

The year 1776 is a monumental year in history because it marks the year in which the American colonies of Great Britain declared their independence, leading to the creation of the United States. In the world of economics, however, the year 1776 is significant as well, since this is the year that Adam Smith published *The Wealth of Nations* which is generally heralded as the beginning of modern economic thought as a formal science. This book put forth the new idea of a “free enterprise” system – what we know today as “capitalism,” though this term was not coined until the 19<sup>th</sup> century – which was consistent with the liberal ideas of the Enlightenment, which were becoming popular in Europe. These ideas were heavily influential in the American economies as well – not only Adam Smith’s ideas of the “invisible hand” as he called market forces, but also John Locke’s ideas of “life, liberty, and property.” The concepts of private property and the “invisible hand” are central to the ideas of capitalism even today, and because of the significant influence that these thinkers had on the Framers of the United States Constitution, we find a great many free market themes throughout the study of our founding document.

To understand the founding philosophy on any issue within the Constitution, economic or otherwise, it is imperative to know the fully context of the debate when the Constitution was being formed. For this, we look to the records of the Philadelphia Convention, and the records of the Ratifying Convention for each State. These sources are often ignored by those wishing to understand the Constitution, who instead look at far less important sources such as the Federalist Papers, the 19<sup>th</sup> Century commentaries – in particular, those by Joseph Story – and the Supreme Court rulings over the years. Out of these, only the Federalist Papers serve as an

original source, but even they only present the view of the Constitution as it was being argued by a single ideological camp (the Federalists), and ultimately had almost no bearing on how the Constitution was understood at the time of ratification because they were barely published outside of New York. When the Constitution was being debated, it was the interpretation of the ratifiers that was significant. It would be these men who had the power to accept or reject the Constitution based on what they believed each passage to mean. Therefore, when looking for the Originalist's interpretation of the Constitution, it is the ratifying understanding that we should seek.

### **Context of the debate**

To understand the original, ratifying interpretation of any element of the Constitution, it is imperative to understand the context under which the debate took place. Due to some post-Revolutionary rebellions and abuses by state governments (such as excessive taxation and tariffs imposed on interstate trade), delegates from each state were sent to Philadelphia in 1787 to amend the Articles of Confederation. A proposition was put forth – supported heavily by Alexander Hamilton – to replace the federal government of the Articles of Confederation with an entirely new government.<sup>1</sup> There was some resistance because the delegates were only sent to amend the Articles, rather than replace them entirely, but ultimately the convention began the drafting of a new government.

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<sup>1</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), I:41-44

The debate over the Constitution divided those involved into two general ideological camps, known as the Federalists and the Anti-Federalists. The names, however, are misleading in regards to what form of government each camp advocated. The Anti-Federalists supported a *federal* form of government; this meant a decentralized government that left as much power as possible with the individual states and citizens. The most well-known Anti-Federalists were men such as Thomas Jefferson (though he was in France during the convention), Patrick Henry, and George Mason, and were generally found among the so-called Anti-Federalists of the time. Although they are known as “Anti-Federalists” today, at the time of the convention, they resisted the term as a deliberate misnomer created by the Federalists to misrepresent their views. Luther Martin of Maryland, himself an Anti-Federalist, wrote that “the word ‘*national*’ was struck out by [the Federalists], because they thought the *word* might tend to *alarm*” and that these men who advocate a national government “pretend to call themselves the *federalists*,” and the men who opposed a National Government and “considered and styled the *federal party* . . . the *antifederal*.”<sup>2</sup>

The Federalists generally supported a *national* form of government, referring to a government that had its power centralized in an authority higher than the state governments. The biggest advocate of a National government was Alexander Hamilton, with other famous Federalists being George Washington and James Madison.

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<sup>2</sup> Martin, Luther. "Genuine Information 1788." <http://press-pubs.uchicago.edu/>. [http://press-pubs.uchicago.edu/founders/documents/a1\\_9\\_1s8.html](http://press-pubs.uchicago.edu/founders/documents/a1_9_1s8.html) (accessed January 15, 2014).

