

Rethinking the Structure of the United States

- ▶ The country had all sorts of problems under the Articles of Confederation
- ▶ Congress didn't have an independent source of revenue to pay off war debts
- ▶ The Continental Army had been demobilized leading to a lack of protection (particularly in the west)
- ▶ States were imposing tariffs and disrupting trade
- ▶ Treaties with Spain and France couldn't be worked out
- ▶ Leaders realized they had to come up with a new structure for the country, the result was the Constitution of the United States

Rethinking the Structure of the United States

It could never be more truly said than of the first remedy, that it was worse than the disease. Liberty is to faction what air is to fire, an aliment without which it instantly expires. But it could not be less folly to abolish liberty, which is essential to political life, because it nourishes faction, than it would be to wish the annihilation of air, which is essential to animal life, because it imparts to fire its destructive agency.

– *Federalist No. 10 (James Madison)*

Rethinking the Structure of the United States

Federalist No. 11 (Alexander Hamilton)

- ▶ A united country would have far more bargaining power with European countries
- ▶ A federal navy would help ensure a strong position for Americans in international trade
- ▶ There are certain things that are naturally best left to federal government: fisheries, navigation of the Western lakes and the Mississippi
- ▶ An integrated economy smooths the effects of local shocks

Rethinking the Structure of the United States

Federalist No. 30 (Alexander Hamilton, December 28, 1787)

“Money is...the vital principle of the body politic...a deficiency in this particular, one of two evils must ensue; either the people must be subjected to continual plunder, as a substitute for a more eligible mode of supplying the public wants, or the government must sink into a fatal atrophy..”

- ▶ Current confederation doesn't work: federal government revenue is dependent on the intermediate agency of its members
- ▶ Internal versus external taxation
- ▶ Need to credibly commit to repayment

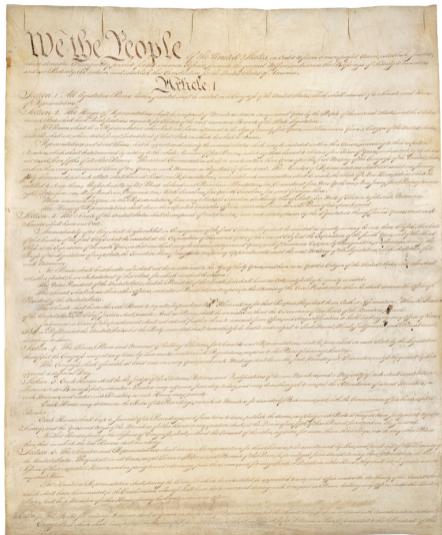
Rethinking the Structure of the United States

Federalist No. 35 (Alexander Hamilton)

“the jurisdiction of the national government, in the article of revenue, should be restricted to particular objects, it would naturally occasion an undue proportion of the public burdens to fall upon those objects...”

- ▶ How to make taxation equitable
- ▶ Distribution of taxes across industries and across states
- ▶ Efficiency: “[Duties on imports] force industry out of its more natural channels into others in which it flows with less advantage...”
- ▶ Representative democracy and economic interests

The Constitution of the United States - ratified 1788



Economics of the Constitution—Article I, Section 8

The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States;

...

To borrow money on the credit of the United States;

...

To regulate commerce with foreign nations, and among the several states, and with the Indian tribes;

...

To coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures;

...

To provide for the punishment of counterfeiting the securities and current coin of the United States;

Economics of the Constitution—Article I, Section 9

No tax or duty shall be laid on articles exported from any state.

...

No preference shall be given by any regulation of commerce or revenue to the ports of one state over those of another: nor shall vessels bound to, or from, one state, be obliged to enter, clear or pay duties in another.

...

No money shall be drawn from the treasury, but in consequence of appropriations made by law; and a regular statement and account of receipts and expenditures of all public money shall be published from time to time.

Economics of the Constitution—Article I, Section 10

No state shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

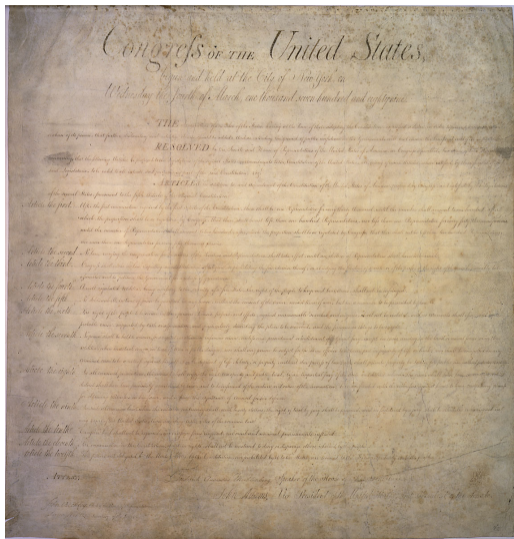
...

