

Why local governments do not maximize profits: on the value added by the representative institutions of town and city governance

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Abstract This paper provides an explanation for the lack of profit-maximizing local governments and for the historically widespread use of more or less representative forms of town and city governance. The analytical part of the paper suggests that profit-maximizing governments suffer from a “proprietor’s dilemma,” which can be reduced by including a representative council with veto power over new taxes. Limited but costly mobility plays a role in the analysis, as does the fact that residents often make investments in a town that are difficult to relocate once made.

Keywords State and local governance · King and council model · Tax constitution · Productive theories of the state · Constitutional political economy · Colonial American history

“We, whose names are hereunder written, being desirous to inhabit in the town of Providence, do promise to submit ourselves, in active or passive obedience, to all such orders or agreements as shall be made for public good by the body in an orderly way, by the major consent of the inhabitants, masters of families, incorporated together into a township, and such others as they shall admit into the same, only in civil things.”
Roger Williams’ town charter oath for Providence, Rhode Island (1636)¹

1 Introduction

The study of local government is arguably the largest and oldest field in contemporary political economy. Much of that literature was induced by a short path-breaking paper by Tiebout

¹From Volume I of *Our country*, available on-line at http://www.publicbookshelf.com/public_html/Our_Country_Vol_1/rhodeisl_fe.html.

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published in 1956. Tiebout suggested, and much of the literature that followed agrees, that research should focus on the properties of competition between local governments, rather than the nature of local governance. Indeed, several papers, including Tiebout's, imply that one can totally ignore local governance, because all local governments are constrained to produce more or less efficient fiscal packages. Competition for mobile residents causes governments to provide local public goods at efficient scale and Lindahl prices, or risk disintegrating as their residents leave for towns and cities with such fiscal packages (Oates 1972; Henderson 1985; Wildasin 1988).

Within the United States at least, there is another reason that local governments can be ignored, they are more or less all the same. Local governments are elected on the basis of broad suffrage, they are representative, and most use variations of what Congleton (2001) calls the king and council template. Although there is some minor variation among community governments, most include an elected town council and a mayor or a council and council-appointed town executive. In a few places this template is augmented by town meetings in which direct democracy is used, but even such places usually have a town executive and council that administers town services between town meetings. This is not to say that small variations in a democratic template have no effects on policies, but to suggest that the similarity in the templates is a partial justification for neglecting local governance. This paper suggests that their surprising similarity should be a subject of investigation.²

One plausible hypothesis about the common architecture of town and city governance is that it is a product of liberal theories of constitutional design. Many towns and cities in the United States and elsewhere emerged in the nineteenth and twentieth centuries as specialization, market-based activities, and population increased, and as liberalism (in the European sense of the term) was nearing its peak. Even cities with long histories were often far larger in 1900 than they were in 1800. "Liberal" ideas about constitutional governance would have naturally affected state legislatures and thereby the rules adopted for incorporating towns and cities. Given this, one might be tempted to conclude that the contemporary representative institutions of city and town governance were products of 19th century constitutional theories.

However, the use of representative forms of the mayor and representative council template for local governance predates the nineteenth century by many centuries. And, it was widely used in time periods and in countries that lack liberal traditions. The long history of mayor and representative council systems for local governments suggests that the representative and divided templates for local governance are not products of liberalism, *per se*.

This paper provides another explanation for the widespread use of more or less representative forms of local governance based on pragmatic, rather than ideological considerations. The analytical part of the paper suggests that profit-maximizing governments suffer from a "proprietor's dilemma," which can be mitigated by including a representative council with veto power over new taxes. Limited but costly mobility (exit) plays a role in the analysis, as does the fact that residents often make investments in a town that are difficult to shift once made. Insofar as investor-residents are mobile, they will be inclined to choose from among towns and villages that are well governed and so have relatively low crime rates, relatively attractive amenities (at a reasonable tax price), and in which returns from their private investments are high and secure. These are more likely to be obtained in communities where

²The relative merits of alternative democratic forms of local government have long been a subject of investigation. See, for example, Hayes and Chang (1990), Grosman et al. (1998), and Borge et al. (2008). Even small differences in democratic constitutions can affect public policies (Congleton and Swedenborg 2006).

investor-residents have some direct control over local public policies than in communities where they do not.

The hypotheses generated by the analysis are tested using historical evidence from the New England towns of the 17th century, a time when many communities emerged, were little constrained by higher levels of government, and actively competed to attract resident-investors.

2 Founding a town

Towns may emerge in essentially two ways. They may emerge spontaneously as persons seek out economic advantages associated with particular locations. For example, spontaneous towns often emerge at the mouths of rivers where flood plains provide fertile land, and a river provides fresh water and economical access to inland resources. Towns may also be consciously *organized* by one or more persons, who I will refer to as formeteurs. Such formeteurs seek out attractive locations for communities and attempt to attract resident-investors and others to the locations chosen.

In the former case, a town may initially emerge without a government. In the latter case, formeteurs will normally create standing procedures for selecting town policies and for selecting the persons entitled to make those decisions as part of their efforts to establish a town. Many town governments originate from such formeteur decisions.

Note that in either case, towns emerge as a consequence of mobility, as persons relocate from other parts of the world to specific places. Mobility, thus, clearly plays an important role in the formation, development, and durability of towns and cities, as argued in the local government and regional economics literatures. However, the fixed investments that may be made by potential residents also play a role, as developed below.

2.1 Intentionally forming a town

Consider a case in which a community is to be intentionally created, what is sometimes referred to as land development. Suppose a formeteur or group of formeteurs attempts to organize a village at a lake or along a river that already has one or more “spontaneous villages” along its shores. As a point of departure, assume that the spontaneous towns are composed of self-sufficient fishermen, who cluster around the mouth of a river entering the lake. There may be a bit of specialization, socializing, and trade among the fishermen, but for the most part, the fisher families simply live autonomous lives at a common location. Many of the residents are investor-residents, because they have purchased or built fixed capital (buildings, docks, local social networks) at their present location. They may also have mobile capital (boats, furniture, inventory, national, and international networks), but these are not important for the present analysis.

