03b. Constitutions

Econ 373: US Economic History

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Fall 2023

Ideals or Interests in Making the US Constitution

- Recall that institutions are rules that structure interactions between people
 - Can apply to politics or economics
- US Constitution proposed fundamental restructuring of power and authority
 - Central government would be strengthened at expense of states
 - Laid groundwork for more open access to economic opportunities
- Where do institutions come from?
 Why did Constitution come out way it did?
 - Outcome of bargaining in context of rapid economic change
 - Clash of <u>ideals</u> versus <u>interests</u>

• In *The Federalist Papers*, Alexander Hamilton, James Madison, and John Jay made case Constitution was a good idea — ideals!

IN CONGRESS, July 4, 1776.

The manimous Declaration of the Aberton units States of Himerica.

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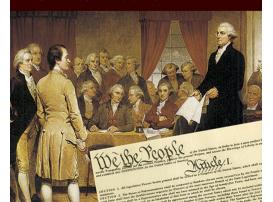
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We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

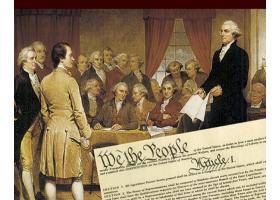
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 - McGuire and Ohsfeldt provide a quantitative test of this hypothesis

Charles A. Beard



Economic Interests and the American Constitution: A Quantitative Rehabilitation of Charles A. Beard

ROBERT A. McGuire and Robert L. Ohsfeldt

An important change in the structure of U.S. institutions occurred when the government under the Articles of Confederation was replaced by a new government under the Constitution. In 1913, Charles A. Beard proposed a view of the formation of the United States Constitution—an economic interpretation—that remains a much discussed yet unresolved explanation of the behavior and motives of the men who wrote the document. This paper provides the first rigorous statistical test of this issue. We summarize the preliminary results of a statistical analysis of the relationship between the voting behavior of individual delegates involved in the making of the Constitution and their economic and personal characteristics. Contrary to current historical wisdom, significant patterns related to economic interests are found in the voting, with the division of interests generally consistent with that outlined by Charles A. Beard seventy years ago.

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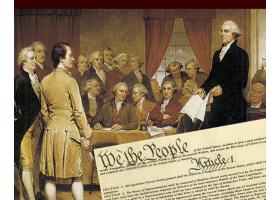


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- Highlights of McGuire and Ohsfeldt analysis:
 - Data on votes and interests of delegates:
 - e.g., 55 delegates at Philadelphia convention on 16 key issues
 - Model interests of participants based on:
 - e.g., occupation, slave ownership, land speculation, public and private debt, personal debt

Findings:

* Slaveowners were less pronational, private security holders were more pronational, delegates from more populous states were more pronational

Conclusion:

* Interests played important role in shaping US political and economiqc institutions – public choice!

Ideals versus interests in the development of the American economy

- Republican thinkers worried that British government had been corrupted in 18thC, feared non-competitive entanglement of economics and politics
- Primarily concerned that political faction would manipulate economic privileges and end up with control over central government
- By accident or intent, genius of US Constitution was to create overlapping jurisdictions of competition (laboratories of democracy... and capitalism)
 - Banking: states chartered banks
 - Infrastructure: states built canals
 - General incorporation: states created general rules for starting businesses

The Economic Effects of the US Constitution

The macroeconomics of the Constitution

- What was effect of Constitution on economic growth? Why?
- United States emerged from War for Independence (in 1783) with large debts and insitutions that disabled central government

• This outcome served the interests of some US citizens but not others...
... also not good for creditors, United States could not establish full faith and credit

The macroeconomics of the Constitution

- To levy taxes under Articles of Confederation, central government required unanimous consent of thirteen sovereign states
- In 1781 and 1783, thirteen states asked to ratify amendments to allow for import duty with proceeds devoted to servicing national debt
 - In both instances, twelve states approved, but one state did not (Rhode Island in 1781, New York in 1783)
- United States entered period of prolonged fiscal crisis
 - Provoked political revolution to renegotiate past promises
 - Resettle accounts among taxpayers and government creditors

Simple theory for the impact of a better constitution

• Value of government debt starts with one-period budget constraint:

$$b_t = s_t + R^{-1}b_{t+1}$$

where R > 1 is gross return, b_t is borrowing, and s_t is surplus

• Alternatively, value of government debt can also be written as:

$$b_t = -R(s_{t-1} + Rs_{t-2} + \cdots + R^{t-1}s_0) + R^t b_0$$

which says debts come from accumulating deficits

• But sustaining large debts requires surpluses in future: $b_t = \sum_{j=0}^{\infty} R^{-j} s_{t+j}$

Simple theory for the impact of a better constitution

• Need to account for uncertainty in forecast of future surpluses:

$$b_t = \sum_{j=0}^{\infty} R^{-j} s_{t+j} = \sum_{j=0}^{\infty} R^{-j} \underbrace{E_{t-1} s_{t+j}}_{\text{"forecast"}} = \sum_{j=0}^{\infty} \underbrace{\kappa_j}_{\text{"policy" "shocks"}} \underbrace{w_{t-j}}_{\text{"shocks"}}$$

- This equation provides structure for problem faced in 1780s
 - ullet Choices embedded in κ_i lowered the value of government debt
 - Institutional reform could set country on new path

Model suggests policies that imply credible commitment are best

The US Constitution in practice

- US Constitution signed in 1789 represented a series of reforms
 - Reorganize fiscal affairs
 - Liquidity and discrimination
 - Federal bailout of states

- Why pay?
 - Gain long-term access to domestic and international credit markets
- Lessons for the United States (and the Euorpean Union) today?

The radicalism of American Revolution (and Constitution)

Preferences, endowments, technology



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