No state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws: and the net produce of all duties and imposts, laid by any state on imports or exports, shall be for the use of the treasury of the United States; and all such laws shall be subject to the revision and control of the Congress.

Economics of the Constitution—Article VI

All debts contracted and engagements entered into, before the adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation

The Bill of Rights - ratified 1791



The Bill of Rights - ratified 1791

- ▶ Article I of the Constitution seems the most obviously relevant part for structuring out economy
- ▶ It lays out the ways that state and federal government can regulate the economy, supply currency and so on
- ▶ But what about the Bill of Rights?
- ▶ Arguably, this is what most people focus on when it comes to the Constitution
- ▶ Does it shape our economy?
- ▶ Let's head to the polls:

<https://pollev.com/jmparman>

Economics of the Constitution—Fourth Amendment

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue, but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Economics of the Constitution—Fifth Amendment

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Economics of the Constitution—Fifth Amendment

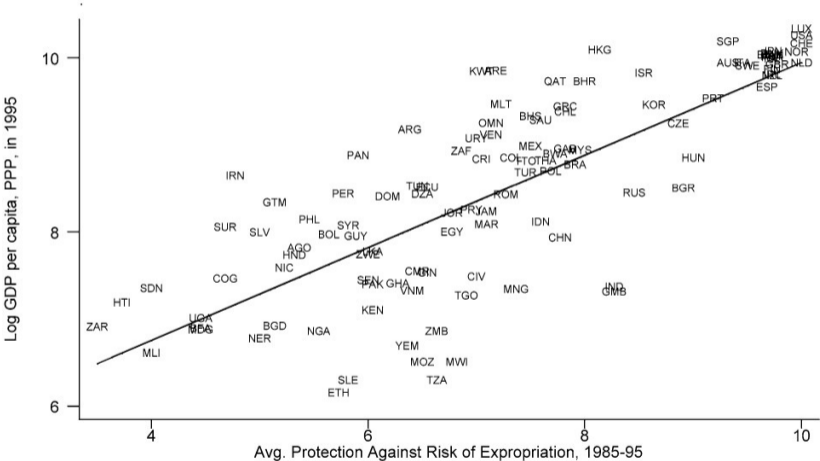


Figure 1. Average protection against risk of expropriation 1985–95 and log GDP per capita 1995.

Summary of Economic Aspects of the Constitution

- ▶ **Article I, Sec. 8** - gives the federal government the power to tax, to borrow money, to regulate commerce between states and with other countries, and to issue currency
- ▶ **Article I, Sec. 9** - provisions to keep trade free between states
- ▶ **Article I, Sec. 10** - prevents states from making their own treaties or issuing their own currency, limits states' ability to tax imports and exports
- ▶ **Article VI** - previous debts will still be honored
- ▶ **Fourth Amendment** - protects private property from unreasonable search and seizure
- ▶ **Fifth Amendment** - people cannot be deprived of life, liberty, or property without due process, private property cannot be taken for public use without just compensation

Summary of Economic Aspects of the Constitution

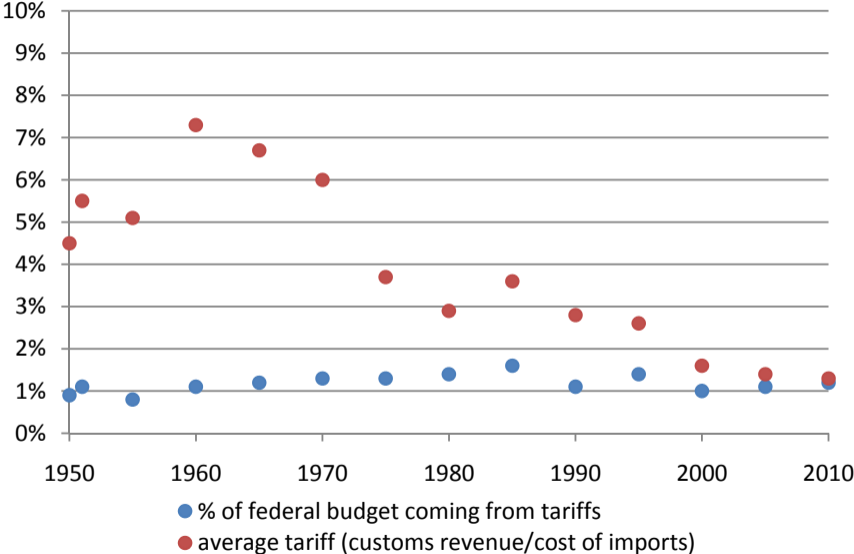
The Constitution did several things to provide stability for the American economy and foster economic growth:

- ▶ It gave the federal government the power to tax, giving it the means to carry out its duty to provide public goods
- ▶ It went to great lengths to keep interstate commerce free and promoted the concept of a national economy
- ▶ It placed the power to issue currency in the hands of the federal government rather than the states
- ▶ It explicitly protected private property

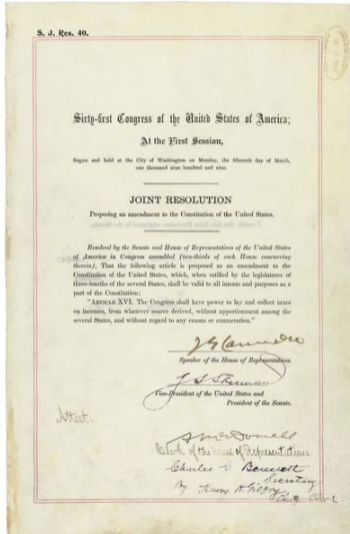
Establishing Foreign Trade Policy

- ▶ The Constitution gave the federal government the power to regulate trade with other nations
- ▶ One main policy instrument for regulating trade is the use of tariffs
- ▶ Tariffs are essentially taxes on imports
- ▶ By effectively raising the price of imported goods, tariffs can benefit domestic producers
- ▶ By generating revenue for the federal government, they could also provide the federal government with a source of funding