To attract residents and resident-investors to a new community, formeteurs either have to provide services not available in spontaneous communities or to find more attractive locations. Location specific services that might induce people to relocate to a new include infrastructure (roads, canals, wharfs, water systems), monumental public buildings (church, meeting hall, defensive structure, trading post), and local governance itself which may assure useful, predictable forms of law and order. The services provided do not have to be classic local public goods to serve as attractors for a new town. What matters is that the service is deemed sufficiently useful by a subset of the residents in other communities that they are willing to relocate and pay a positive price (or tax) for the services provided. Solving any

Table 1 Left: The Infrastructure Dilemma. Right: Organizational Solution

	Team Member <i>B</i>				Team Member <i>B</i>		
	Build (<i>B</i>)	Shirk (<i>B</i>)	Exit (<i>B</i>)		Build (<i>B</i>)	Shirk (<i>B</i>)	Exit (<i>B</i>)
Build (<i>A</i>)	3, 3	1, 4	1, 1	Build (<i>A</i>)	<i>R, R</i>	<i>R, R - P</i>	<i>R, 2</i>
Shirk (<i>A</i>)	4, 1	2, 2	1, 1	Shirk (<i>A</i>)	<i>R - P, R</i>	<i>R - P, R - P</i>	<i>R - P, 2</i>
Exit (<i>A</i>)	1, 1	1, 1	1, 1	Exit (<i>A</i>)	<i>2, R</i>	<i>2, R - P</i>	<i>2, 2</i>

The cell entries are utilities, which provide a rank order for the payoffs of the residents (*A, B*). The dilemma in the “spontaneous case” is that both team members shirk rather than build (contribute labor to build the community wharf)

of a wide variety of social dilemmas and coordination problems can be sufficient to attract residents to a new town.

As a possible illustration, consider the construction of a relatively large wharf that is to be available to community residents (for a price). In the initial circumstances, individual residents may not have much labor or capital above that required for subsistence, so no single fisher family can afford to build the wharf. Consequently, in the absence of an organized effort to provide the service, it is not provided, even though such a wharf would be advantageous for the entire community of fishermen. The unrealized productivity of the wharf creates an opportunity for formeteurs to profit by solving the associated capital and labor pooling, coordination, and team-production problems.

Table 1 provides the essential logic of the initial “under” provision of local services equilibrium and for the organizational opportunities associated with that “organizational failure.” The left-hand matrix of Table 1 illustrates the appeal and inefficiency of a natural, spontaneous, community. The unorganized community is viable, because of its fortunate location where more fish can be caught than in other locations known to the residents. However, the community produces less output than would have been the case had all members contributed a bit of labor to build a community wharf, rather than fishing from the shore or in their own small boats.

The natural incentives are such that residents “shirk,” rather than “build” the missing, but useful wharf. “Building” and “shirking” may involve a number of relevant behaviors. Building may entail physical construction, forming organizations, pooling risks, or creative risk taking. Shirking may include unproductive activities (free riding, rent seeking), or simply taking more leisure than would be jointly optimal for community members, who might have “spontaneously” built the wharf themselves. The spontaneous community is viable despite a good deal of social shirking, because of natural advantages associated with its location, $(2, 2) > (1, 1)$.

A variety of artificial compensation systems can produce additional units of output that can be shared between the formeteur(s) and community members. In such cases, the value potentially added by a well-designed organization may be sufficient to induce formeteurs to tackle the “collective action” problems. In the case illustrated, the shirking production problem characterized by the left-hand matrix of side Table 1 can be “solved” by replacing the natural system of rewards on the left with the “artificial” system of rewards on the right, with $3 > R > 2 > R - P$.

The illustration also indirectly demonstrates the difference between “ordinary” fishermen and formeteurs. The latter consider a broader range of possibilities and recognizes organizational possibilities that the typical fisherman does not fully consider. It also demonstrates why the provision of missing, but useful, services can be self-financing. If the new organization is successful, residents will join the new community in order to have access to the new

services—and, moreover, will be willing to pay more than enough to finance the service of interest, here a major piece of infrastructure. It bears noting that local governments often have abilities to solve problems that firms and clubs cannot, because they have authority to tax, regulate, and punish that other organizations do not, but this is not central to the analysis being developed here.

It is also clear that insofar as the value added by the service extends beyond the facility itself, formeteurs would attempt to capture that value as well. Property values would subsequently rise, as the value of the wharf's location specific services are capitalized into land values. In settings in which property claims are respected, formeteurs might simply purchase the land near their intended wharf. If a community is organized near the wharf, there might also be location specific fees as part of property sales contracts to pay for infrastructure and other services, as within contemporary condo associations and many neighborhood associations.³

The success of a town formeteur will naturally encourage imitation, and other formeteurs will form similar communities by providing similar services. As organizational innovation takes place through time, other missing or under-provided services might be added gradually to the menu of town services and amenities. A street system might be planned, lots organized, a defensive wall provided, a court system established, sidewalks built, and so forth.

As a consequence, organized communities may gradually replace spontaneous ones as individuals relocate to formally organized communities offering higher income and/or urban amenities. Moreover, in the face of local competition, the spontaneous communities may organize themselves to provide such services. (A subset of the residents of spontaneous villages may serve as formeteurs within their own community and create institutions that can overcome local team production and public service dilemmas.)

2.2 Community size and profitability

Whether community fees are in cash or in kind, the magnitude of those fees and the advantages of community membership will affect the locational and investment decisions of actual and potential residents. If fees and taxes are set higher than the relative benefits of community membership, the community would fail to emerge or be too small to finance the services promised. A surplus maximizing government has an incentive to make the access fees as high as they can be without discouraging entry or encouraging exit.

The essential logic of setting fees for membership in a new community can be characterized within a two-stage model of local government and resident choice. Suppose that a single proprietor-formeteur determines the annual local service level G and fee, T , for each person in their community (a head tax) in the first stage. Given this, mobile persons make a locational choice in the second. Suppose also that persons moving to the community normally purchase or build an immobile asset at a cost of W . They might, for example, construct a dwelling or shop in order to profit from the community that emerges, because of local service G .

To simplify the analysis, assume that the formeteur knows the tradeoffs faced by potential residents (or at least has an unbiased estimates of them). Let $N = g(G, T, W, G^0, T^0)$ be the in-migration function for the community's services, with G and T being the community of

³There may be more than one government in a given location, and indeed service districts may overlap in a manner similar to Frey and Eichenberger's (1996) Functional Overlapping Competing Jurisdiction (FOCJ) concept. For the purposes of this paper, it is sufficient to focus on single service or unified service districts.

interest's service and tax combination, and G^0 and T^0 being the fiscal package offered by an alternative community. Assume that the proprietor selects G and T to maximize net income with $\Pi = NT - c(G)$. Setting T and G to maximize the residual requires:

$$N + N_T = 0 \quad (1)$$

$$TN_G - C_G = 0 \quad (2)$$

Given T^* and G^* a particular community can be assembled, which can be called N^* with

$$N^* = g(G^*, T^*, W, G^0, T^0) \quad (3)$$

and a total investment of N^*W in the community by investor-residents.

