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### The Mistakes of 1937

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## THE MISTAKES OF 1937

*Richard A. Epstein\**

### INTRODUCTION

The subject of this brief article is the fiftieth anniversary of the Supreme Court's epic 1937 term. Did the Court make two mistakes in 1937: first when it undid the old order of enumerated powers with its expansive interpretation of the commerce clause, and second when it decisively rejected the principles of substantive due process as they applied to ordinary economic liberties — the right to hold, use and dispose of property, and to enter into contracts to dispose of one's own labor? Today both parts of the Court's 1937 synthesis are regarded as sound and necessary cornerstones of American constitutional law and indeed of modern American political thought.<sup>1</sup> The year 1937 is widely regarded as a moment for public celebration of the judicial wisdom that came none too soon, and almost too late: in Thomas Reed Powell's words, as "the switch in time that saved nine." My view is quite the opposite. I regard the revolution of 1937 as an intellectual and political mistake that ought to be undone if only we could find the way.

This normative conclusion rests on a positive theory about the nature and behavior of man.<sup>2</sup> The first question on the constitutional agenda is this: What kinds of people are constitutions designed to govern? I think that the simplest answer to that question is people like you and me, people with good days and bad days. Within the context of government power, however, we are more worried about what people will do on their bad days than we are pleased about their behavior on their good days. A fine despot may do won-

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1. See, e.g., B. Ackerman, *Discovering the Constitution* ch. 12 (unpublished).

2. I pursue this theme further in Epstein, *Self-Interest and the Constitution*, 37 *J. Legal Educ.* 153 (1987).

ders for a while: public roads may be constructed, the trains may run on time, and the Dow may reach three thousand. But a bad despot, or a good despot turned bad, has quite the opposite effect. Our concerns go beyond potholes, train delays, and the bear market. We worry about tyranny, terror, confiscation, segregation, imprisonment, and death. There is more to fear from the downside than there is to gain from the upside. It is not that all people will behave in irresponsible ways once they assume public office. It is enough that a few unprincipled people in high positions can wreak public havoc. The lesson to be learned is this: the two different forms of error do not have equal weight. We should set our presumption against the concentration of power in the hands of government. Too much power is more dangerous than too little.

That presumption in turn translates itself into a general maxim: in thinking about the nature and structure of political organization, do not view government as an unalloyed good, but treat it gingerly as a necessary evil. It is necessary, for otherwise unrestrained individuals will embroil themselves in bloody conflicts. Lest we become preoccupied with exotic forms of market failure, the major object of government still is to restrain and control private use of force. But while necessary, government may become evil. The only way that the state can constrain force is to use force itself. We should therefore strive to create institutions that prevent the public officials who wield the monopoly of physical power from turning that power on their defenseless citizenry. It is often unclear whether the cure will become worse than the disease. If we survey the wreckage of Hitler's Germany, Stalin's Russia, Pol Pot's Cambodia, and Amin's Uganda, to mention only some twentieth century examples, we should be thankful for the tragedies that our constitutional structure has helped avert.

Owing to the magnitude of the problem, we should expect redundancy in social institutions. Our constitutional framework has adopted two separate strategies to control the use of public power.<sup>3</sup> The first strategy limits government jurisdiction. We should not view these jurisdictional issues as technical, dry, obscure, and unimportant. They rank as equals to the higher principles of natural justice or the subtleties of utilitarian calculation. In practice, jurisdictional limitations offer a way to set governments in competition with each other. The citizen's right of exit counters the monopoly power of government officials and exerts a constant pressure against public misbehavior. Our original system, with its separate states, and its enumerated and limited federal powers, served this end well. The goal is to create a system where government power never dominates the market. If there are national markets, then we want free trade across state borders, which local governments cannot

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3. There is in fact a third — separation of powers — which I do not pursue here.

block, coupled with the right of exit from any state, to guard against excessive internal regulation and taxation.

However important these jurisdictional limitations, they cannot be the sole source of control against official misconduct. Limiting the power of the states does not prevent the federal government from cartelizing the transportation industry. Similarly, local governments are highly adept at finding ways to extract profits from local activities. Today we have unquestioned local hegemony over land use, and the zoning laws show how it is systematically possible to expropriate wealth and capital from some landowners, while transferring it to others, all in a system devoid of protection for individual property rights. A robust constitution therefore must also seek to entrench individual rights against all levels of the state, not because we believe the rights are natural, sacred, or inviolate, but because we know that if usable property rights are not made permanent and definite, then political actors will have far greater power over the fortunes of their citizens than is necessary for the maintenance of the public order. The protection of property is not only an end in itself. It is also a way to decentralize influence and power and ultimately to protect liberty and human happiness.