Because each clause proposed at the Convention was debated and voted on by delegates from each side, the Constitution is – as James Madison intended – a document establishing a mixture of both a National and a Federal government (prior to the Civil War, the United States government had primarily Federal qualities, but has been distinctly National since).<sup>3</sup> This means that most clauses were proposed, modified, and rejected before finally being approved by a majority of the delegates. By reading the records of the debates, we can actually see what drafts were rejected and on what grounds. This often neglected study of the Constitution helps offer a perspective on other clauses that are not entirely clear from the final draft of the Constitution after more than two centuries of cultural change.

The single most important point in understanding the ratifying interpretation of the Constitution is that the understanding at the time it was drafted was that any power not granted explicitly to the Federal Government was Constitutionally prohibited. On numerous occasions, James Madison made it clear that the Federal Government had no power other than those “expressly delegated” to it by the States.<sup>4</sup> This interpretation is not always accepted in Constitutional debates, but when studying the records of the debates at the Philadelphia Convention, it is difficult to deny that the Framers of the Constitution certainly believed in this interpretation, and it will play an important role in the understanding of the economic clauses of the Constitution.

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<sup>3</sup> Madison, James. "The Federalist No. 39. The Conformity of the Plan to Republican Principles." *Independent Journal*, January 16, 1788, <http://www.constitution.org/fed/federa39.htm> (accessed March 13, 2014).

<sup>4</sup> Jonathan Elliot, ed., *The Debates in the Several State Conventions on the Adoption of the Federal Constitution as Recommended by the General Convention at Philadelphia in 1787* (New York, NY: Burt Franklin Reprints, 1974), III:455

## Money and Banking

Banking is not explicitly addressed in the Constitution, but money is and the two issues are inseparable, especially in the historical context of the Constitutional debates. It is perhaps the most well known controversy during the Washington administration as to whether or not the Constitution allows for the chartering of a central bank. The debate around a Federally chartered central bank, however, revolved completely around the Revolutionary Era disagreement on paper money.

The single most telling clause in the Constitution regarding the view on paper money in 1787 is Article I, Section 8, Clause 2, which states that “[Congress shall have the power] To borrow money on the credit of the United States.” While the provision allowing the government to borrow money is worthy of scrutiny regarding free market aspects of the Constitution, the more important matter regarding money is what was rejected. The first draft of this clause actually read, “to borrow money, and emit Bills on the Credit of the United States.” On August 16, 1787, “it was moved and seconded to strike the words ‘and emit bills’” and the motion passed 9-2.<sup>5</sup> The rejection of paper money was not a light issue, either, especially with the Anti-Federalists. Much of the disdain for paper money was established from the earlier drive for paper money in 1775 which was started by Gouverneur Morris. He pushed for the printing of paper money – known then as “Continental” - to fund the Revolutionary War, and the impending inflation was so bad it led to the phrase “not worth a Continental.” The Continental collapsed on its

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<sup>5</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), II:303

own and was removed from circulation by the end of the war.<sup>6</sup> However, the lesson was well-learned that the power to print paper money was a dangerous one to grant the Federal Government, so much so that the move to strike out the words “and emit bills” during the Constitutional debates was led by the very same Gouverneur Morris who pioneered the issuance of Continentals barely more than a decade earlier. The opposition to paper money ran deep, even among many Federalists, but it is notable to point out that there is no strict prohibition against paper money in the Constitution. This further illustrates the central point in understanding the Constitution in that any power not explicitly delegated is prohibited. If this were not the case, then it is difficult to imagine that there would not have even been a motion to prohibit paper money when, according to Luther Martin, “a majority of the convention . . . [was] willing to risque any political evil rather than admit the *idea* of a paper emission, in any *possible* case, refused to *trust* this authority to a government.”<sup>7</sup> An understanding of this concept will remain key in specific regards to the constitutionality of a central bank.

The second clause to look at regarding the Constitutional view on money is Article I, Section 8, Clause 5, which read “[Congress shall have the power] To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures.” As should be obvious after studying the second clause of Section 8, the word “coin” specifically refers to coins and not paper. In fact, one of the early drafts of the clause specified this with the words “paper prohibit” in

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<sup>6</sup> Murray N. Rothbard, *A History of Money and Banking in the United States: the Colonial Era to World War II* (Auburn, AL: Ludwig Von Mises Inst, 2002), 59-60.

