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Critique of Woody Holton's "Did Democracy Cause the Recession that Led to the Constitution?"[1]

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Professor Holton attempts to re-evaluate the debates leading to the ratification of the US Constitution in 1789 under the context of the economic recession of the late 1780s. This effort is neo-Beardian[2] in that it uses economic determinism as a basis for analysis, however Holton's theses focuses specifically on the recession occurring at the time of the debates over the Constitution in addition to the larger social relations of those present at the founding. Specifically Holton makes the claim that it was not entirely a populist 'tyranny of the majority' in the thirteen states which lead to the violation of the property rights of the minority revolutionary war bond holders and thus an investment climate which lead to a recession, and in fact makes the claim that the recession was in part the fault of the monied classes.

[1] JAH 92 (September 2005), pp 442-469.

[2] Charles A. Beard's *The Economic Interpretation of the Constitution of the United States* (1913) is seen as the first and canonical historical study of the United States Constitution based on the economic interests of those involved in the founding.

The states and the national government under the Articles of the Confederacy borrowed extensively to fund the revolutionary war.[3] It was not clear of course how the war was to turn out nor how indeed the debt was to be repaid. This lead to high real interest rates on the debt, and tax levels which were high but perhaps not high enough to where a rational investor could assume that the debts could be repaid. In the literature the people who invested in these bonds are called speculators or elites. These speculators are then juxtaposed with the agriculture class who in the literature are the class who is burdened with paying the taxes necessary to fund the interest on the debt and thus advocate relief in terms of lower taxes and an inflating paper currency. It should be noted here that it is not clear why the debt burden should only fall on the non-elites, the justification for this assumption seems to be missing. Did not the rich also pay taxes? However, much is made in the paper on the non-collection or inconsistent collection of taxes, both state and national, by the states. Perhaps the elites were treated differently in tax collection efforts – much as they are in our current rent-seeking corporate welfare state - however, tax relief for the elites is not made clear in the narrative.

Because of the uncertainty of the fiscal and contract enforcement situation in the new nation, costs of borrowing were high and thus investment was low, international trade stagnated due to questionable financing (and it should be noted pending tariff legislation for revenue-creation), and the elites were accused of hording precious metals due to what we would now call negative expectations. This is the context under which the nascent nation found itself in a recession at its founding.

[3] Beard references Callender who states that $80 million (approximately $250 billion in 2008 dollars) was raised, whereas in fact only $30 million was needed. Callender labeled those that held these bonds 'speculators' (Beard, p. 35, fn). If in fact this is true in today's language we would call those that lobbied for unnecessary debt in order to gain profit at public expense "rent-seekers".

The economic debate over the ratification of the Constitution then focuses on Article I, Section X. which prevents the states from forgiving debts and from allowing anything but gold and silver-backed currency in the repayment of debts. This of course was expected to, and did, re-instill confidence in the economy.[4] However historians have also viewed this as a transfer of wealth from the non-holders of government debt to the holders of debt. It is for this reason that the Constitution is seen as elitist.

Holton continues with this reading of history however adds his own two-part thesis on how to read the adoption of the Constitution based on the recession. The first part is that "the debate was a class conflict in a different sense. It hinged upon which segment of society should bear the burden of reviving the economy" (p. 468). The second part is that "Yes, the Framers rescued the nation from a terrible economic slump, but it was a crisis that they and their friends helped create. Yes, the Constitution revived the economy, but the same result could have been achieved without imposing so many restraints on popular power. Yes, the Framers redeemed the Republic; but that did not prove what it is widely assumed to have proved – that the reins of government reside most safely in the hands of the few" (p.469). I argue here that both of these theses could be improved.