Moreover, I think it is clear that this grim, but not wholly pessimistic view of mankind, heavily influenced the drafting of the original constitution, which for these reasons includes the Bill of Rights adopted in 1791. I shall talk about two essential parts of this overall scheme: the commerce power and substantive due process. I should like to show why they were, and should have remained, essential portions of the overall constitutional design, and how they had been eroded prior to 1937, only to be finally abandoned by the decisive 1937 cases.

## I. THE COMMERCE CLAUSE

Historically this journey begins with the commerce clause.<sup>4</sup> It is instructive to dwell for a moment on textual construction, because in all the recent debates about original intention and the living constitution, far too little attention has been given to how a close textual reading of an individual clause may provide solid information about its function and meaning. The commerce clause provides: “The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.”<sup>5</sup> This basic text is written in tripartite fashion, in that

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4. I have recounted this view of the clause at much greater length in Epstein, *The Proper Scope of the Commerce Power*, 73 Va. L. Rev. 1387 (1987).

5. U.S. Const. art. I, § 8.

commerce of three different types is the subject of Congress's power. The first interpretative question is the scope of the term "commerce." As a matter of sound construction we should like to fix on a meaning of commerce that is congruent with the three separate spheres to which it applies. We want "commerce with foreign nations," "commerce among the several states," and "commerce with the Indian Tribes" each carry independent weight, so that each covers a territory that is not occupied by the other two.

We must next ask how this test plays out against two alternative meanings that could be assigned the word "commerce." One meaning treats it as an equivalent to the word "trade," as in the sale or exchange of goods and services. The other meaning treats commerce as a synonym for all the varied kinds of productive human activities. It would include, for example, agriculture and manufacture within each state. Which account fits better with the text as a whole?

The broader construction makes the commerce clause, as written, obtuse. Congress shall have the power to regulate manufacture with foreign nations, although it is not clear just what that means. Congress can regulate manufacture among the several states, an extremely awkward construction. Also, Congress can regulate manufacture with the Indian Tribes, another grotesque turn of phrase. Each sphere is so vast and amorphous that the need for the other two is far from clear.

If "commerce," however, is read the other way, we can run the term "trade" through the entire clause in a manner that makes each of its parts intelligible. Congress could regulate trade with foreign nations, trade among the several states, and trade with the Indian Tribes. The ease of this reading suggests that commerce means trade, just as it does in ordinary English — a powerful, if neglected, guide to constitutional construction.

The history of the case law under the commerce clause has been movement from the narrow to the broad definition of commerce. Commerce as trade was the lesson of John Marshall's opinion in *Gibbons v. Ogden*,<sup>6</sup> handed down in 1824. Commerce as everything was the position taken in *NLRB v. Jones & Laughlin Steel Corp.*,<sup>7</sup> decided in the critical spring of 1937. It is necessary to stress the difference between these two polar cases because it has often been said that Chief Justice Marshall in *Gibbons v. Ogden* articulated the present expansive view of the commerce clause, from which the cases between 1824 and 1937 had timidly retreated. Justice Jackson wrote that "[a]t the beginning Chief Justice Marshall described the

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6. 22 U.S. (9 Wheat.) 1 (1824).

7. 301 U.S. 1 (1937).

federal commerce power with a breadth never yet exceeded.”<sup>8</sup> On this view *Jones & Laughlin* does not represent a radical departure from our original constitutional position, but a restoration of our great nationalist past. The truth is otherwise. The 1937 cases marked a legal revolution, not a historical revival.

While the practice has become somewhat unfashionable in modern constitutional scholarship, it is useful to start with some facts. In *Gibbons v. Ogden*, Fulton and Livingston had been able to obtain from the state of New York an exclusive franchise for the use of steamboats in New York waters. Ogden was their assignee. When Gibbons’s rival steamship company started its route from Elizabethtown, New Jersey to New York City, the New York courts told his company that it could keep its engines running only until they entered New York waters. Once in New York waters, they had to turn off the engines, and hoist their sails. Gibbons did not take long to conclude that the restrictions of the New York law placed him at a severe competitive disadvantage with Ogden’s company, which could use steam power over the entire length of the journey.