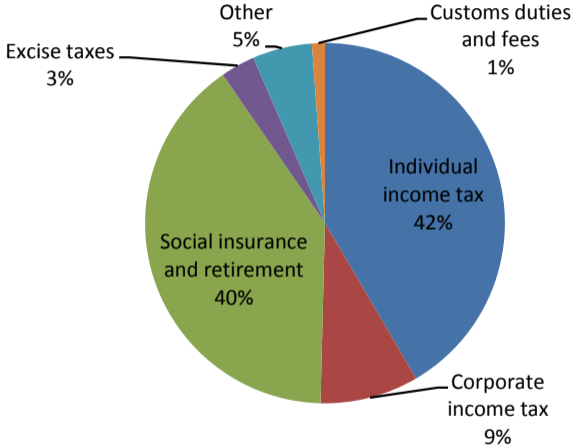
Modern Tariffs



The Modern Federal Budget

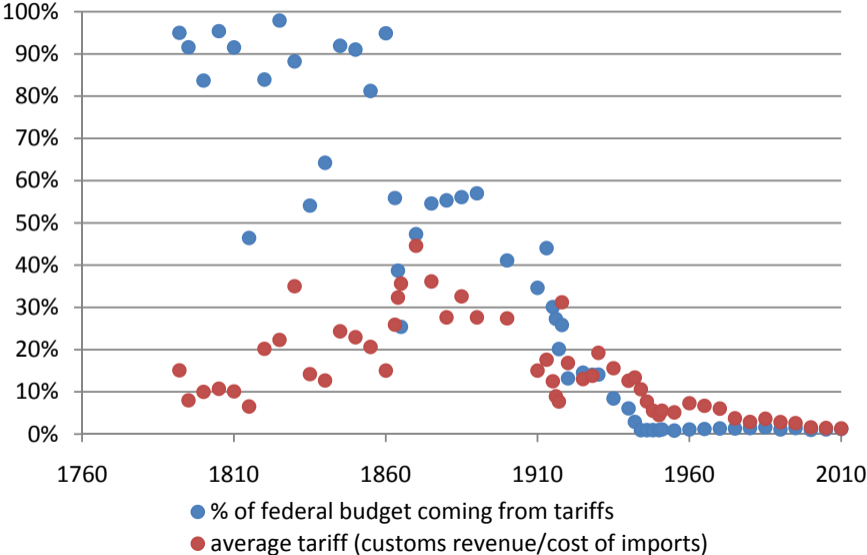


The Modern Federal Budget



Revenue sources for the federal government, 2010

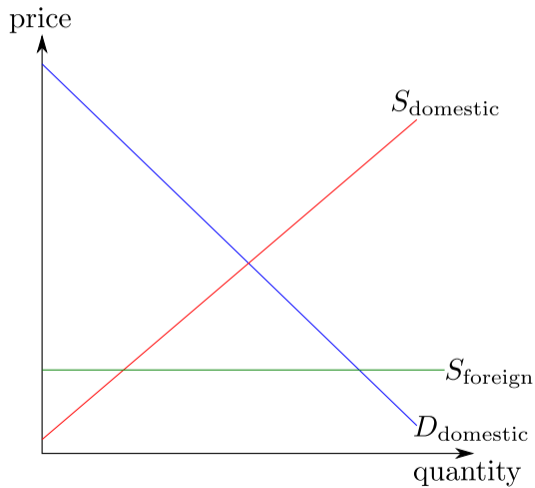
Historical Tariffs



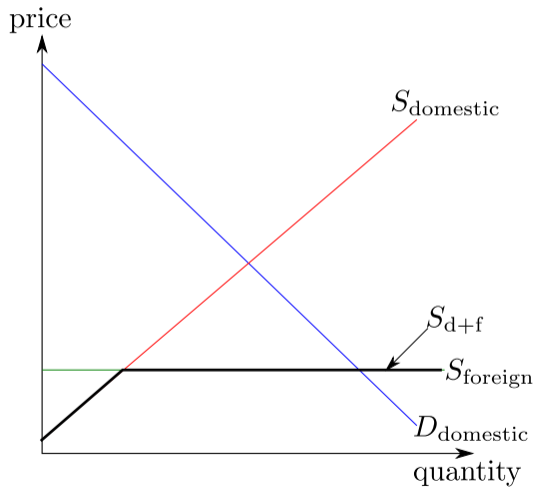
Historical Tariffs

- ▶ So tariffs were much higher in the nineteenth century
- ▶ There were also a much more important component of the federal government's revenue
- ▶ So why has policy shifted away from the use of tariffs over time?
- ▶ Why have we decided that income tax is a better way to fund the federal government and free trade is better than protectionism?