2.3 The proprietor's dilemma

Service and locational decisions similar to those above are widely used in the local government literature to model the founding and equilibrium size of communities. Formeteur decision making, however, does not stop after a community has reached its equilibrium size, as often implicitly assumed in classic Tiebout models. Subsequent fiscal decisions can advance or threaten both formeteur and resident interests. To see why a new community's government is unlikely to remain a proprietorship or partnership in the long run, we add a third stage in which a proprietor may revise his or her fiscal package after a community has been formed.

In the setting of interest here, the persons living in the community have not only relocated to a particular town, but they have made immobile investments at that location. This provides a town proprietor with another possible source of income, namely taxes on immobile wealth. Proprietors realize that investor-residents will stay in their communities at tax levels or rates greater than those which would have induced their initial move to the community, because their immobile investments, in effect, anchor them to the community.

In stage three, proprietors can increase their net revenues by imposing a new wealth-based fee or new head tax on investor residents. Resident investors may be able sell their immobile investments to new residents, but cannot recover the amounts invested, because the tax is capitalized into the value of their fixed assets. For example, if the new wealth tax is X , the value of fixed investment W falls to $W - X$, assuming that taxes are raised without compensating increases in services. Indeed, tax assessments higher than the total investment in fixed capital assets are possible if there are complementarities and/or network effects associated with the investments. The value of a town's commercial center is normally greater than the sum of the individual investments, which creates another immobile source of locational rents that can be extracted by formeteurs

Indeed, the possibility of future "rent extraction" may induce formeteur(s) to initially promise a very favorable combination of taxes and services to encourage a community larger than N^* to emerge. The initial tax-service combination may be set below Lindahl levels in stage one, but taxes would be raised well above Lindahl rates in stage three after the community grows to its equilibrium size. Sites near the wharf may initially be given away, rather than sold or rented.

Maximizing the immobile tax base in period one requires maximizing the number of investor-residents, N , which requires G and T such that:

$$N_G = 0 \quad (4)$$

$$N_T = 0 \quad (5)$$

The future net revenue available after the community forms can induce formeteurs to promise free and plentiful public services, and then renege on those promises in stage 3.

Of course, forward-looking resident investors in stage two would understand the proprietor's temptation to, in effect, take their investment in stage three. As a consequence, many, perhaps most, resident-investors would be unwilling to join such proprietary communities. In such cases, the local public services may no longer be self-financing, and it would no longer pay formeteur-proprietors to attempt to found such communities. Had the new taxes been anticipated, the town would have been smaller by $D^* = g(G^*, T^*, W, G^0, T^0) - N^* - g(G^*, T^* + X, W, G^0, T^0)$.

3 Institutional solutions to the proprietor's dilemma

The analysis implies that only residents that make little or no fixed investments would move to communities organized by profit-maximizing proprietors. These are, of course, the type of residents analyzed in Tiebout's original paper. To attract investor-residents, some method of protecting the fixed investments of residents has to be devised. Mobility is not enough to solve the proprietor's dilemma.

There are several institutional alternatives to pure proprietorships that can reduce or solve the proprietor's dilemma while increasing formeteur net income. The remainder of this paper focuses on a particular template for governance that has long been used for local governance.

Local governments are often based on somewhat representative forms of the king and council template: a mayor or town executive and a town council elected by a subset of town residents. In other work (Congleton 2001, 2011: Chaps. 2, 3), I have argued that there are a variety of practical information, succession, power sharing, and flexibility reasons to use governments drawn from the "king and council" template. For the purposes of this paper, it is the ability of a representative council with veto power over new taxes to reduce the Proprietor's dilemma that is of central interest.

If the king and council template can be used to solve the proprietor's dilemma, this provides a possible explanation for the wide use of the mayor-town council forms of government in times and places without strong representative or democratic traditions or norms.

3.1 The value added by a town council

Suppose that instead of proprietary rule by formeteurs, the town is governed by a mayor and a town or tax council, in which both the mayor (formeteur) and the council have veto power over new taxes and new rules.⁴ Suppose also that the council members are selected by or from resident investors in the community of interest. Such a council clearly has interests that differ from the formeteur's with respect to taxation and services. The council members will tend to veto any tax increase for investor-residents that is not associated with a compensating increase in the quality or quantity of local services.

In the setting of interest for this paper, the creation of a town council adds a fourth stage to the three-stage game analyzed above. In the first stage, the formeteurs propose a tax and service package (and a tax council). In the second, individuals and families make locational and investment choices that produce a village or town. In the third stage, the formeteurs propose tax and service changes. In the fourth stage, the council accepts or vetoes

⁴I focus on the case in which a formeteur serves as mayor or governor to simplify the analysis. Formeteurs may also simply appoint a person to serve as mayor, rather than serve as the town's executive themselves.

the proposed change in the fiscal package. The existence of the fourth decision node affects choices at all three of the nodes previously discussed.

By reducing the possibility of wealth-extraction after the community is formed, this form of the mayoral-town council system of government induces formeteurs to select the profit-maximizing tax-service combination characterized by (1) and (2) at the first stage, which yields a community of size N^* in the second. In the third stage, no new taxes will be proposed unless coupled with new services, because the formeteur knows that the tax council will veto such proposals. As a consequence, relatively few vetoes in the fourth stage will be observed (e.g. only mistakes by the formeteur or his successors). In equilibrium, such town councils may look like “rubber stamps,” but are nonetheless providing an important service.

Dividing policymaking authority, rather than shifting it entirely to investor-residents, also protects the formeteurs’ initial investment from wealth-extracting taxes aimed at formeteurs that advance investor-resident interests. Without retaining some authority during the period in which formeteurs remain engaged in production and management of their new services, the investments of formeteurs would be more risky and less likely to be self financing.

Under suitably representative forms of the mayoral-town council template for local government, as opposed to proprietorships, the formeteurs adopt fiscal policies in the manner characterized in the two-stage Tiebout models widely used in the literature on competitive local governance.

3.2 Selecting town council members

Simply creating a system of governance with a mayor and town council does not automatically avoid the Proprietor’s Dilemma. The interests of the council must be aligned with those of the resident-investors in the community of interest for it to have this useful effect on local fiscal policy. If resident-investors are homogeneous and discriminatory taxation is not possible, essentially any council composed of resident-investors would represent that group’s interest. In such cases, only locally Pareto superior changes in the initial fiscal package can be adopted. However, if discriminatory taxation is possible—and it usually is—an appointed tax council can be “captured” by the formeteur(s) by exempting council members from taxation and/or giving them a share in the government’s net revenues. Such a council would not significantly reduce the fiscal risks for investor-residents who are not on the council.