Gibbons sued. He argued that the New York franchise was improper because the ship’s route was controlled by the federal government under its commerce power. In sustaining that argument, Marshall had to meet a series of arguments from the New York State court, which previously had given an extremely narrow construction to the commerce clause. In *Livingston v. Van Ingen*,<sup>9</sup> Chief Justice Kent of New York said that “internal commerce” included any navigation that took place on New York State waters. The state had a monopoly over who could use those waters. The power of the federal government was limited to monitoring the crossing between New York and New Jersey; presumably the federal government could perch some official at the state line, at least if he did not tiptoe into New York waters. It could do no more.

Marshall understood that this construction of the commerce clause meant the end of the unified internal American market. New Jersey, for example,

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8. *Wickard v. Filburn*, 317 U.S. 111, 120 (1942). L. Tribe, *American Constitutional Law* § 5-4 (4th ed. 1987), takes up this point of view, and is I think wrong in all its historical particulars. See, Epstein, *supra* note 4, at 1401-08. A rather different view of 1937 has been taken by Bruce Ackerman, who recognizes the enormous shifts that took place in 1937 but justifies them as the outgrowth of a key “transformative moment” in which older constitutional conceptions were displaced by a powerful political consensus, in this instance for the expanded welfare state of the New Deal. See, e.g., Ackerman, *Transformative Appointments*, 101 Harv. L. Rev. 1164 (1988). The difficulty with the Ackerman theory is that the change of 1937 can be swept away by yet another incoming tide. If elections are not supposed to determine constitutional principles, then neither should decisive outcomes, such as Roosevelt’s 1936 defeat of Alf Landon.

9. 9 Johns. 506 (N.Y. 1812).

had already passed its own trade laws to retaliate against New York's exclusion of their ships. He therefore sought another account of commerce that preserved the economic union. The term on which he fastened was "intercourse," by which he meant the ability to control certain kinds of interstate transactions — sales, bills of lading, contracts of common carriage. Intercourse also comprehends navigation, and navigation does not start and stop at the state boundaries but extends into the interior of each state. It covers the full journey from Elizabethtown to New York.

As written, *Gibbons* hardly seems startling. It says that the instrumentalities of interstate commerce are subject to federal regulation. The power did not extend to those affairs that "preceded" commerce among the states. Marshall's particular illustrations of those matters outside of commerce were inspection and quarantine laws.<sup>10</sup> Understood in its institutional setting, Marshall's clear national motive led him to fasten on a reading of the commerce clause far broader than Chief Justice Kent's puny construction. Even though Marshall has a reputation, built largely on his opinion in *Marbury v. Madison*,<sup>11</sup> for being somewhat devious on constitutional issues, in *Gibbons v. Ogden* he was true to both the particular clause and its larger institutional structure.

Nonetheless *Gibbons* has been misread to support the far more extravagant reading of the commerce clause in vogue since 1937. Isolated words from the decision have been wrenched from context to serve ends unintended by the author. Two examples suffice.

The first critical term is "plenary." Marshall did say that Congress has plenary power over interstate commerce. Plenary means "full and complete." The modern rendition treats plenary as synonymous with "comprehensive and all-embracing." Marshall's meaning was quite the opposite. "[T]he sovereignty of Congress, though limited to specified objects, is plenary as to those objects . . ." <sup>12</sup> Marshall's position is that the power of Congress is limited to discrete objects, but let a statute fall within that chosen domain and Congress must prevail. He never said that every issue of economic importance falls within the commerce clause.

Marshall also used the phrase "affects commerce." In *Jones & Laughlin and Wickard v. Filburn*<sup>13</sup> this phrase is read to hold that Congress may control all things which affect commerce even if they are not a part of it. Yet when Marshall says that the commerce power "does not extend to or affect

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10. *Gibbons*, 22 U.S. (9 Wheat.) at 203.

11. 5 U.S. (1 Cranch) 137 (1803).

12. *Gibbons* 22 U.S. (9 Wheat.) at 197.

13. 317 U.S. 111 (1942).

other States,"<sup>14</sup> he does not thereby implicitly acknowledge the power of Congress to regulate every local activity that does affect interstate commerce. His proposition only covers local "commerce" that affects commerce among the states. Nowhere does Marshall even mention any possible power of Congress to regulate local manufacture or agriculture at all; nor does he suggest that these activities affect commerce among the states. Marshall used the "affects" language to counter the suggestion that only New York could regulate that portion of the journey that took place in its waters. His concern was to adjust the boundaries between local and interstate trade; it was not to covertly include agriculture and manufacture within the scope of the congressional power.