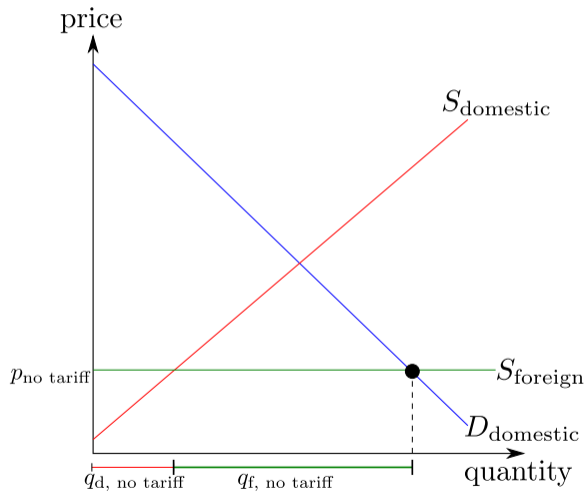
The Economics of Tariffs



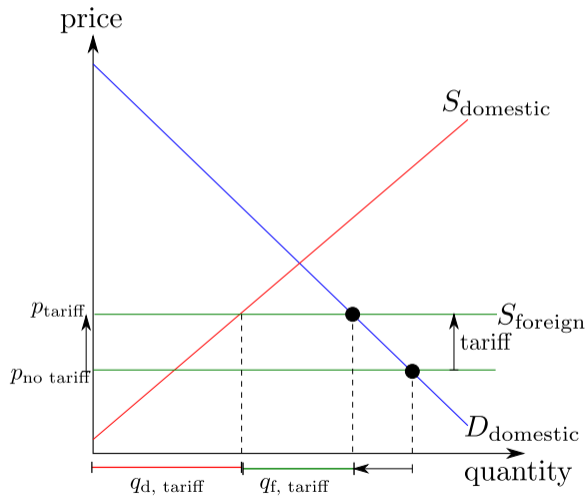
The Economics of Tariffs



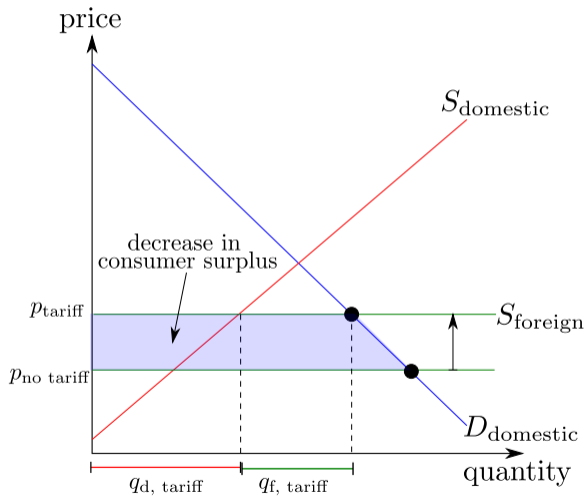
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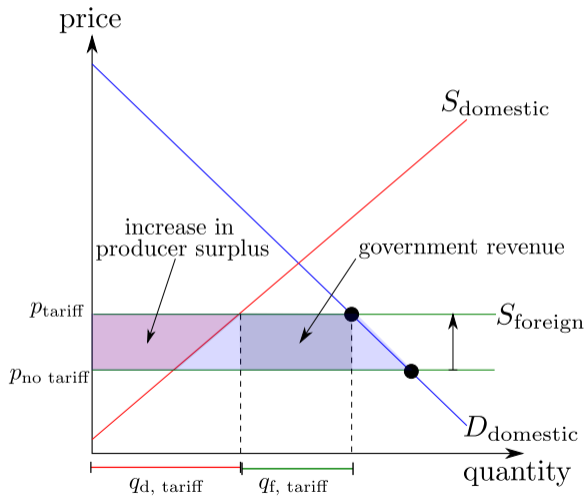
The Economics of Tariffs



The Economics of Tariffs



The Economics of Tariffs



The Economic Argument Against Tariffs: Efficiency

- ▶ So there are a few economic consequences of imposing tariffs
- ▶ Consumers end up paying higher prices and consuming less
- ▶ Domestic producers sell more at higher prices
- ▶ Foreign producers sell less at the same price as before (after subtracting the tariff)
- ▶ Tariffs generate revenue for the government
- ▶ The gain in government revenue and producer surplus is smaller than the loss in consumer surplus

The Economic Argument Against Tariffs: Comparative Advantage

A simple comparative advantage argument:

- ▶ Suppose an American worker can produce 2 units of food (F) or 1 unit of manufactured goods (M) and a British worker can produce 1 unit of F or 2 units of M
- ▶ Assume each country has one hundred workers
- ▶ Say American consumers want 50 M
- ▶ Without trade, that would take 50 workers, leaving 50 workers for food production (or 100 units of F)
- ▶ Britain also wants 50 units of M , this takes 25 workers leaving 75 workers to produce 75 units of F
- ▶ What if America specializes in food and trades 1.5 units of F for every 1 unit of M ?

The Economic Argument Against Tariffs: Comparative Advantage

- ▶ If America uses all 100 workers to produce food, it will produce 200 units of F
- ▶ America trades 75 F for 50 M from Britain, leaving America with 125 F and 50 M
- ▶ If Britain uses all 100 workers in manufacturing, it will produce 200 units of M
- ▶ It trades 50 of those units for 75 F , leaving Britain with 150 units of M

The Economic Argument Against Tariffs: Comparative Advantage

- ▶ So without specialization and trade:
 - ▶ America gets 50 M and 100 F
 - ▶ Britain gets 50 M and 75 F
- ▶ With specialization and trade:
 - ▶ America gets 50 M and 125 F
 - ▶ Britain gets 150 M and 75 F
- ▶ Specialization and trade has made everybody better off

The Economic Argument Against Tariffs

- ▶ So tariffs are inefficient, they generate a deadweight loss to society
- ▶ Add to this Hamilton's point about forcing "industry out of its more natural channels"
- ▶ Restricting trade reduces the benefits from exploiting comparative advantage
- ▶ The economic arguments for tariffs start to look pretty weak
- ▶ Was the US foolish to rely so heavily on tariffs?