There are several methods for reducing a proprietor’s ability to “capture” a town council. One technique used in ancient Athens was to select council members at random with short terms of office. Such council members turnover too rapidly and unpredictably to be fully captured. Another possibility, more widely used in medieval Europe and colonial America, is to select council members through elections with suffrage limited to investor-residents (e.g. major property owners). Elections allow captured and incompetent council members to be replaced when they stand for reelection, which reduces prospects for capture. Relatively frequent elections further reduce the potential for capture.

Other institutions can address problems that arise when different classes of investor-residents have systematically different interests. For example, large investors may have different interests than small investors. In such cases, a bicameral town council might be adopted, under which one chamber is elected by major and the other by minor property owners. Wealth-based bicameralism allows each group of investors to protect themselves from extraction by the other. If the interests of major and minor property owners are reasonably well aligned, but those with more at stake take greater pains to understand the consequences of public policy, wealth-weighted voting may be used to select more diligent town council members in a manner similar to the rules used by stock-companies to select board members.

Generality rules (Buchanan and Congleton 1998) may also be applied to reduce extraction risks associated with differential taxation by investment level. Given such rules, unicameral town councils elected by taxpayers may be sufficient to reduce the risk of wealth extraction by the town's government.

Note that the same logic does not apply to universal suffrage unless all residents are investor residents. In cases in which a majority of the residents have made no investment (those with $W = 0$), other redistributive risks of the sort noted in Meltzer and Richard (1981) tend to emerge under universal suffrage. In the latter case, various policy norms and property laws (generality and "takings" laws) may be adopted to reduce the risk of rent extraction. In general, it seems clear that elected town councils, per se, reduce rent extraction risks only when the electorate consists mainly (or only) of investor-residents and the terms of office are relatively short. Selection of town officials via universal suffrage is evidently based on ideological, rather than economic considerations. (The role of ideology in suffrage expansion is discussed at length in Congleton 2011: Chaps. 7–8.)

If the above analysis is correct, narrowly representative systems of local governance will be adopted unilaterally by formateurs under, authoritarian and aristocratic regimes, as well as by communities of liberals and communitarians, for entirely practical non-ideological reasons.

The economic advantages of representative systems of governance and representation grounded in property ownership do not require a democratic outlook or liberal constitutional ideology. By allowing the possibility that fiscal packages may be revised through time, the mayoral and town council system of governance also tends to perform better in the long run than communities that simply freeze initial taxes and services. The best possible combination of taxes and services is unlikely to be completely evident at the moment a town is organized.

3.3 Implications of the proprietor's dilemma for the nature of local governance

The above analysis suggests that mayor and town council governance in which members of the council represent resident-investor interests should be commonplace in history and substantially independent of prevailing ideological norms. Additional considerations such as ideology may also affect the size and nature of the electorate and also qualifications for holding positions on the council, but may somewhat reduce the viability and formation of towns and cities insofar as the risk of wealth extraction is increased.⁵

The fact that towns and villages have long been governed by various forms of the mayor and town council template is superficially consistent with this analysis. That town councils have often been elected by and/or consisted of major property owners in those communities is also consistent with the analysis. Such town and city governments are common throughout Western history (until the nineteenth century) and also in many other parts of the world (Pirenne 1925/1980; Moraw 1994).

4 Historical evidence from colonial America

The remainder of the paper uses historical case studies from colonial America to assess the explanatory power of the above model of the emergence of the institutions of local

⁵See Congleton (2011: Chaps. 7–8) for a discussion of how ideology affects suffrage rules.

government. A statistical test of the above theory of the institutions of local government using contemporary data is difficult, because in most settings the formation of new towns is constrained by a variety of laws adopted by higher levels of government. Rules governing the incorporation of villages, towns, and cities are centuries old in the West (Daniels 1978; Curry 1997). Indeed, the founding of a town is often said to occur when a higher level of government formally recognizes the existence of a community and allows it to collect taxes of various kinds. Insofar as town charters are limited to a few templates by such rules, the competitive advantage of representative systems will be evident in modern and medieval data only insofar as efficient templates emerged in earlier periods when the constraints of central governments were less binding.

To find cases in which the governance of towns and cities was not significantly affected by rules imposed by higher levels of government requires instances in which higher levels of government were nonexistent or incapable of regulating the formation of towns. The early history of the United States of America provides many relatively well-documented instances of the intentional creation of such new communities. Even in early American history, however, incorporated communities were often formally constrained by central governments, although the constraints varied from state to state, territory to territory, colony to colony, and time to time as one goes back through American history (Daniels 1978; Curry 1997: Chap. 1).

Nonetheless, many towns were founded in places relatively far from central government control, as in frontier trading posts, territorial mining towns, and in unchartered wilderness.

If the above analysis is correct, there should be widespread use of representative mayor-town councils systems for local governance. The electorates enfranchised to select councils should be based on investments or tax payments in the communities of interest in the absence of ideological consideration. Council members will be resident-investors and there may be rules for the uniform assessment of taxes among resident-investors. Profit-maximizing formeteurs of new communities will voluntarily adopt such systems to increase the viability and resources of “their” towns. Towns that have town councils selected by investor taxpayers will tend to be larger, wealthier, and grow more rapidly than those with proprietor governance.

4.1 Intentional cities: on the effects of initial siting by formeteurs

Among the most freely-formed communities in modern history were the towns formed during the first century or so of colonial development in the territory that became the United States of America. During this period, many new towns were intentionally formed by individuals and small groups that set out to build communities of one kind or another. Many, perhaps most, were founded by profit-seeking enterprises. This is true, for example, of several of the oldest successful towns in the United States. Jamestown was founded by the Virginia Company, a joint stock company, in 1607. New York City was founded and laid out by the Dutch West Indies Company in 1625 (as New Amsterdam). Boston was founded by the Massachusetts Bay Company in 1630. A partnership of “lords proprietors” founded Charleston, South Carolina in 1670 and laid out the city streets before any buildings were constructed (Rosen 1982: 13). A single English proprietor took the initiative in founding and laying out Philadelphia in 1681 in an area previously lightly settled by Swedish and Dutch colonists (William Penn).

The sites of these four settlements were carefully chosen with attracting resident-investors in mind. The sites were all relatively easy to defend, had plentiful freshwater, access to inland farmland, and all but Jamestown were situated at places with excellent natural harbors. In a manner consistent with the theory developed in the first part of this paper,

all of these enterprises adopted representative councils early in their histories, with suffrage based on investments and/or tax payments made in the new “company” towns.⁶

Except for Jamestown, all these intentionally formed towns gradually became large cities, because they were both well sited and evidently well governed. By 1790, New York, Philadelphia, Boston and Charleston were the four largest cities in the area that had become the United States of America in 1776.⁷ New York, Philadelphia, and Boston remain major cities today.