To give any broader reading to the commerce clause throws the history and text of the Constitution into disarray. It is quite inconceivable that the Constitution could ever have been ratified if the commerce clause had been construed in 1787 as it has been read after 1937. The use of slaves in agriculture would have been squarely within the congressional power, a step which would have been unthinkable to the south. The broad reading of the clause would make hash of the detailed grant of power in article I, section 9, regulating "the Migration or Importation" of Slaves.<sup>15</sup> The narrower reading averts these difficulties.

Marshall's interpretation was decisively rejected only in 1937. In the interim most of the cases struggled valiantly to keep their decisions within the basic framework of the original decision in *Gibbons v. Ogden*. *United States v. E.C. Knight Co.*,<sup>16</sup> with its celebrated distinction between manufacture and commerce, is vintage *Gibbons v. Ogden*. The same is true, I believe, of the more difficult issue presented in *Houston, E. and W. Ry. v. United States (the Shreveport Rate Case)*.<sup>17</sup> That case concerned the competition between an interstate railroad operation out of Shreveport, and an intrastate

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14. *Gibbons*, 22 U.S. (9 Wheat.) at 194. The full paragraph reads:

It is not intended to say that these words [commerce among the several states] comprehend that commerce, which is completely internal, which is carried on between man and man in a State, or between different parts of the same State, and which does not extend to or affects other States. Such a power would be inconvenient, and is certainly unnecessary.

*Id.* The last sentence is clearly purposive in its interpretation.

15. "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." U.S. Const. art. I, § 9, cl. 1. In the face of this guarded clause it would be strange to read the commerce clause as giving Congress "plenary" power to regulate the use of slave labor after importation.

16. 156 U.S. 1 (1895). I discuss the case in greater detail in Epstein, *supra* note 4, at 1432-35.

17. 234 U.S. 342 (1914), which I discuss in Epstein, *supra* note 4, at 1415-21.



Texas railroad, both serving various points in East Texas. The precise issue was whether the commerce clause allowed the federal government, through the Interstate Commerce Commission (ICC), to regulate the local Texas routes in order to preserve the competitive balance between the two lines. Justice Hughes sustained the power of the ICC to so regulate in an opinion which contains a sentence which reads in full as follows:

Its [i.e. Congress's] authority, extending to these interstate carriers as instruments of interstate commerce, necessarily embraces the right to control their operations in all matters having such a close and substantial relation to interstate traffic that the control is essential or appropriate to the security or that traffic, to the efficiency of the interstate service, and to the maintenance of conditions under which interstate commerce may be conducted upon fair terms and without molestation or hindrance.<sup>18</sup>

As written the sentence gives to Congress a broad interpretation over an admitted domain, the instruments of interstate commerce, including of course the rails. As construed, however, the sentence became something quite different. *Wickard v. Filburn* cuts out the first, underlined, part of the sentence before the word "matters" and makes it appear as though anything which affects the interstate traffic is subject to regulation under the commerce clause,<sup>19</sup> not just rival intrastate rail traffic. It is another example of winner's history. The *Shreveport Rate Case* never once challenged the decision in *E.C. Knight* that manufacturing was outside the scope of the federal commerce power. Yet it was turned to just that end in the New Deal cases that solidified the broad interpretation of the commerce clause.

This extension of federal jurisdiction has been for the worse. Before 1937 only state and local governments could regulate agriculture and manufacture, but they could do little to disrupt the operation of competitive markets because there was too much competition between the states. Today the United States does have the power to cartelize the entire domestic industry and to usher in a bewildering program of agricultural and crop subsidies that have worked major national harm. The same story applies to manufacture. The ability of firms to migrate across state boundaries was a powerful counter to excessive regulation in local labor and product markets. Yet today it is possible to cartelize labor markets nationwide. The newer institutional arrangements are inferior to the old. It is tragic that fifty years later this structural blow to the original constitutional design has become a permanent part of today's working governmental arrangements.

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18. *The Shreveport Rate Case*, 234 U.S. at 351 (emphasis added).

19. See *Wickard*, 317 U.S. at 123 (quoting *The Shreveport Rate Case*, 234 U.S. at 351).

## II. SUBSTANTIVE DUE PROCESS

Like the commerce clause, substantive due process is also involved in the issue of government control over the economy. Many people think that substantive due process is an oxymoron: talk about substance cannot be talk about what process is due. The objection stops the entire enterprise in its tracks. There is some steely consistency to this hard-edged position, although on balance I believe that it is wrong. Process includes legislative process, and where the legislature acts in ways that are contrary to the general welfare, then it has not acted with due process. So stated the link between process and substantive outcomes becomes far closer. Can we say that the legislative process has been sound when the state expropriates property without just compensation?<sup>20</sup> To acknowledge the overlap between procedure and compensation is to reject the strict separation of substance from procedure. The modern law rejects the substantive due process cases of old that dealt with economic liberties. Nonetheless, as in the abortion<sup>21</sup> and voting rights cases,<sup>22</sup> substantive due process itself has not been rejected as a constitutional norm. The norm has only been turned to new ends.