The Economic Argument For Tariffs

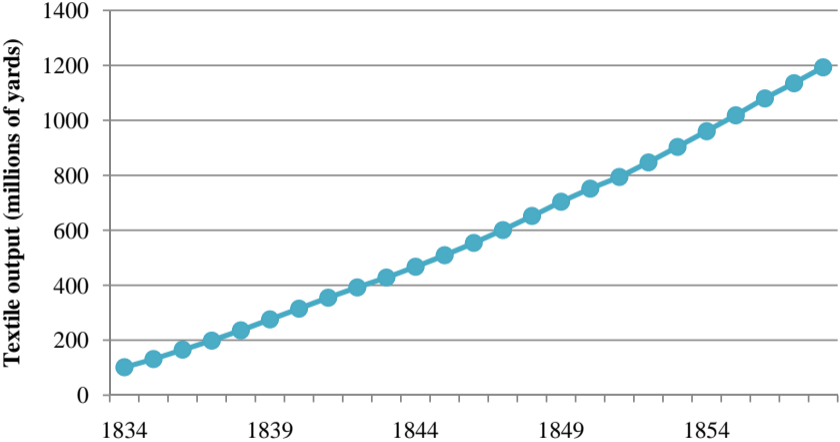
The economic case for tariffs, courtesy of Hamilton in the 1792 *Report on Manufactures*:

“The superiority antecedently enjoyed by nations who have preoccupied and perfected a branch of industry, constitutes a more formidable obstacle...to the introduction of the same branch into a country in which it did not before exist.”

The Economic Argument For Tariffs

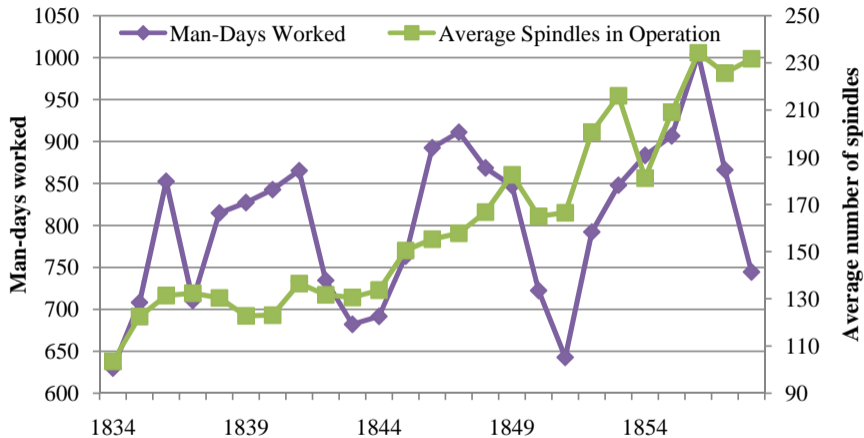
- ▶ The basic argument is that infant industries need protection early on
- ▶ It takes time for firms to become efficient and until they are, their high costs mean they can't compete with mature firms
- ▶ This is especially important if you consider Britain's head start on manufacturing, particularly textiles
- ▶ Economists have shown that a fair amount of *learning by doing* took place in the textile industry
- ▶ If learning by doing is important, you can't expect to be competitive right away even with the latest technology