The paper refers extensively to the malaise of the farmer over the tax burdens caused by the war debt and how this malaise may have contributed to the recession due to lack of incentive for productivity on behalf of the farmers. This is perfectly

[4] Note however that the federal government was under no such constraints and could borrow on "the Credit of the United States" (Article I, Section VIII of the Constitution) without a specification for species-backed currency nor an obligation to prevent the violation of contracts. It could be stated today that the current government bailout of certain institutions and not others might be seen as an arbitrary application of law similar to the revolutionary war bond debt forgiveness during the founding (but at the national not state level). In addition, the expansion of the paper money-base of the United States by the Federal Reserve Bank may have contributed to the housing bubble which precipitated the current crisis.

understandable and thus relates to the Holton's first thesis. Forgiving a farmer's debt burden (or anyone's debt burden for that matter) would perhaps make them more productive in the short term however, this relief, like so much debate over economic policy to address an immediate concern, has unintended consequences in the long term. Farmer debt forgiveness would have prolonged the negative investment environment for an uncertain short-term gain. It is not clear in the paper as to why Holton believes the Federalists caused or prolonged the recession. However the narrative is clear that the Federalists did not want to forgive the debt of the farmers and Holton references a vast literature which formulates that farmers were despondent during the debates over ratification. This could imply that the elites contributed to the recession. (It should be noted that the farmers have made out quite well in generations of farm support to this day).

Holton writes "The debate over which classes should sacrifice for the good of the whole was largely a disagreement about what to do on the frequent occasions when the two imperatives for economic renewal – attracting capital and encouraging labor – clashed". This is a false dichotomy. What is missing from the analysis is that perhaps the Framer's of the Constitution visualized a classless society. The Constitution, with some exceptions, called for a strictly limited government which would coincide with a low, and uniformly and non-arbitrarily applied, tax base.[5] What Holton calls the 'reins of government' residing 'in the few' is actually a limited government residing in the hands of all, with a government limited in its ability to favor special groups through positive rights. Low taxes and a non-interventionalist government attracts both capital and labor and makes them both

[5] One glaring exception to the general rule of the Constitution being non-arbitrary is given by Beard who lists 27 special interest groups (pages 42 -46) who petitioned the new House of Representatives for trade protection "a few days after that body had settles down to business" (p. 42) in April 1789.

more productive. With a small government without burdensome tax levels no untoward sacrifice on the part of any is needed.

Additionally Holton states “Americans who wished to transfer more wealth from debtors and taxpayers to creditors and bondholders often acknowledged that doing so would inflict temporary pain on farmers, although they affirmed that this pain would quickly be forgotten as the economy mended” (p. 468). This again is a false dichotomy. The enforcement of contracts under a rule of law is not a wish to transfer wealth but a wish to adhere to previously agreed-upon commitments.

I would like to raise one last point in regards to Professor Holton’s analysis. He makes the argument that “taxpayers [note again the rich are not included here], debtors, and their supporters” (p. 446) petitioned the government for debt relief and requested that war bonds be redeemed at the market price instead of at face value. He also states that merchants who “monopolized a commodity in order to create an artificial shortage” (p. 447) defended this market price, yet “switched sides” (p. 447) and asked that war bonds be redeemed at face value instead of market value. Holton believes that this means “in short both sides’ views of the market were flexible”. I would like to suggest that this shows a misunderstanding of the market. A market is based upon agreement to deliver a good or service based on an exchange of value. If someone, including a government, issues a bond with agreed-upon payment terms at certain point in the future, it is the future price that should hold in a court of law, not its current price. A voluntary contract and its enforceability under law is not an arbitrary power transfer or the perpetuation of a class struggle but is the foundation of a free society. The paper under review does not provide enough evidence that elites were acting arbitrarily or abusing economic power to create unjust laws, and only implies that they were trying to enforce previously agreed-upon contracts.

Finally, Professor Holton writes "Today it is commonplace among economists that excessive taxation and overly restrictive monetary policies – or a combination of the two – can throw an economy into a recession" (p. 465). This is true, however some economists also emphasize, in addition to sound monetary and fiscal policies, the quality of institutions and rule of law. It is this aspect of the founding's economic context which in unfortunately under-emphasized in the paper under review.[6]

[6] Note that Beard laments the lack of historical institutional analysis in both private and public law, see especially Chapter 1.