Let us turn now to the internal evolution of the doctrine from the period of circa 1890 to 1937. Here the obvious place to begin is *Allgeyer v. Louisiana*,<sup>23</sup> which held that the due process clause protected the individual liberty to contract. No one, including Justice Holmes in his famous dissent in *Lochner v. New York*,<sup>24</sup> challenged that judgment head on: substantive due process had gained, in a sense, unanimous acceptance. But this picture is misleading given the intense debate over the exceptions to the basic constitutional doctrine under the “police power.” When could the state regulate to preserve the “health, safety, morals and welfare” of the society at large?

Consider first the then critical distinction between what were then termed “labor” and “health” statutes. Every member of the *Lochner* Court accepted the proposition that health and safety statutes were essentially within the power of Congress and the states to enact. At the same time, the Court held that labor statutes were beyond their powers. Why make this distinction?

The theory of private contracts provides some useful clues. The basic theory of contract is that both sides to an agreement have the best subjective estimation of what goods and activities they desire, and how highly they

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20. See, e.g., *Chicago, Burlington & Quincy R.R. v. City of Chicago*, 166 U.S. 226 (1897), which expressly equated “without due process of law” to “without just compensation.”

21. *Roe v. Wade*, 410 U.S. 113 (1973).

22. *Harper v. Virginia Bd. of Elections*, 383 U.S. 663 (1966).

23. 165 U.S. 578, 591 (1897).

24. 198 U.S. 45, 74 (1905).

value these goods and activities. When the parties trade goods and services, each person gives up something which he values less in order to obtain something that he values more. Statutes that interfere with the terms and conditions on which labor is bought and sold prevent individuals from making these comparisons and disrupt the competitive operation of labor markets generally. The labor side of the line should be understood as an effort to prevent the state cartelization of labor markets. Barriers to entry in the form of minimum wage laws were struck down, as were statutes mandating collective bargaining by labor unions.<sup>25</sup> The labor side of the line is solid in principle.

The health side is far more complex. If someone wants to take risks with health or safety in order to obtain a higher wage, then so much the better. The classical theory of contract gives no reason to prohibit that transaction. It becomes somewhat awkward therefore to place health and safety under the police power without further refinement, given that the same theory of freedom of contract applies to both. To be sure, it is highly appropriate for government to regulate private contracts that work to impose added health risks upon third-party strangers who otherwise would receive no compensation for the losses that they might suffer. The control of externalities is generally an appropriate government function. But the Supreme Court quickly overran this externality line and assumed that health risks to the contracting parties presented the same occasion for government intervention as health risks to strangers.<sup>26</sup> The line between the voluntary assumption of risk and inflicting harm upon strangers is part of a comprehensive theory of markets, but it never secured a central place in constitutional discourse.

Today we can identify some sensible reasons for health and safety regulation, even in the context of contractual arrangements. Sometimes safety, and especially health risks are latent, which raises the prospect of employer misrepresentation or worker ignorance about those risks. Misrepresentation is often difficult to ferret out in individual cases, and nondisclosure may in practice be tantamount to concealment. To counteract the information shortfall, it may be efficient to impose duties of disclosure or perhaps to mandate certain substantive protections for workers where disclosure turns

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25. See, e.g., *Coppage v. Kansas*, 236 U.S. 1 (1915); *Adair v. United States*, 208 U.S. 161 (1908).

26. See, e.g., *Block v. Hirsh*, 256 U.S. 135 (1921) (rent control); *New York Central R.R. v. White*, 243 U.S. 188 (1917) (worker's compensation); *Plymouth Coal Co. v. Pennsylvania*, 232 U.S. 531 (1914) (mine safety regulations for workers). Note that *Plymouth Coal Co.* and *New York Central Railroad* are both concerned with obvious safety risks. The rent control statutes in *Block* are quite a different matter.

out to be cumbersome or inadequate. We could thus concentrate on these informational difficulties in the health and safety area to distinguish them from the regulation of wages. But even that line does not allow us to conclude automatically that all health and safety statutes are proper. Rather, the government would be required to show how its statutes remedied some perceived information gap. However, the risk remains that anticompetitive labor statutes could masquerade as ostensible health statutes.