The Economic Argument For Tariffs



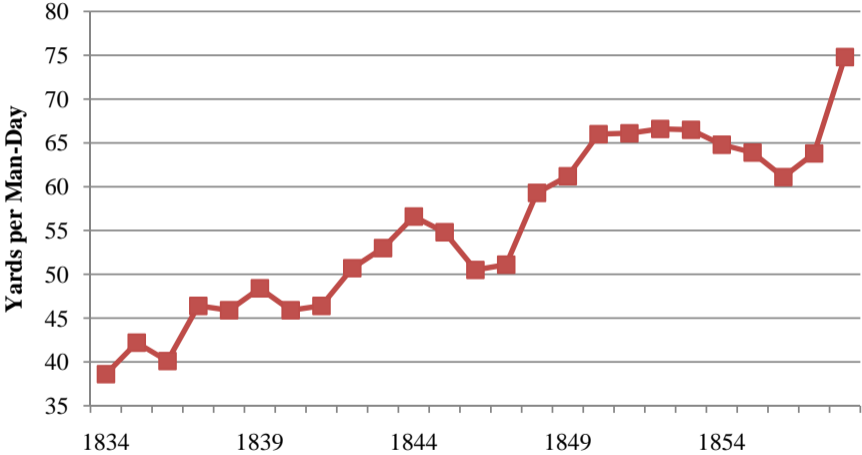
American textile output, 1834-1858

The Economic Argument For Tariffs



Inputs in the American textile industry, 1834-1858

The Economic Argument For Tariffs



Labor productivity in the American textile industry, 1834-1858

The Economic Argument For Tariffs

Growth in the American textile industry, 1833-1859

	1833-1839	1855-1859
Growth rate of cloth output per man-hour:	6.67%	3.20%
<u>Due to:</u>		
Increase in spindle-hours per man-hour	0.74%	0.43%
Increase in raw cotton per man-hour	3.33%	1.60%
Growth of productivity of all inputs	2.60%	1.17%
Growth in productivity from learning by doing	2.02%	0.54%

The Politics of Tariffs

- ▶ Policy is not strictly guided by economic analysis
- ▶ The politics of tariffs are also important in understanding why we relied on a potentially inefficient policy tool
- ▶ Consider the reasons Hamilton gave Congress for enacting a tariff:
 - ▶ To support the government
 - ▶ To discharge the debts of the United States
 - ▶ To encourage manufacturers

The Politics of Tariffs



INCOME TAX – THE MORE YOU WORK, THE MORE TAXES YOU MUST PAY

The Politics of Tariffs

\$ IN YOUR POCKET \$

Protect Your Job--Your Farm---Your Business

The Only Issue Before The Voters is The

PROTECTIVE TARIFF

UNDER THE REPUBLICAN PROTECTIVE TARIFF--

Employment at High Wages.
Home Market--The World's Greatest--Preserved For
the Farmer.
Expansion of Business.
Thriving Industry.

UNDER DEMOCRATIC FREE TRADE--

Labor competes with low-paid foreigners.
Farmer faces flood of imports--
Industry and Business Depressed

Canadian Wheat
Chinese Eggs
Danish Butter
Argentine Corn
Australian Wool, Etc.

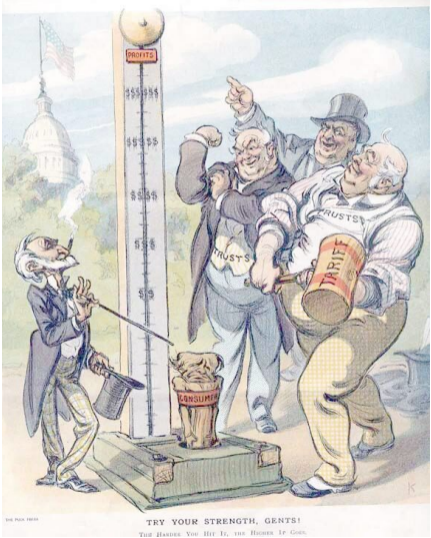
Stand By The Party That Stands By You!

VOTE FOR

THE TARIFF	AMERICAN PRICES FOR AMERICAN PRODUCTS
LOWER TAXES	PAYMENT FOREIGN DEBTS
RESTRICTED IMMIGRATION	LABOR EMPLOYED
	AMERICAN WAGES FOR AMERICAN WORKERS

VOTE STRAIGHT REPUBLICAN
NEXT TUESDAY--NOVEMBER 2

The Politics of Tariffs



The Politics of Tariffs

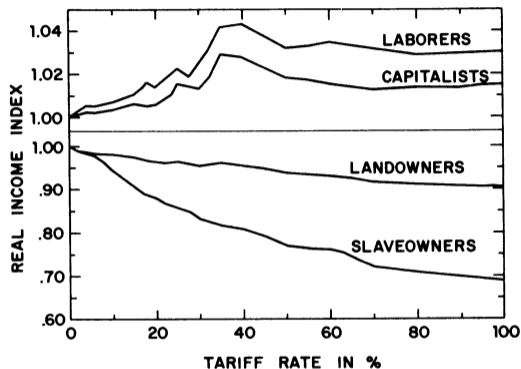


FIGURE 2. DOMESTIC MANUFACTURING OUTPUT
AS A FUNCTION OF THE TARIFF RATE, 1859

From "The Optimal Tariff in the Antebellum United States" by John James, *American Economic Review*, Vol. 71, No. 4, 1981