4.2 Effects of town chartering rules

At about the same time that the earliest American towns were founded, the colonial formateurs also adopted various “town policies.” For example, Massachusetts adopted a “town system” under which land would be granted to those founding a town and establishing its initial government. That town system subsidized the formation of communities and allowed some local discretion over the form of government chosen. Virginia, in contrast, used the English county system under which local officials were appointed by higher levels of government (in this case, by the colonial government) (Taylor 2001: Chaps. 7–8; Brown and Brown 1964: Chap. 10; Curry 1997: Chap. 1; Wakelyn 2006).

These differences in colonial rules for local governance persisted for most of the seventeenth and eighteenth centuries and had significant effects on the formation of viable towns. If the theory developed in the first half of the paper is correct, there should have been more representative local governments in Massachusetts, where town formateurs were less constrained (or required to adopt such councils), than in Virginia, where the formation of representative local governments was more constrained. The colonies that allowed the use of local town councils to limit wealth extraction from investor-residents should have more and larger towns than those that did not.

This was largely the case. New England is famous among historians for its use of relatively democratic, representative, systems of governance. Most took the predicted form with a mayor (governor) and town council (council of assistants). Suffrage in New England communities was, as predicted, initially based on property or tax payments (although there were initially additional religious qualifications). As predicted, there were more and larger towns in Massachusetts than in Virginia. For example, in 1790, the three largest cities of Massachusetts were Boston (18,320), Salem (7,921) and Lowell (6,474). The three largest cities of Virginia, with nearly twice the population (692,000 versus 379,000), were Norfolk (2,959), Petersburg (2,828), and Alexandria (2,748).⁸

⁶Charleston is a partial exception to this rule, because it was governed by the colonial government, rather than being independently governed. The colonial government, however, included a governor, a council, and an elected assembly. The electorate for the latter was based on wealth, race, and religion qualifications. As in Virginia, local officials (commissioners of various kinds) were appointed by the colonial government, rather than selected by the residents of the city. The main public works in Charleston, beyond the layout of the city and law and reasonable order, were wharfs of various kinds (Rosen 1982: 22, 39).

⁷The nine largest cities in 1790 were: New York NY, Philadelphia PA, Boston MA, Charleston SC, Baltimore MD, Northern Liberties PA, Salem MA, Newport RI, and Providence RI. Northern Liberties, an area north west of Philadelphia, was absorbed by Philadelphia in 1854. See U.S. Bureau of the Census (1998): <http://www.census.gov/population/www/documentation/twps0027/tab01.txt>.

⁸City populations are from *On population total by race, 1790 to 1990, and by Hispanic origin, 1970 to '990, for large cities and other urban places in the United States*: <http://www.census.gov/population/www/documentation/twps0076/twps0076.html>. State populations are from Series A 195–209 of the *Historical statistics of the United States colonial times to 1970*, Part I (1976). Additional supporting anecdotal evi-

5 Selecting governments without central government constraints: evidence from Providence Plantation and Rhode Island

“Until the Charter granted to them from King Charles the Second, they never had any government before, but what they set up among themselves, and exercised all authority thereby as largely and amply even to death itself, as if they had the most legal and warrantable power in the universe.” Brinley (1696–1709: 1709 letter to Col. Nickholson, published in Perry 1900: 94–95)

The founding of the villages that became the eighth and ninth largest cities in the United States in 1776 provides additional and somewhat sharper tests of the theory. The towns founded in the area that became the state of Rhode Island were partly a result of doctrinal disputes and other disagreements that arose within the Massachusetts Bay colony. As a consequence, those leaving the Massachusetts Bay colony attempted find lands where they were not subject to Massachusetts’ law. This meant that the founders of the Rhode Island (Narragansett Bay) towns were initially free to adopt any form of government that they thought would be useful for the long term success of their settlements.

All four communities in the Narragansett Bay were founded by persons that thought in grand terms, and so the towns were laid out on a relatively large scale and their laws for governance were similarly ambitious, at least in their prose.

What is most relevant for the purposes of this paper is that the formateurs of the Narragansett Bay towns could have chosen to adopt and retain proprietor-based governments, because the new towns were initially outside the chartered territories around them, and so not constrained by colonial or English law. Instead, they chose representative governments that would be attractive to potential investor-residents. As predicted, in spite of support for civic equality in many of their community ordinances, not all residents were granted the right to participate in town governance. Instead, this privilege was initially limited to men admitted into the “fellowship” (e.g., partnership), and owning property in the new communities.

Focusing on the new towns of Narragansett Bay, rather than the new towns of Connecticut, has the advantage that movement between the communities was relatively easy, which increased both “yard-stick” and Tiebout competition between the new settlements. Moreover, there was a sharper break between the Narragansett Bay towns and the Massachusetts colonial government than between the Connecticut towns and the Massachusetts Bay Colony’s government (Osgood 1904: 305). Indeed, several of the formateurs of the Narragansett Bay towns had been banished from Massachusetts.

5.1 A digression on early governance in the Massachusetts Bay towns

In order to appreciate the innovations and problems confronted by the Rhode Island towns, it is useful to provide a short overview of the settlement and governance of the Massachusetts Bay colony. In 1606, the English government delegated authority to develop the northern and southern parts of the Atlantic coast of what became the United States to two groups of investors. The charter for the south (sometimes called the Virginia charter) ranged from 34 to 40 degrees north. The charter for the north (sometimes called the New England charter)

dence on the emergence of towns in New England can be found in Brown (1955), Brown and Brown (1964), Carpenter and Arthur (1872), Douglas (2005), Green (1877), James and Boseman (1999), and James et al. (2000).

ranged from 38 to 45 degrees north. The combined area ran from what approximately the contemporary Florida-Georgia border to Nova Scotia.⁹

The group charged with managing development in the south, the adventurers of London, granted several charters beginning in 1608. These included the charter of the Virginia company, and perhaps surprisingly, that of the Pilgrims, who were supposed to settle along the northern boundary of the southern territory, but actually settled far to the north of that line.¹⁰ Development of the northern territories was administered by the adventurers of Bristol and Plymouth, who began authorizing colonies and settlements (often called plantations) in 1620.

The most successful of the early northern charters was issued to the Massachusetts Bay Company in 1629. That charter described both the territories to be developed and the governing institutions of the stock company that would administer the new colony. The company's government would have the authority to increase the number of freemen and to include non-stockholders as freemen, who would meet four times a year in a general court (company meeting). The company would also have the power to "establish all manner of wholesome and reasonable orders, laws, statutes and ordinances. . . not contrary to the ordinances of this realm of England."

The company's government would consist of one governor, one deputy governor, and eighteen assistants chosen from the company's freemen (its stockholders or partners). The Massachusetts Company's government was thus drawn from the king and council template, which was widely used by stock companies in this period (Konig 1978). There were initially over 100 freemen in the company, who had the right to elect the governor, deputy governor, and 18 assistants.