Sorting out health statutes from labor statutes can be very tricky. Nonetheless, the public choice literature suggests that the risk of covert anti-competitive regulation is too great to be ignored. The confusion of purposes can be found in stranger cases where health and safety regulation is surely permissible in principle. Environmental regulation of coal pollution has given dirty eastern coal undeserved protection against its cleaner western rival.<sup>27</sup> Statutes prohibiting the use of plastic milk containers are less concerned with environmental protection than with the protection of the manufacturers of paper containers from competition.<sup>28</sup> Health statutes may have anticompetitive effects in contractual settings as well. Occupational Safety and Health Act regulations impose differential costs on regulated firms, which may give a net competitive advantage to the businesses that can comply at relatively low cost with these regulations, even those that are neutral on their face.<sup>29</sup> The comprehensive acceptance of "health" regulation in the pre-1937 period was too broad. From the outset, zoning regulations<sup>30</sup> went far beyond any ostensible health rationale, and the systematic government regulation of dairy products and their non-dairy substitutes did far more to hurt the health of consumers than to protect it.<sup>31</sup>

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27. B. Ackerman & W. Hassler, *Clean Coal/Dirty Air: Or How the Clean Air Act Became a Multibillion-Dollar Bail-Out for High-Sulfur Coal Producers and What Should Be Done About It* (1981).

28. See, e.g., *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981).

29. See, e.g., Bartel & Thomas, *Direct and Indirect Effects of Regulation; A New Look at OSHA's Impact*, 28 J.L. & Econ. 1 (1985). For criticism, see M. Kelman, *On Democracy-Bashing: A Skeptical Look at the Theoretical and "Empirical" Practice of the Public Choice Movement*, 74 Va. L. Rev. 199, 251-55 (1988). Kelman's remarks are designed to show that some health and safety legislation may be genuine public interest legislation. He shows some empirical difficulties with the studies, but offers no independent empirical evidence of his own to the contrary. The clean air/dirty coal alliance seems to fit the public choice model quite well. Nor does Kelman discuss the power of public choice theory with other forms of regulation, such as zoning, rent control, dairy regulation, trucking regulation and the like, where the evidence in support of the model seems far stronger.

30. See *Euclid v. Ambler Realty*, 272 U.S. 365 (1926).

31. See, e.g., *Hebe Co. v. Shaw*, 248 U.S. 297 (1919). The so-called "filled milk" regulations are discussed in G. Miller, *The True Story of Carolene Products*, 1987 Sup. Ct. Rev. 397 (detailing the health social losses from the anti-filled milk regulation routinely sustained before 1937).

The health cases represented only the most important of the exceptions to the freedom of contract doctrine. *Adkins v. Children's Hospital*,<sup>32</sup> which struck down a minimum wage law for women, shows the weakness within the framework of freedom of contract of the purported categorical distinction between health and labor statutes.<sup>33</sup> Sutherland's opinion sought to distinguish between maximum hours and minimum wage legislation. Sutherland insisted that it was possible to contract around hour legislation but not wage legislation. The statutes regulating hours

deal with incidents of the employment having no necessary effect upon the heart of the contract, that is, the amount of wages to be paid and received. A law forbidding work to continue beyond a given number of hours leaves the parties free to contract about wages and thereby to equalize whatever additional burdens may be imposed upon the employer as a result of the restrictions as to hours, by an adjustment in respect of the amount of wages.<sup>34</sup>

His argument is wrong. To be sure, any account of regulation has to take into account the prospect that the parties will contract around the rule, but it is very hard to hold that the regulation is justified because the regulated private parties are able to evade it. The private mitigation of the social losses from regulation never brings us back to the level of job gains that the parties could achieve in an unregulated market. If some other contractual solution served the joint interest of the parties, it is hard to think that they could miss it themselves, only to have regulation supply it. There is no ability for parties to "equalize" the additional burdens of regulation. They can only use agreements to divide the losses imposed by regulation — assuming that the market will still operate.

More generally, there is no reason to accept any blanket proposition that the clutches of hours regulation hold tighter than those of wage regulations. Contracts do not have "hearts." They only have networks of separate terms. Everything depends upon the relationship between the contract optimum and the statutory mandate. If the gap between the market wage and the minimum wage is small, then it might be possible to shade hours, preparation time, workbreaks, home labor in a way to get around the statute. If, however, the

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32. 261 U.S. 525 (1923).

