

Handout 2: The Economic Features of the U.S. Constitution

Directions:

What follows are five illustrations of the economic features of the U.S. Constitution. Each feature includes language from the U.S. Constitution, an explanation of what the language means, and a problem for your group to address that applies the Constitutional feature to a new situation. Be ready to summarize what the Constitution says and explain how you would solve the problem.

Feature 1: The Commerce Clause

What Does the Constitution Say?

Article I, Section 8

“The Congress shall have power. . . to regulate commerce with foreign nations, and among the several states, and with the Indian tribes;”

What Does It Mean?

This clause prevents states from doing their own regulating of interstate commerce. States, for example, are prevented from imposing tariffs on goods and services from other states. The Commerce Clause created a free-trade zone among the 13 states. This action encouraged the expansion of division of labor, specialization, and trade. This is one of the main provisions of the Constitution that is clearly in line with Adam Smith’s views on free trade.

Solve Problem 1

The Florida legislature, annoyed by the endless bragging of neighboring Georgia peach farmers that they grow the sweetest peaches in the country, passes a 10 percent tax on all peaches “imported” from Georgia to Florida. What do you predict will happen? Who will be helped? Who will be hurt? What might the Georgia legislature do? How will that affect consumers in Georgia and Florida?

Feature 2: The Contract Clause

What does the Constitution Say?

Article I, Section 10:

“No state shall . . . pass any . . . law impairing the obligation of contracts.

What Does It Mean?

This provision protects the enforcement of contracts by the court system. Contracts must be enforceable so that property can be exchanged easily and with confidence. Without freedom of contract and the enforcement of contracts, there would be little stability in commercial arrangements. The uncertainty of people living up to their commitments would discourage economic activity. People could only trust close friends and family members when doing business.

Solve Problem 2

Jay is 21 and is buying his first car. Jay has saved enough money to make a nice down payment but he will need to borrow \$7,500 from a local bank. The terms of the car loan specify that Jay has 24 months to pay back the loan with interest. Both Jay and the bank loan officer sign the contract. They smile, shake hands, and congratulate each other. Both sides win.

What would happen if Jay could legally ignore the terms of the loan? What if he could just walk away with no consequences? In this situation, would banks be willing to make loans to Jay and others? What might banks do instead?

What would happen if the bank did not have to adhere to its end of deal? Imagine the loan officer told Jay to forget the 24 months, he had to pay the whole loan off immediately. How would this affect other car buyers? How would this affect car dealerships? How would it affect car manufacturers and auto workers? What would be the final outcome?

Feature 3 Checks and Balances

What Does the Constitution Say?

Article I, Section 1

“All legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.”

Article I, Section 7

“All bills for raising revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments as on other bills.”

Article I, section 7

“Every bill which shall have passed the House of Representatives and the Senate, shall, before it become a law, be presented to the President of the United States; If he approve he shall sign it, but if not he shall return it, with his objections to that House in which it shall have originated, who shall enter the objections at large on their journal, and proceed to reconsider it. If after such reconsideration two thirds of that House shall agree to pass the bill, it shall be sent, together with the objections, to the other house, by which it shall likewise be reconsidered, and if approved by two thirds of that House, it shall become a law.”

Article II, Section 1

“The executive power shall be vested in a President of the United States of America.”

Article III Section 1

“The judicial power of the United States, shall be vested in one Supreme Court, and in such inferior courts as the Congress may from time to time ordain and establish.”

What Does It Mean?

These five sections of the Constitution spell out what is known as the system of checks and balances. Checks and balances make passing legislation more difficult because each branch of government can counter the others. Legislation must pass both houses of Congress, receive the approval of the President, and be considered constitutional by the Supreme Court.

Thousands of bills are considered by Congress each year, but only a handful are enacted into law. Critics of checks and balances complain when their favored bills are not passed. Supporters of this feature of the Constitution respond that checks and balances reduce the power of political parties and other factions to pass laws that do not have sufficient popular support.

The slower pace that checks and balances encourages the system to take also encourages the kind of caution in lawmaking that Adam Smith would have approved. He famously advocated for limited government and for lawmakers who when they “cannot conquer the rooted prejudices of the people by reason and persuasion . . . will not attempt to subdue them by force” (*Theory of Moral Sentiments*, Part VI, Section II, Chapter 2).

Solve Problem 3

Thousands of Americans are dying unexpectedly due to the outbreak of a deadly new disease. A bill is introduced into Congress that allows the President to raise taxes, impose new taxes, and spend money without limit for six months. The members of the House of Representatives and the Senate pass the legislation by narrow majorities. The President signs the bill into law as soon as it hits the President's desk.

Will the Supreme Court rule that this legislation is constitutional?

What could go wrong if the legislation stands and so much power is concentrated in the executive branch? When it comes to unlimited spending and taxing for six months, what incentives might influence the President's decision? Who might benefit? Who might be hurt?

Feature 4: The Takings Clause of the Fifth Amendment

What Does the Constitution Say?

Amendment 5

“No person shall be held . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.”

What Does It Mean?

The Fifth Amendment limits the ability of the government to restrict property ownership and ensures rule of law. In other words, it requires that even the federal government obey the law. The federal government cannot legally steal from the people. This protection for private property makes it easier for individuals to invest in their futures and businesses without fear that the federal government might someday, for some reason, confiscate their property.

Solve Problem 4

Fidel Castro fought a successful revolution against the dictator Fulgencio Batista in 1959. Once in power, Castro wasted no time nationalizing (taking over without compensation) all foreign-owned businesses. Then he nationalized all Cuban-owned businesses.

Large cattle ranches, sugar haciendas, and rice farms were confiscated. Before their farms were confiscated, private cattle ranchers imported grasses as special feed for their cattle. These grasses were plowed under by Castro in order to grow rice, corn, and beans, but the land was not suitable for growing these crops. Without the special feed for cattle, meat was

in short supply. Rice cultivation followed the same pattern. Production fell by half in one year. The same story was repeated in tobacco and coffee production.

In 1962, facing massive supply chain malfunctions and food shortages, Castro implemented the most stringent food rationing system Cubans had ever experienced.

What explains why agricultural production plummeted in Cuba after the Revolution of 1959?

Feature 5: The Taxation Clause

What Does the Constitution Say?

Article I, Section 8

states that Congress shall have the power “to lay and collect taxes.”

What Does It Mean?

This power enables the federal government to use tax revenue to pay for public goods such as national defense, building roads, assisting with education, providing health care for veterans, and so forth. It also allows the federal government to borrow money when necessary.

Solve Problem 5

Under the Articles of Confederation, Congress had no power to tax. The Congress had to depend on revenue provided by the states. Not surprisingly, state legislatures were reluctant to make the payments requested by Congress. They had their own financial problems.

For decades, the U.S. federal government has run budget deficits. A deficit means that the government spends more than it receives in tax revenue. The government finances its deficits by selling bonds. Government bonds are loans that eventually have to be paid back, with interest. The money from the sale of bonds is used to pay for the shortfall in tax revenues so the government can meet its spending obligations.

What might happen to confidence in U.S. bonds if the federal government did not have the power to tax? Would potential bond holders have confidence to buy U.S. bonds?