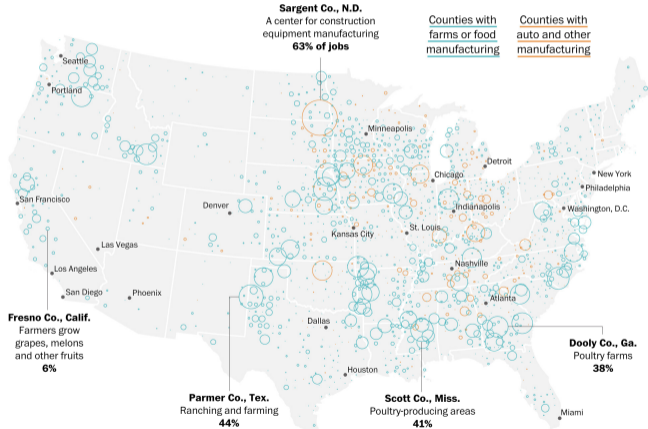
The Political Economy of Tariffs

- ▶ The impacts of high tariffs differed greatly across occupational groups and geographical regions
- ▶ In general, manufacturers of protected goods benefited, consumers were hurt
- ▶ This meant factory owners and skilled workers in the North made more money
- ▶ It also meant that producers of unprotected goods would pay the price by getting fewer manufactured goods in exchange for their output
- ▶ Most southerners fell in this latter category

The Politics of Tariffs

SHARE OF JOBS EXPOSED TO CHINESE TARIFFS, BY COUNTY

Circles sized based on percentage of jobs affected in that county



Tariffs in the Twentieth Century



1930

Tariffs in the Twentieth Century



1947

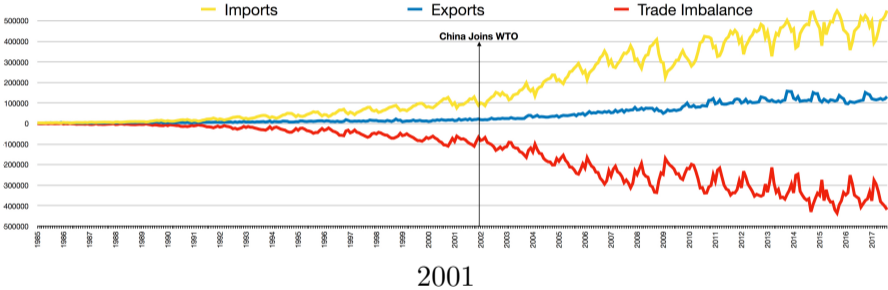
Tariffs in the Twentieth Century



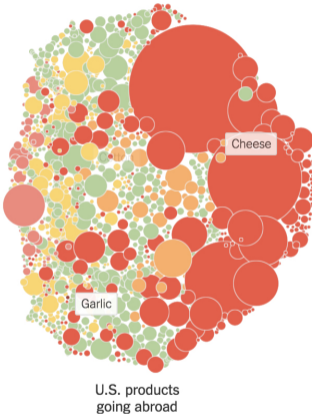
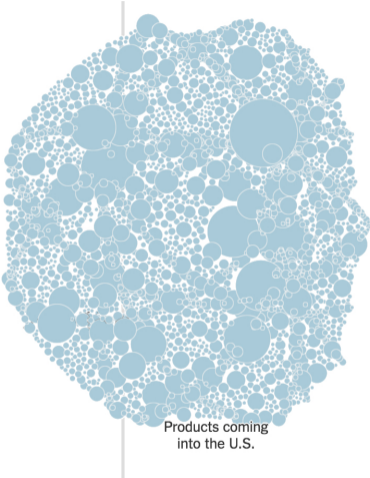
WORLD TRADE
ORGANIZATION

1995

Tariffs in the Twentieth Century



Tariffs in the Twentieth Century



The 2018 Trade War

Announcements

- ▶ Readings for next lectures: Federalist Papers No. 11, 30, 35, Ziebarth (2013)
- ▶ Planning to do a little mini-conference on Tuesday to show you the latest research related to our course
- ▶ Make certain you are working on your first referee report
- ▶ Feel free to stop by office hours with any and all questions or email me
- ▶ Also remember that I am happy to look at full or partial drafts (but count on that taking longer than answering direct questions)

Announcements

- ▶ Make certain you are working on your first referee report, due October 10th
- ▶ Feel free to stop by office hours with any and all questions or email me
- ▶ Also remember that I am happy to look at full or partial drafts (but count on that taking longer than answering direct questions)
- ▶ Mini-conference plans fell apart (research was too cutting edge, no one had working papers available)
- ▶ This week, tariffs and banking, Ziebarth (2013) is the relevant reading for the banking sector