<sup>7</sup> Martin, Luther. "Genuine Information 1788." <http://press-pubs.uchicago.edu/>. [http://press-pubs.uchicago.edu/founders/documents/a1\\_9\\_1s8.html](http://press-pubs.uchicago.edu/founders/documents/a1_9_1s8.html) (accessed January 15, 2014).

parenthesis.<sup>8</sup> This clause was also intended to give exclusive power to the Federal Government for the coinage of money – a rarity in the Constitution which originally left most power in the hands of the states – to prevent State central banks from issuing their own bank notes, which was a power previously abused by many states causing a calamity of inflation and complicated trade ratios for the different state currencies. The fact that this clause includes the power to “fix the Standard of Weights and Measures” is also telling. While this power extends beyond money, the fact that it is included in the same clause as the power to coin money is not arbitrary; the Framers knew that standardized weights were needed to define a dollar as much as they were needed to define a mile or a gallon.

It is also interesting to note that the term “dollar” was used in the Constitution.<sup>9</sup> The most popular coin in the colonies at the time was a Spanish silver dollar known as the Spanish Milled Dollar, which consisted of 387 grains of pure silver.<sup>10</sup> The coinage clause of the Constitution was put in place with no intention of redefining the dollar with any other amount of silver. Rather, it was intended to use the same ratio that was already in place, but simply give the Federal Government the power to coin it into a unique American coin with the same standard. The power to standardize weights and measurements also allowed for the government to set ratios of exchange between gold and silver so that higher-value coins could be

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<sup>8</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), II:144

<sup>9</sup> Article 1, Section 9, Clause 1: “The Migration or Importation of such Persons as any of the States now existing shall think proper to admit, shall not be prohibited by the Congress prior to the Year one thousand eight hundred and eight, but a Tax or duty may be imposed on such Importation, not exceeding ten dollars for each Person.”

<sup>10</sup> Murray N. Rothbard, *A History of Money and Banking in the United States: the Colonial Era to World War II* (Auburn, AL: Ludwig Von Mises Inst, 2002), 49.

minted in gold. It can be argued that giving the government the authority to standardize the exchange ratios is anti-free market to a degree (it certainly means that Constitutional money is not completely free), but the intended policy was to keep inflationary power out of the hands of a central authority, which is decidedly free market.

The issue of government-sanctioned central banks is not addressed specifically in the constitution, but as the central function of any central bank is to issue paper notes, it is difficult to accept any argument supporting the constitutionality of a central bank according to the original intent of the Constitution. The typical argument for and against a central bank is the one waged between Thomas Jefferson and Alexander Hamilton regarding the power of the “Necessary and Proper” Clause.<sup>11</sup> Thomas Jefferson’s chief argument is that the charter of a bank is not a power granted in the Constitution, and is therefore prohibited – a valid point in its own regard considering the understanding that has already been established on this matter.<sup>12</sup> The Constitutional prohibition of paper money both supports this argument (on the merit that it is not explicitly prohibited but the records of the debate indicate that the prohibition of paper money was understood by the Framers and the ratifiers) and adds to it another point. If paper money is prohibited, then a federally chartered central bank cannot have this power; without the power to print money, a central bank is unable to function. The

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<sup>11</sup> Article I, Section 8, Clause 18: “To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.”

<sup>12</sup> Philip Kurland, Ralph Lerner, and Liberty Fund Inc., “Article 1, Section 8, Clause 18, No. 10: Thomas Jefferson, Opinion on the Constitutionality of the Bill for Establishing a National Bank” in *The Founders’ Constitution*, ed. Philip B. Kurland (Indianapolis: Liberty Fund, 2000), 3:245-247.



Federal Reserve exists today as a pseudo-private bank that is simply granted the power to issue paper money (Congress does not hold the power itself), which it then loans to the Federal Government by way of purchasing treasury securities. While this method of printing money maintains the strict textual power in Clause 2 – the power to borrow money – it violates the intent and understanding of the Constitution that the Framers had when debating each clause regarding money.