The company held a series of meetings in England, and in a very unusual move, the freemen voted to move the company government to its Massachusetts Bay colony, so that its development could be directly managed. At the same time, the company promised to repay all investors within seven years. The company leaders also encouraged shareholders to move to the new colony, but only a couple dozen investors made the trip across the ocean (Adams 1921: 142).

In this manner, a private company's government became the regional government of the Massachusetts Bay colony. With the charter in hand, the first "great migration" of about a thousand persons was organized by John Winthrop to the area around present-day Salem and Boston.¹¹ The governments of most other company-based English colonial enterprises remained in England, because that is where their shareholders and governing officers lived.¹²

⁹Note that the northern and southern divisions of the greater Virginia territory overlapped in the area between present day Delaware and New Jersey. This territory was claimed by the Dutch in 1609, who began settling in New Amsterdam (New York City) and the Hudson River valley in 1625.

¹⁰The Pilgrims were supposed to settle around the mouth of the Hudson River, where the Dutch settled a few years later. Instead, they landed well north of the Hudson in the territories controlled by the adventurers of Bristol and Plymouth. Ambiguity about their right to settle in the New England territory eventually caused the Plymouth colony to be merged with the Massachusetts Bay colony, but not until 1691.

¹¹Winthrop (1588–1649) is famous partly for his activities as formateur in the colony and town of Boston, and partly because he kept prodigious records of all his activities inside and outside government, which provide one of the best accounts of the emergence and development of the Massachusetts Bay colony. His fellow formeteurs, including John Endicott, wrote less and are much less well known.

¹²The other companies normally delegated a good deal of authority to persons who resided in their colonies. Their appointed governors, in turn, normally created councils composed of other resident investors to help them administer the colony.

At first, the electorate (general court) of the new colonial government consisted of around two dozen persons, nearly half of whom were company officers and all but one or two of whom were Puritans. Meetings of the investors (the general court) had the authority by charter to expand their numbers and to adopt laws and ordinances. During the first year of settlement, there were negotiations within the company leadership in Massachusetts and between it and the colony's resident-investors. As a consequence, approximately 100 new freemen were added, all Puritans, and a rule was adopted that limited future additions to propertied members of the Puritan congregation. At the same time, authority to elect the governor and assistant governor was delegated to the assistants (Adams 1921: 144–145).

As a consequence of these quasi-constitutional decisions, a somewhat aristocratic, prime-ministerial form of government emerged, under which the colony's religious elite would select the colony's council, who would then select the governor. The governor was often Winthrop or Endicott during the first twenty years of the colony's life.¹³

In 1634, representatives from new towns were added to the General Court, evidently because of yardstick competition from the Virginia and Bermuda colonies, which had created representative assemblies with town representatives in 1619 and 1620. At the same time, the General Court was acknowledged to have veto power over new taxes (Adams 1921: 154, 160).¹⁴

The religious and property restrictions for suffrage and high office caused the government to have both religious and commercial interests. Puritan strands of religious laws were adopted and rigorously enforced, and so were property rights. The governors and assistants obtained relatively large, although not enormous, personal land holdings. The decisions of government were supported by a legal system with jury trials and a range of punishments.

The new colony flourished partly because of its Puritanism, as emphasized by most historians, but it also flourished because it was a place where land in fee simple was easily obtained by emigrants and because the colonial government provided essential services and promoted a work ethic (backed by law). It bears noting that of the 16,000 persons that arrived between 1629 and 1640, only a third were members of the Puritan congregation (Adams 1921: 122). A representative general court had veto power over new taxes, which reduced the ability of the governor and his assistants to extract wealth from the colony's successive waves of investor residents.

Nonetheless, those who failed to defer to the government on legal and religious matters were often banished from the colony and sometimes executed if they returned.

5.2 Early governance in the Narragansett Bay towns

Several of the formateurs of new settlements in what became the colony and state of Rhode Island were banished from the Massachusetts Bay colony for a lack of deference to the rulers and rulings of the Massachusetts government. Disagreements included legal, ideological, and theological ones. In many previous cases, banishment led to the death of those banished, who could not survive without the laws, specialization, and social insurance provided by the

¹³The revised council of 1630 was to be composed of: "the thirteen of such as shall be reputed the most wise, honest, expert, and discrete persons resident upon the said plantation [the Boston area settlement] shall from time to time, and at all times hereafter, have the sole managing and ordering of the governments and our affairs there..." and the government characterized as "the Governor and Council of London's Plantation in the Massachusetts Bay in New England" (Wakelyn 2006: 93).

¹⁴The town representatives were selected from freemen in those towns, who were significant property owners (investor-residents) in those towns, by definition.

Massachusetts Bay colony. In the case of interest here, banishment of several ambitious and talented men and women led to the formation of several new towns outside the jurisdiction of the Massachusetts Bay Colony.

The nearby Narragansett Bay had several advantages as a location for new communities. It was outside the territory described by the Massachusetts Bay colony's charter. Several rivers entered the bay, which provided plentiful fresh water and access to inland resources and fertile land. Several large islands in the bay had good harbors. The bay itself was a fine source of fish and its relatively long shoreline reduced transportation costs. Water borne transportation was far more cost-effective than overland transport during this period.

The Narragansett communities began as informal partnerships of roughly a dozen men, in which a "senior partner" would purchase a parcel of land from the local Indian tribes. The partnership would then begin developing the new lands and attempt to attract settlers.

The new towns attempted to attract residents in three ways. First, they were carefully sited with fresh water, protection from the natives, and shipping in mind. (Two of the first towns were on a large island in the bay called Rhode Island.) Second, the towns attempted to provide local services such as law and order, village defense, local transport networks, and management of the village commons. Third, they adopted somewhat more liberal laws than Massachusetts had for both the governance of their towns and the civil liberties that were to be guaranteed to residents. The ordinances of the town governments include some of the earliest statements of the principles of popular sovereignty, equality before the law, and religious tolerance in the English language.

The settlements were fairly small at first, and the procedures for governance were often informally based on consensus or majority rule among those founding the new communities. Formal institutions of governance normally were adopted during the first decade of settlement.

Regular meetings were held and decisions recorded in writing; so, a good sense of the governance and public policies of the new settlements is provided by town records. The records show that town governments were occupied largely with recording property sales to new residents and admission of new owners to the subset of residents entitled to participate in town governance (freemen). The meetings also addressed the provision of local services, including: (i) establishing legal proceedings, whipping posts, and prisons, (ii) defense from the Indians (including requirements that all households be armed and trained in the use of guns and bows and arrows), (iii) the planning of town roads and harbors, (iv) the management of communal lands, and (v) controlling free-ranging (but private) hogs within town limits (which evidently were a major nuisance in all four towns). Freeman attendance at the early town and general court meetings was mandatory, and fines were imposed on those skipping meetings or arriving late.