33. Sutherland listed four separate categories of contracts which *could be regulated* by the state: contracts fixing rates and charges by businesses impressed with a public interest; statutes relating to the performance of public works; statutes prescribing the character, methods and time for payment of wages; and statutes fixing the hours of labor. *Id.* at 546-47. Note that the first of these categories, "affected with the public interest," is sufficiently elastic to tolerate all forms of state-run cartels. Again the dairy industry offers a good illustration. See *Nebbia v. New York*, 291 U.S. 502 (1934).

34. *Adkins*, 261 U.S. at 553-54.

optimal contract requires a long work day, as for workers on long distance airline flights, then you cannot easily contract around a ten hour statute by seeking appropriate wage adjustments for the shorter day. The market may yield no contracts if the costs of the regulation are greater than the private gains from contracting.

*Lochner* itself shows the point. It was no accident that the statute in that case stated a ten hour maximum and only applied to certain kinds of bakers. The statute was championed by rival unions and their employers who prepared bread for market in two shifts; one to bake the bread in the afternoon and a second to deliver it the next morning. These firms and workers were not touched by a ten hour statute. *Lochner's* bakers baked their bread in the evening, slept on the job, and packaged it the next morning. They worked far more than a ten hour day, and to them the hours statute was devastating. *Lochner* was not brought by disgruntled workers seeking shorter hours. It was a criminal prosecution. If that prosecution had been allowed to prevail, then hours regulation would have eliminated certain firms from the market, namely, those run by German immigrants, without political clout.

Sutherland's other point of distinction was that minimum wage statutes were coercive because they required the employer to pay the workers more for the labor than the labor itself was worth. He wrote:

To the extent that the sum fixed exceeds the fair value of the services rendered, it amounts to a compulsory exaction from the employer for the support of a partially indigent person, for whose condition there rests upon him no peculiar responsibility, and therefore, in effect, arbitrarily shifts to his shoulders a burden which, if it belongs to anybody, belongs to society as a whole.<sup>35</sup>

The passage contains some powerful insights, but lacks economic precision. Initially, I have no wish to quarrel with the last half of the sentence which claims that the welfare function rests upon the public at large and not any particular segment of it.<sup>36</sup> But minimum wage statutes are not coercive in the sense that "the sum fixed exceeds the fair value of the services rendered." So long as a minimum wage law does not require the employer to retain any set number of workers, he will never hire any worker whose value to him is less than the minimum wage.<sup>37</sup> The situation here is the same as with maxi-

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35. *Id.* at 557-58, quoted in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379, 409-10 (1937).

36. See *Armstrong v. United States*, 364 U.S. 40, 49 (1960), for the articulation of the same principle in the takings context. As it applies to certain rent control statutes, see *Pennell v. San Jose*, 108 S. Ct. 849, 859 (1988) (Scalia, J., dissenting).

37. Note in this regard that minimum wage statutes are less coercive than the rent control statutes, which in addition to setting maximum rents require the landlord to renew leases to existing tenants. Note that Sutherland distinguished the rent control cases on the ground that

minimum hour statutes. Both limit contract options, but neither requires the employer to enter into a losing contract.

The minimum wage statute does two things. First, it reduces the employer's surplus for all workers so hired by an amount equal to the difference between the minimum wage set by statute and the market wage. At best that differential represents an implicit wealth transfer from employer to worker. At worst all or part of that gain can be competed away in the political process, which typically will happen, to some extent. Second, the statute forces out of the market those workers who would have been hired for a figure less than the minimum wage but more than the market wage. Here again the employer suffers lost profits, just as does the worker who is kept from selling his, or in the case of *Adkins*, which applied only to women, her labor. The women who are hired after passage of the statute are, however, worth what they are paid; otherwise, they would not be hired. The social and private costs of minimum wage legislation comes in ways that Sutherland did not understand, and which in fairness was not fully understood at his time. The maximum hour laws, it should be noted, also preclude some mutually beneficial contracts, but it is less clear that they work an effective transfer of wealth to any or all workers under the contracts that remain, given that wages are still free to move.