### **Taxation**

The 16<sup>th</sup> Amendment changed the Constitutional view on Federal taxation, but in learning the Framers' view on a free economy, the original tax clauses are still important to analyze. Taxation was a particularly divisive issue during the Constitutional debates because this was one of the major motivations behind the Revolutionary War in the first place. The Articles of Confederation, however, had no means of raising revenue and could only ask for donations from the State governments, who could – and usually did – refuse. As a result, the debates on taxation were heated and even more distinctly than most issues, divided clearly between the Federalists and the Anti-Federalists.

The first clause of Article I, Section 9 grants Congress the power to “lay and collect Taxes, Duties, Imposts and Excises . . . but all Duties, Imposts and Excises shall be uniform throughout the United States.” As a general power, this clause was never intended to be an economic issue, but merely a revenue-raising clause. The only economic issue brought up in the ratification debates was George Mason's concern that the tax on exports would harm the economic security of the South, as

the southern states were more dependent on foreign trade.<sup>13</sup> Most of the economic context of this clause, however, came in the debates on the Section 9 clauses qualifying it.

Clause 4 of Section 9 is certainly the most significant tax clause in terms of understanding the economic intent of the Framers. It reads, “No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.” The term “capitation” is not well understood today, but is one of the more significant words in the clause. A capitation is a tax levied on the basis of an amount fixed per person. Instead of taxing 20% of somebody’s income as we see more commonly today, the government might tax a state \$10 per person within that state. This could also have applied to land and property, but it was eventually settled to refer specifically to census population during the ratifying conventions.<sup>14</sup> The qualification of a “direct tax” is another important element to look at economically. The Framers made it clear that revenues should be raised almost exclusively from indirect taxes. Gouverneur Morris argued that “the people of America will not have money to pay direct taxes” for a long time.<sup>15</sup> But when Rufus King asked at the Constitutional Convention what a “direct tax” was, nobody answered him. While there was no defining of “indirect” and “direct” taxation in the convention, it can be extrapolated that indirect taxes were ones that were viewed as

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<sup>13</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), II:305

<sup>14</sup> Jonathan Elliot, ed., *The Debates in the Several State Conventions on the Adoption of the Federal Constitution as Recommended by the General Convention at Philadelphia in 1787* (New York, NY: Burt Franklin Reprints, 1974), IV:210

<sup>15</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), II:305

voluntary. As James Wilson explained during the Pennsylvania ratifying convention, “it is voluntary. No man is obliged to consume more than he pleases . . . [and] the price of the commodity is blended with the tax.”<sup>16</sup> While he was referring specifically to imposts, his reasoning applies to exports, duties, and excises taxes (or any sales tax). It was generally understood that the apportionment scheme devised for direct taxation was only necessary for emergencies, such as war, as Thomas Davies argued during the Massachusetts ratifying convention.<sup>17</sup>

While there was a great deal of legitimate criticism against the tax system put into place by the Constitution by the Anti-Federalists, the original system of taxation was relatively minimal (albeit protectionist, regarding imports and exports). The Federal Government could tax the sale of excises, which generally meant non-essential goods such as tobacco and alcohol (which actually led to the infamous Whiskey Rebellion), imports and exports, and duties – which specifically referred to non-consumable imports and exports, such as a stamp tax.<sup>18</sup> Any direct tax was to be levied on the State, rather than the citizen, as long as the tax was levied on all states in equal proportion to the population. The State could then pay the tax out of its treasury if funds were available, or levy a tax at its discretion to raise the federal revenue (for example, the State could tax people of a certain income bracket directly to raise the funds that were owed to the Federal Government, thus leaving more

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<sup>16</sup> Philip Kurland, Ralph Lerner, and Liberty Fund Inc., “Article 1, Section 8, Clause 1, No. 7: Brutus No. 5” in *The Founders' Constitution*, ed. Philip B. Kurland (Indianapolis: Liberty Fund, 2000), 2:416.

<sup>17</sup> Jonathan Elliot, ed., *The Debates in the Several State Conventions on the Adoption of the Federal Constitution as Recommended by the General Convention at Philadelphia in 1787* (New York, NY: Burt Franklin Reprints, 1974), II:42

<sup>18</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), II:305

power in the hands of the individual State). Despite this minimalist system for taxation, however, it remained among the most hotly contested issues of the Constitution.

