First, territorial governors were appointed by the president. Consequently leadership changes were more likely to occur in response to regime changes in Washington D.C. than in response to local conditions. This was often frustrating for local politicians. For example, Democratic politician Edmund Ross was sent to be the governor of largely republican New Mexico in 1885, where he spends his time in office vetoing nearly everything put before him.

This experience led the vast majority of politicians to prefer the independence of statehood to any benefits that might have been associated with territorial status (Moussalli 2012, 21).

Second, federal oversight over territorial expenditures was often burdensome. The Treasury criticized and refused to pay many territorial expenses even after they were already incurred. The Territory of Arizona was only granted sufficient funds to pay one of their four postmen because only one was authorized by statute. Even the fact that the Territory had spent money on a typist instead of hand writing reports was questioned by federal overseers (Moussalli 2012, 38-41).

Third, as the main finding of part one suggests, statehood came accompanied with a significant increase in the power to tax. The government of New Mexico more than doubled relative to the size of the private economy after statehood. As an example of how this might work in practice, consider that land holdings in the Territory of New Mexico were often assessed well below market value. By one estimate large land holders were paying taxes on 1/10 the value of their land (Moussalli 2012, 22). The greater discretion that states had over allocations of tax revenues would have provided legislators with more than sufficient incentive to correct these lax assessment practices.

Further, Moussalli finds that the increase in the size of government following statehood far overshadows federal subsidies previously granted to the jurisdiction because of its territorial status. The increase in local revenue was 28 times greater than federal subsidies in New Mexico and 35 times greater in Arizona (Moussalli 2012, 48). The sheer magnitude of this finding casts doubt on the claim that the loss of federal subsidies would have motivated territorial politicians to oppose statehood.

Territorial politicians stood to benefit from statehood in many ways. If the pursuit of statehood required politicians to act in the interest of the population, then territorial politicians would have been more subject to competitive pressures than politicians in a post-statehood environment. Rather than statehood expecting to constrain the growth of government, this conception of jurisdictional competition predicts that statehood will relax the constraints faced by territorial legislators.

The particular nature of the quest for statehood—namely, the role that population played in the territory's quest to obtain Congressional support for statehood—does suggest that territorial politicians would have been motivated not only to appease the local population but also to attract new residents. The Northwest Ordinance, written by Thomas Jefferson in 1787, established a population requirement as one of the conditions under which a territory could apply for statehood. Territories were to be permitted to petition for entry to the union when the population in the territory reached 60,000. In the 1850's this requirement was increased so that the territory had to attain a population sufficient to merit a seat in the United States House of Representatives (Owens 1987). This emphasis on population created an incentive for local political leaders to encourage population growth within their territory of residence.

The emphasis on attracting and maintaining population created an incentive for territorial politicians to develop an interest in whether or not people and businesses settled in their territory. This motivation helps explain why railroad routes were so bitterly contested in the 19th century—railroads exerted a great influence over the flow of population, and as such had the power to either help or hinder a territory's attainment of statehood. Governor Henry Haight illustrates the quest for population in his 1869 address to the Senate and Assembly of California: "[the transcontinental railroad's] completion has occasioned heartfelt rejoicing throughout California… The importance of facilitating immigration from the Eastern States and Europe is felt by all who are interested in our material development" (Gov. 1869).

Conclusion

Territorial governments in the 19th century United States were subject to an unusual form of jurisdictional competition. Due to the significant gains associated with statehood and the fact that attracting population was an important part of the quest for statehood, territorial politicians were particularly susceptible to the influence of jurisdictional competition. Consequently, admission to the union actually removed a source of competitive pressure that had previously constrained the fiscal behavior of the newly formed state.

The Fiscal Case Against Statehood bring this incentive structure to light with rich institutional detail. In doing so it takes advantage of a highly valuable but little employed research opportunity—the study of jurisdictional competition in a time and place in which the conditions for its function were more closely met than most other times and places in history. The governments of territories and new states in the 19th century United States had an unusually high degree of autonomy in the creation of constitutions and laws; the disciplining entry and exit of potential residents was far from costless, but was an active social movement; and the entry and exit of new jurisdictions was at least possible given the incompletely formed nature of the American union of states.

If more scholars follow Moussalli in her choice of subject and her attention to detail, the study of the political economy of competitive government will be greatly advanced.

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