The persons who founded the four new towns in the area that became the state of Rhode Island a century and a half later had no official charter from England, and consequently did not have to form a government that would be acceptable to the English governmental officials. (Indeed, some residents expressed concerns about whether their new communities could lawfully create a government without an English charter.) Nonetheless, the town formateurs adopted governments that were in many respects similar to those of the Massachusetts Bay colony and used many of the same terms to describe their government officials. There are good reasons for being institutionally conservative, even in new towns (Congleton 2011: Chap. 3).

The procedures for making public policy choices were modified through time to cope with problems faced by growing communities, and to assure that the communities would continue to attract new residents. The reforms tended to make the town governments more

open, more tolerant, and somewhat more democratic than those of the colony they left. For example, the Rhode Island town formeteurs admitted most new resident-investors to their body politic, as freeman with the right (and duty) to attend and vote at meetings of the general court (town meetings).

Examples of liberal quasi-constitutional decisions include the 1636 *Town of Providence Oath* quoted at the beginning of this paper, which explicitly limits governmental authority to civil matters, and thereby implicitly excludes religious ones. Another is an ordinance adopted by the town of Newport in 1641 at a meeting of its general court:

It is ordered and unanimously agreed upon, that the government which this body politic doth attend unto in this island, and the jurisdiction thereof, in favor of our Prince, is a democracy or popular government: that is to say it is in the power of the body of freemen orderly assembled or the major part of them to make or constitute just laws by which they will be regulated and to deputize from among themselves such ministers [town officials] as shall see them faithfully executed between man and man. (1641, quoted in Wakelyn 2006: 145).

Both the town oaths and laws of governance clearly go beyond the language that would be expected from a simple land-development company, even though the town meetings initially resembled such meetings. That investor-residents could become freemen without satisfying religious constraints advanced economic as well as early liberal ideological interests. It allowed a broader cross section of investor-resident interests to be directly represented in government councils.

The timing of these innovations is also significant for the history of political theory, because Hobbes did not finish his famous book with its chapters on popular sovereignty and social contracts until 1651 and Locke did not complete his equally famous volumes on government until 1689. In the new colonial towns, such statements were not the mere ideas of philosophical men, but ordinances of community law.

The formeteurs of the new towns could have held onto authority, yet all four communities allowed most new property owners to vote in their town meetings. Governance in Newport, for example, began with 9 formeteurs in 1638 and had grown to approximately 60 freemen in 1641 (Bartlett 1856/2006: 87, 110). The founders evidently attempted to attract new residents partly by their choice of site, but also through local public services, laws, and method of governance. The most open and secular community, Newport, grew the fastest.

In 1640, Newport put “aside earlier desires for a church and state in partnership implementing divine law. Newport... henceforth embraced the pattern that came to prevail throughout the colony. No longer was government conceived as having a divine source, no longer would secular power be put behind any religious purpose.” Newport thrived and became the largest of the towns in just eight years. (Peterson 1853: 14–15, 50)

Emigration and imitation evidently favored well-sited, relatively open, and representative forms of town governance over proprietary governance. Providence and Newport grew to be cities and are still the largest in the state of Rhode Island.

The advantages of relatively open and representative governance also affected the form taken by the colonial government adopted when the new towns banded together to formally create a new colony a few years later.

5.3 The colonial government of Rhode Island and the Providence Plantation

The political and territorial domains of the English colonial grants were never completely clear or secure, and all of the New England colonies invested significant resources in le-

gal contests in England that gradually determined which company had control over what territories.¹⁵ Disputes with the Massachusetts colony over their right to form new local governments in the Narragansett Bay region occurred from the earliest days of Rhode Island. To preserve their governing authority and more tolerant laws, the new towns jointly funded Roger Williams to go to England and seek a proper colonial charter.

Williams successfully obtained a charter in 1643 that granted the towns control of the territory around the Narragansett Bay and the authority to form a colonial government to make laws for that territory. After three years of negotiations among the towns, a new colonial government was formed in 1647 under that colonial patent. The result was a representative confederation of the four towns: Providence, Portsmouth, Newport, and Warwick. The 1647 colonial constitution states that

“the form of government established in Providence Plantations [Rhode Island] is ‘democratical’ that is to say, a government held by free and voluntary consent of all or the greater part of the free inhabitants” (quoted in Bartlett 1856/2006: 156).

The proprietary and somewhat aristocratic origins of many colonial charters were largely absent from the federation of towns that constituted the colony of Rhode Island. Town officials were elected by freemen (most property owners), who in turn elected or appointed colonial officials. There was no crown-appointed governor, nor a formal proprietor or proprietor class, except insofar as suffrage was still restricted to property holders and many of the formateurs remained major land owners.¹⁶

It is clear that the form of government adopted was not a response to English authority or pressures from the Massachusetts Bay colony, because both governments were opposed to democratic governance. Rather, it was because of the success of the representative systems of town governance in Narragansett Bay. Town representatives negotiated the charter and it seems clear that town leaders (many of whom were formateurs) expected that their colonial charter would attract new residents to Rhode Island. The voluntary contractual nature of the new colonial government is evident in the deference accorded to the towns on matters of legislation and taxation. Proposed reforms were to originate and be accepted at town meetings before being taken up by the colonial government (Adams 1921: 186).

The result, however, was not a liberal democracy or confederation in the contemporary sense of those terms. Suffrage continued to be limited to a subset of male property owners, as predicted by the theory of developed in the first part of the paper, in a setting where women were unlikely to be investors. Due process of law and jury trials were supported. Property and civil rights and duties were supported by a court system and formal legal code. Toleration of alternative forms of Protestantism was a matter of law and custom.

By the standards of history, the freely constituted towns and colony of Rhode Island were among the first modern polities grounded in elections and equality before the law. That suffrage remained property based suggests that practical considerations, rather than democratic ideology or early ideas about popular sovereignty, motivated their representative systems of governance.

¹⁵It seems likely that such ambiguity was a method through which the King and his various agents and allies could influence company (patent holder) decisions and extract rents from them through time. Recall that even the initial division of responsibilities for developing the southern and northern parts of the Atlantic Coast explicitly overlapped in the initial charters.

¹⁶The new colonial government also created its own short legal code for the usual range of property, sexual, and informational crimes. The first laws included short provisions for dealing with bankruptcy and civil disobedience, provisions for licensing ale houses, and provisions for the relief of the poor (Bartlett 1856/2006: 143–190). The towns remained the main source of most public services and ordinances.