### **Interstate Commerce**

Article I, Section 8, Clause 3 reads: “[Congress shall have the power] To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” The Clause is known as the “Interstate Commerce Clause” and has been one of the single greatest justifications for Federal expansion since the founding of the United States. The nearly exclusive focus of this clause over the years has been the portion allowing the regulation of trade “among the several States.”

A common pro-free market interpretation of the clause is that the word “regulate” merely meant “to make regular” at the time of the Constitutional Convention. Unfortunately, there does not seem to be any examples in dictionaries of the time supporting this theory. However, the modern interpretation in which the Federal Government is able to exercise any power it wishes in the name of “regulating commerce” is especially absurd. This clause does give the Federal Government the power to impede trade to some degree, but it was also meant to facilitate trade between the states.

The Framers were, for the most part, free trade advocates. Even Alexander Hamilton – the greatest advocate of an expansive government at the convention – argued the merits of free trade in *The Federalist, No. 11*: “An unrestrained intercourse between the States themselves will advance the trade of each by an

interchange of their respective productions . . . and will acquire additional motion and vigor from a free circulation of the commodities of every part.” This highlights the intention of the power to regulate commerce among the states. During the Confederation Era, states were restricting trade with each other through interstate tariffs and similar regulations. James Madison cited this as one of the primary reasons that the Interstate Commerce Clause was drafted, writing that the lack “of a general power over Commerce led to an exercise of this power separately, by the States, wch not only proved abortive, but engendered rival, conflicting and angry regulations.”<sup>19</sup> By centralizing the power of commerce regulation, the Framers believed that they would be facilitating free trade among the states.

However, the other motivation behind inserting a commerce clause into the Constitution was to impede foreign trade. Madison and others expressed intent to pursue protectionist regulations against foreign nations. James Madison worried that by not instituting these regulations on foreign trade, the Confederacy “had produced . . . a monopolizing policy injurious to trade of the U. S.”<sup>20</sup>

In all the records on the Commerce Clause, however, there is only discussion of trade regulations in the form of tariffs and similar restrictions used to regulate trade between sovereign nations. This is important to note because when the Constitution was drafted, the States were viewed more as sovereign nations (thus the usage of the word “state” rather than provinces, or some other inner-territorial term) than as subservient territories within a larger nation. The modern

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<sup>19</sup> Max Farrand, ed., *The Records of the Federal Convention of 1787* (New Haven: Yale University Press, 1937, 1966), III:547-548

<sup>20</sup> Ibid

interpretation of the clause is that anything that could be construed as “interstate” can be regulated in any fashion – and this broad definition has been used to allow regulations on every form of industry in the country. All records regarding the debate at the time, though, indicate that regulations meant restrictions and standards on imports and exports, which trade between states at the time was effectively seen as. While trade restrictions on imports and exports are not purely free market, the original interpretation was certainly more free market than the modern interpretation of the clause.

### **Conclusion**

There is always more that can be said about the elements of capitalism in the Constitution. From the economist’s perspective, the entirety of the Constitution can be said to regard the free market, in a way either for or against it. After all, everything the government does – or even chooses not to do – has economic implication. The power granted to Congress to build Post Offices and Post Roads (or, in fact, any infrastructure project that was considered and rejected in the Constitution) can be viewed as an issue of whether or not the free market can adequately supply such essential products. The Framers did not view this as a necessarily economic issue, but such implications can be important. Similarly, the Fifth Amendment with its power over eminent domain has certain economic aspects that should not be overlooked. Without going clause-by-clause through the entire Constitution, it is impossible to cover every possible economic element in the document as a whole. However, by examining those powers most clearly associated with the study of economics, we can see that the Constitution has many elements

that advocates of capitalism should and usually do support. We also find parts of that Constitution that it would irresponsible to present as anything other than anti-capitalist, such as the Interstate Commerce Clause, which many pro-free market Constitutionalists have unfortunately tried to distort in the past. What is certain, though, is that the original interpretation of the Constitution is one that is decidedly more in favor of free enterprise than the modern government of the United States abides by today.