

## 03b. Constitutions

Econ 373: US Economic History

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# Ideals or Interests in Making the US Constitution

# An economic interpretation of the 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 ideals versus interests

## An economic interpretation of the constitution

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

## The unanimous Declaration of the thirteen united States of America.

When in the course of human events, it becomes necessary for one people to dissolve the political bands which have connected them with another, and to assume among the powers of the earth, the separate and equal station to which the laws of nature and of nature's God entitle them, a decent respect to the opinions of mankind requires that they should declare the causes which impel them to the separation. We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness. That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed. That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such Principles, and organizing its Powers in such form, as to them shall seem most likely to effect their Safety and Happiness. Prudence, indeed, will dictate that Governments long established should not be changed for light and transient causes; and accordingly all reference hitherto to them, should be borne in mind, when we consider that the principal object of this Declaration is to inform the inhabitants of these Colonies, that mankind are now separated from all political connection with them, and to inform the rest of the world, that the United States of America, by the unanimous Declaration of the thirteen united States of America, have declared their independence, and have assumed among the powers of the earth, the separate and equal station to which the laws of nature and of nature's God entitle them.

But when a long train of abuses and usurpations, pursuing invariably the same Object, evinces a design to reduce them to absolute Tyranny, it is their duty to throw off such Government, and to provide new Guards for their future security. Such has been the patient sufferance of these Colonies, and such has been the perseverance with which they have borne them, that by the unanimous Declaration of the thirteen united States of America, they have declared their independence, and have assumed among the powers of the earth, the separate and equal station to which the laws of nature and of nature's God entitle them.

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John Miller

Edward G. Loring

Thos. H. Hays  
James G. Smith  
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- The preamble of the Constitution is quite lofty – again, ideals!



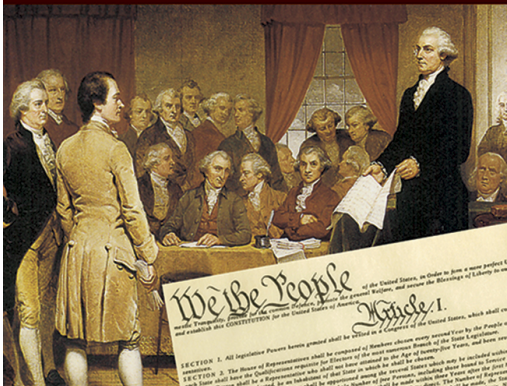
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# An Economic Interpretation of the Constitution of the United States

# Charles A. Beard



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  - McGuire and Ohsfeldt provide a quantitative test of this hypothesis

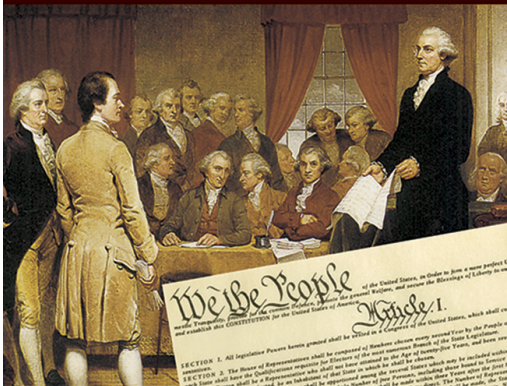
# An Economic Interpretation of the Constitution of the United States

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## *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.



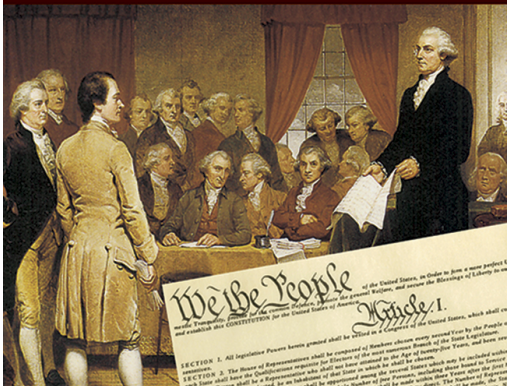
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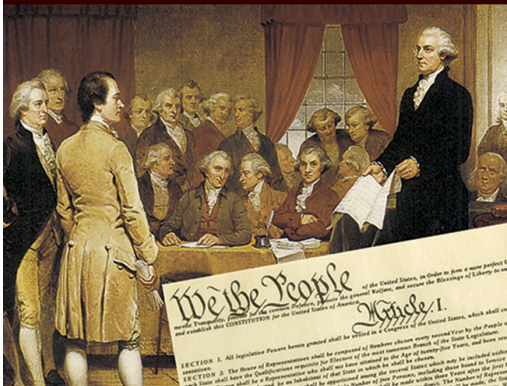
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# An economic interpretation of the constitution

- 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 economic 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 institutions that disabled central government
- Articles of Confederation created Continental Congress, weak executive. . .  
... worked as intended to restrain central government from taxing and spending
- 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:

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

- This equation provides structure for problem faced in 1780s
  - Choices embedded in  $\kappa_j$  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 European Union) today?

# The radicalism of American Revolution (and Constitution)

Preferences, endowments, technology



Institutions  
Liberalism

Mercantilism

Economic (and Political)



Outcomes

?

# The radicalism of American Revolution (and Constitution)

Preferences, endowments, technology



Institutions

Mercantilism

Economic (and Political)

Liberalism



Outcomes

?

**Representative Government**

**Economic Prosperity**

**Inequality**

**Possibility of Reform, Dynamism**