Some Institutional Background to the Rise of American Business

Due process and contracts:

One reason why this nation switched to a Constitution rather than revising the Articles of Confederation was to protect existing property rights. The due process clause and the obligation of contracts clause were both inserted to that end.

Due process clause:

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

Contracts clause:

> No State shall ... pass any ... Law impairing the Obligation of Contracts ...

The two most important Marshall era contract clause cases, Fletcher v. Peck and Dartmouth College v. Woodward, set the tone of judicial protection of vested rights.

1. In Fletcher v. Peck [1810], Chief Justice John Marshall upheld the rights of an individual who unwittingly purchased land the Georgia legislature had fraudulently transferred in 1795 when the following legislature attempted to negate the grant that led to the purchase. Marshall noted that, in this case:

   the state of Georgia was restrained, either by general principles which are common to our free institutions, or by the particular provisions of the Constitution of the United States

2. In Dartmouth College v. Woodward [1819], the Court held that the Royal charter the college received in 1769 could not be altered subsequently by the state of New Hampshire.

   This charter was a contract within the definitions of the Constitution, and its "obligations" could not be "impaired." The effect of this decision was to establish a precedent for the immunity of all charters, university or business, from state control.

These and the other Marshall Court decisions generally did not address state policy toward economic growth, except to assert that states encourage progress by honoring contracts.

The contract clause was apparently inserted into the Constitution because of a perceived threat against optimal economic growth: the threat from state debtor relief legislation passed during the postwar recession.

This concern is consistent with both mercantilist and classical interpretations.

Under the mercantilist view the state should be an active participant in economic development.

e.g. Alexander Hamilton in his 1791 Report on Manufactures recommended a wide varied of bounties, subsidies, quotas, duties, and outright prohibitions of imports and exports to stimulate industry (as distinct from agriculture). There was substantial dissent from this view.

Some Jeffersonians (e.g. Madison) objected that these would stimulate only "artificial" types of manufacturing, those that could not survive in the absence of subsidies. They believed that the state should encourage whatever manufacturing developed naturally.

Other Jeffersonians were motivated by their agrarian ideology: the U.S. was to be a nation of farmers, so manufacturing bounties, subsidies and the like would prove to be a drain on the farm economy and encourage the development of a privileged class which was creating problems in England.

While the mercantilist view held sway in the Court, the Jeffersonian view proved of sufficient popularity that there was little stimulation of industry beyond that created by world political conditions.

With the rise of the Jacksonians in the early 1820s, a more aggressive, pro-industrial movement began to emerge.

It agreed with Hamilton as to the goals, but differed from him as to the means.

Federalists tended to view new investments as risky.

By the 1820s conditions had begun to change, particularly in the U.S.

Capital was still scarce, but economic growth rapid. Businesses could enter the market and survive, sans subsidy.

Monopoly grants, tax exemptions, & direct subsidies were now viewed bad; they interfered with a world where skill should determine what businesses entered and survived; if a firm needed a subsidy, it could not enter and succeed on its own.

Implied powers:

The enumerated powers of the federal government are those expressly set forth in the Constitution. The implied powers are those inferred from the final clause of Article 1, Section 8 which authorized the Congress

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....

This may not have been intended as a grant of further powers, but it was so interpreted by the Supreme Court in the famous decision of the case McCulloch v. Maryland in 1819.

The state of Maryland had imposed a tax on notes issued by the Second Bank of the U.S., a bank established by the federal government.

When sued, it advanced the defense that nothing in the Constitution had empowered the Congress to set up a bank.

Yet the Court sustained the validity of the Second Bank and rendered it immune from control by state governments, thereby furthering the national (as opposed to the local) interest.

The Court admitted that this power was not explicit, but held that it could reasonably be deduced from those that were. Chief Justice John Marshall wrote:

> Let the end be legitimate, let it be within the scope of the Constitution, and all means which are appropriate...which are not prohibited, but consist with the letter and spirit of the Constitution, are constitutional....

This decision was of paramount importance in extending the scope of federal powers.

From this time on, the federal government was permitted not only to do things that the Constitution said, but also to do things that the Court was willing to infer from the Constitution.

Reserved powers:

Those powers which the states did not delegate to the federal government were retained by the states.

Police powers:

Laws affecting business have thus been enacted, in the interest of public safety, health, and morals, and the general welfare, under what has been known as the police power of the states.

This power, though not mentioned in the Constitution, has long been recognized by the courts.

> Without definite limits, it has afforded a basis for such activities as the licensing of automobile drivers to insure public safety, the inspection of dairies to protect public health, the censorship of motion pictures to safeguard public morals, and the payment of mothers' pension to promote the general welfare.

Power to create corporations:

In Charles River Bridge v. Warren Bridge (1837) the Court established the state's freedom to incorporate competing franchises if it pleased.

> The grant of a franchise to operate a toll bridge did not mean that the state could not make a grant to another corporation to build a competing bridge
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> State franchises were not to be construed as being a grant of monopoly; multiple franchises could be awarded: competition was good for the country.

As noted, what the Charles River Bridge case represents is a decision that corporate charters must be strictly construed, a necessary position if states are to be permitted to withdraw from entanglements with private corporations.

Taney's court also retained the Marshall's court view of commerce clause (as opposed to contract clause) cases. The two most important of these are Cooley v. Board of Wardens of Port of Philadelphia (1851) and the Bank of Augusta v. Earle (1839).

> Cooley established that the city of Philadelphia could impose rules with regard to local importation, but no more.
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> > This is an explicit statement of the classic doctrine that certain types of business precluded state regulation by "imperatively demanding a single uniform rule."

> The Bank of Augusta case gave legal recognition to the fact that corporations have the same capacity to do business outside their home state as within it.

Together these two cases facilitated the growth of corporations.

> The Earle case in particular meant that corporations could freely send their agents into other states and enjoy the legal protections afforded by those states.

Stave vs. Federal conflict:

Where state and federal powers come into conflict, the latter must prevail. Article VI notes that,

> "This Constitution and the Laws of the United States which shall be made in Pursuance thereof...shall be the supreme Law of the Land."

This now familiar phrase was repeated by Chief Justice Marshall in McCulloch v. Maryland:

> The government of the United States, though limited in its powers, is supreme, and its laws, when made in pursuance of the Constitution, for the supreme law of the land.

There has been a steady trend, over the years, toward centralization of functions in the federal government. Why?

1. Some regulatory activities require the establishment of uniform standards
2. The industries to be controlled extend beyond state borders
3. A state may fail to act because its producers, if compelled to incur higher costs, would be placed at a disadvantage
4. Responsibility for a service has been assumed by the federal government because it is not being met by the states.
5. The federal government can raise more money than the states.