5.4 Subsequent developments in Rhode Island, Massachusetts, and Connecticut

If the above analysis of Rhode Island is correct, the success of its more open, representative, form of government should have induced other governments in the region to adopt similar procedures or risk significant out-migration. Yardstick competition would also affect the institutions of governance insofar as innovations produced practical economic advantages for resident-investors, who participated in local and colonial governmental decisions elsewhere. Formateurs would thus adopt relatively liberal governments, because these would attract resident-investors. There is some evidence to support this contention.

At about the same time that the Rhode Island towns were founded, towns with suffrage and representation similar to that in the Massachusetts Bay Colony began to extend representation in their town meetings (general courts) to more of their resident-investors. This was not required by English or colonial law, but appeared to be part of efforts to attract investors and to reduce conflict within the new settlements and colonies.

The religious qualifications for becoming freemen tended to be weaker in the territories settled beyond Massachusetts control. For example, 1643 ordinances for the government of New Haven stated that:

Hearafter, none shall be admitted to be free burgesses in any of the plantations within this jurisdiction, but such planters as are members of *some or other* of the *approved churches* in New England, nor shall any but such free burgesses have any vote in any election. . . (*Government of New Haven* in MacDonald 1916: 51)

The ordinance was evidently adopted by New Haven (a small independent colony at the time) to *slow down* the expansion of suffrage in the new towns of that new colony.

The ordinance tightened the rules for suffrage in New Haven, but implied a somewhat broader suffrage than allowed by the Massachusetts Bay colony. All colonial officials were to be elected by the freemen (free burgesses) of the towns in the New Haven colony, and each town would send two elected representatives to the general court, which among other duties would “settle and levy rates and contributions upon all the several plantations, for the public services of the jurisdiction.” Members of *all approved churches* could be freemen, not simply members of a particular strand of Anglican Puritanism.

Competition for residents and perhaps a slow shift in ideology tended to favor representative local governments in New England during the seventeenth century. For example, in southern New Hampshire new towns were established by groups with various religious beliefs, including conventional Anglican ones, but with relatively open general courts. As a consequence, “the people had become accustomed to self government in open town meetings.” These local town meetings were sufficiently powerful and representative that they were able to reject several externally proposed governors (McClintock 1888: 46, 68).

In contrast, suffrage in the Massachusetts Bay Colony was not extended to investor-residents from non-Puritan strands of Christianity until 1664, when it was encouraged to do so by a letter from King Charles II.¹⁷ There was no slippery road to universal suffrage in Massachusetts.

¹⁷Charles II’s father, Charles I, had been executed by England’s Puritan parliament in 1649 in the period of parliamentary rule after the English civil war. Partly to undermine Puritan political influence, the king required that “in the election of the governor or assistants there be *only considerations had of the wisdom, virtue and integrity* of the persons to be chosen and *not of any affection with reference to their opinions* and outward professions. . . all the freeholders of competent estates. . . though of different persuasions concerning church government may have their votes in the elections of all officers, both civil and military” (Elis 1888: 503). The king’s letter of 1662 seems to require freeman suffrage throughout the colony, although the qualifications for the status of a freeman were not defined.

The property and residence requirements for suffrage, however, are of greater interest for the purposes of this paper than are the religious qualifications. As long as discriminatory taxation was not routinely used, the secular and economic interests of investors with the “wrong” religions would be well represented by investors with the “right” theological convictions. Boston and Massachusetts, Hartford and Connecticut, grew throughout the period even as though many investor-residents were excluded from political life and many others relocated to towns with more open and representative governments.

Representation in Massachusetts was evidently sufficiently broad and sufficiently elastic to reduce the residual claimancy of town governments, and to reduce the formateur’s ability to capture their tax councils (or general courts) through discriminatory policies. That the religion-based rules somewhat impeded long run development is suggested by the successful entry of new towns in the territories around the Massachusetts Bay colony and the more rapid growth of colonies elsewhere in New England.

6 Conclusions: constitutional competition and liberal societies

This paper provides a possible economic explanation for (i) the lack of proprietor forms of local governments and (ii) for the existence of local governments in which suffrage and offices in government are limited to investor-residents, rather than formateurs alone or extended to all residents. Just as potential investors in a modern economic enterprises are likely to make larger investment when their investments come with some control over a company’s major decisions, so are potential resident-investors in a new community more likely to risk their lives and property in towns in which they have some control over community decisions, especially taxation.

In the absence of such proprietor dilemmas, one might have anticipated most town governments to resemble proprietorships or partnerships in which a single owner or small group of partners managed their communities to maximize profit. Although many of the early towns were created by independent profit-maximizing companies, those same companies usually adopted procedures for making policy decisions that included representative assemblies of taxpayers with veto power over new taxes and other policies. The analysis of this paper suggests that such policies helped to increase the long run net income of formateurs by preventing them from maximizing their short run profits or net tax receipts.¹⁸

The theory developed in this paper also provides a possible economic explanation for mayoral-town council form of local government, for the tax veto authority of town councils, and for the method through which town councils have historically been selected. Only a subset of a town’s residents were normally eligible to participate in town elections and/or meetings prior to the nineteenth century.

Experiments in local governance were impeded to some extent by colonial and empire levels of governance. These attempted to constrain the permissible forms of local governance during and after the period examined in this paper. However, such rules could not prevent all experimentation, and those experiments clearly favored “king and council” governance with office holders selected on the basis of relatively broad, but not universal, suffrage among investor-residents during the first century or two of U.S. history.

¹⁸With this prediction in mind, it bears noting that the investors and formateurs of many private businesses face similar problems and use similar solutions. In corporations, the policies of a CEO are normally constrained by a shareholder elected board of directors. In condo associations it is normally condo owners, rather than condo renters, that are entitled to vote in elections for condo association offices. See Barzel and Sass (1990) and Sass (1992) for an analysis of voting rights in condominiums.

This is not to say that religion and ideology did not also affect the scope of suffrage. Religious beliefs were often among the qualifications for suffrage during the colonial period at both the local and colony level. Liberal ideas of social contract and commonwealth were also evident in New England from the earliest days of settlement. Both religious and popular sovereignty approaches, however, would have favored the extension of suffrage to all church or community members. That suffrage remained based on property qualifications suggests that economics, rather than ideology, largely determined suffrage in the colonies during the seventeenth and eighteenth centuries.

Ideological trends may well be central to understanding the subsequent extension of suffrage rights to non-property holders in the eighteenth and early nineteenth centuries, as I have argued elsewhere (Congleton 2011: Chaps. 8, 18); however, the inclusion of representative councils with veto power over new taxes among the institutions of local governments does not require ideological support. The economic interests of town formateurs and potential resident investors provide a sufficient explanation.

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