The weakness of the Sutherland position helped open the way for the dramatic reversal worked some fourteen years later in Chief Justice Hughes's rhetorically skillful opinion in *West Coast Hotel Co. v. Parrish*.<sup>38</sup> Hughes wrote as follows:

The exploitation of a class of workers who are in an unequal position with respect to bargaining power and are thus relatively defenceless against the denial of a living wage . . . casts a direct burden for their support upon the community. What these workers lose in wages the taxpayers are called upon to pay . . . . The community is not bound to provide what is in effect a subsidy for unconscionable employers.<sup>39</sup>

The passage is both powerful and mysterious. It is powerful because it sweeps aside all the refined distinctions that had grown up under the pre-1937 law. The reference to "inequality of bargaining power" made clear that any regulation that ostensibly protected workers was constitutional. The line between health and labor statutes was rejected, if not explicitly, then by

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"the operation of the statutes was temporary to tide over an emergency and that the circumstances were such as to clothe the letting of buildings . . . with a public interest so great as to justify regulation by law." *Adkins*, 261 U.S. at 552. I have explored the rent control cases in far greater depth in Epstein, *Rent Control and the Theory of Efficient Regulation*, \_\_ Brooklyn L. Rev. \_\_ (1988) (forthcoming).

38. 300 U.S. 379 (1937).

39. *Id.* at 399.

indirection. Notwithstanding this reference to “unequal bargaining power,” the opinion does not explain how workers are helped by rules that reduce their opportunities to contract *ex ante*. It does not explain why employers could earn more than a normal return on capital in a competitive market; nor did it identify who pays the subsidy that workers within the market are said to receive.

The language of “subsidy” is also misplaced. Hughes does not believe that employers are under a duty to hire workers at some particular wage, regardless of the value that they receive in exchange. Why then should employers be allowed to hire workers only if the wage is above some preset figure? At common law, all workers owned their labor and employers owned their capital. Exchanges took place on terms that were mutually advantageous. Hughes does not explain why this baseline is inappropriate; nor does he substitute any alternative baseline in its place. Are workers entitled to particular jobs with wages of \$1.00 per hour, or \$100? The attack on the minimum wage, then, is not dependent on a theory that seeks to place common law rules outside the domain of political judgment, as some “natural” or “prepolitical” ideal.<sup>40</sup> The argument against the minimum wage is that it represents an inferior set of social arrangements to those routinely achievable when freedom of contract was an appropriate constitutional norm.

The unsound economics of Justice Hughes should not count as the last word in constitutional theory. Indeed they do not. The statute in *West Coast Hotel* applied only to women, but that was no obstacle to Chief Justice Hughes. “The argument that the legislation in question constitutes an arbitrary discrimination, because it does not extend to men, is unavailing . . . . The legislature ‘is free to recognize degrees of harm and it may confine its restrictions to those classes of cases where the need is deemed to be the clearest.’ ”<sup>41</sup>

It does not take the Bork hearings to note that this statute would be struck down on its face today as a violation of the equal protection clause. The modern attitude on this issue is correct. So-called “protective” legislation often puts women at a systematic disadvantage to men. That suspicion about who is protected should not end even if the coverage of the statute is extended to men. Now there are other forms of distortion. The “protection” of all low-paid workers may benefit other higher paid workers, often union workers, in competition with firms that use cheaper labor. Or the minimum wage laws may benefit rival firms that have heavier dependence on capital. The intuition in the equal protection sex discrimination case — that legislation

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40. See, e.g., Sunstein, *Lochner's Legacy*, 87 Colum. L. Rev. 873 (1987).

41. *West Coast Hotel*, 300 U.S. at 400.



benefits strangers to the contract and not the ostensible protected parties — is correct. It is also subject to generalization. The minimum wage laws continue to do mischief to the poor and the dispossessed, as well as to the overall productivity of society at large. Both liberty and utility are hurt by the same legislation. I see no intellectual or practical reason why *West Coast Hotel* should not be overruled, even today.

#### CONCLUSION

In closing I think that it is appropriate to mention again the single theme that links the commerce clause and the minimum wage cases: the attitude toward government. If one takes the James Madison view of government as a necessary evil, then the impulse is to divide power and to limit power. It is only if we think that government legislation is generally benevolent that our guard will be lowered. But we will pay a high price for this optimism by allowing interest groups to obtain a powerful grasp on government power, which they will use for narrow instead of general interests.

The singular virtue of judicial review is that it requires the proponents of class legislation to cross two hurdles instead of one. It may well be that the system will misfire, as it has for example, with *Roe v. Wade*,<sup>42</sup> where the police power justifications for state control are substantial. But if judges keep their eyes on the basic principles they will not go astray. They should be aware of the keen importance of jurisdictional limitations that frustrate the power of legislators. They should protect individual liberty and private property save where the state offers full compensation for the restrictions it so imposes, or limits liberty in order to protect strangers from the use of force and fraud. Our Constitution contains coherent theories of jurisdiction and individual rights. Both were discarded by the mistakes of 1937.

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42. 410 U.S. 113 (1973).