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Foreword: Unconstitutional Conditions, State Power, and the Limits of Consent

Richard A. Epstein

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FOREWORD: UNCONSTITUTIONAL CONDITIONS, STATE POWER, AND THE LIMITS OF CONSENT

Richard A. Epstein

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UNCONSTITUTIONAL CONDITIONS, STATE POWER, AND THE LIMITS OF CONSENT

Richard A. Epstein*

I. INTRODUCTION

A. A Ubiquitous Problem

The Supreme Court’s decision in Lyng v. International Union, UAW,¹ decided during the 1987 Term, looks like a creature of the modern activist state. Lyng asked the Court to resolve the constitutional tension between the Food Stamp Program and the National Labor Relations Act (NLRA). Before the New Deal, the issues presented by the case would not, and probably could not, have arisen. Politically, Congress did not have the will to pass either of these programs. If passed, each would likely have been found to fall outside Congress’ commerce power.² It was also unresolved whether the Food Stamp Program could have been sustained under Congress’ spending...
power.\textsuperscript{3} For good measure, the NLRA might well have been held to work an impermissible infringement of the liberty of contract of both employer and employee.\textsuperscript{4}

The New Deal transformation and its aftermath have placed both statutes beyond political controversy, just as they have immunized the statutes from direct constitutional attack. When a 1981 amendment to the Food Stamp Program provided that food stamps would not be distributed to workers who go out on strike in a labor dispute other than an employer lockout,\textsuperscript{5} however, the stage was set to examine what first and fourteenth amendment principles apply to the interaction of these two complex statutory systems. The respondent union claimed that the statutory change “coerced” workers into sacrificing their first amendment right to freedom of association in order to obtain the food stamps that Congress provided to persons generally in need, and even to nonstriking workers who had quit their jobs.\textsuperscript{6} Its equal protection claim covered much the same ground: although the Congress need not have provided any food stamp benefits at all, once it embarked upon such a program, it could not discriminate between striking workers and other needy recipients.

Cast in this form, the respondent’s case is a curious blend of old and new. While its setting may be novel, \textit{Lyng} raises the basic structural issue that for over a hundred years has bedeviled courts and commentators alike under the mysterious title of “unconstitutional conditions.”\textsuperscript{7} In its canonical form, this doctrine holds that even if a

\textsuperscript{3} The spending power authorizes Congress “to pay the Debts and provide for the common Defence and general Welfare of the United States.” U.S. Const. art. I, § 8, cl. 1. Madison read the clause to authorize Congress to spend only for those purposes that fell within the other enumerated powers of article I, section 8. See United States v. Butler, 297 U.S. 1, 65 (1936). \textit{Butler}, however, rejected the Madisonian view in favor of Hamilton's and Story's construction, which allowed any expenditure that advanced the “general welfare of the United States” without limitation to the enumerated powers. See id. at 65–66. The food stamp program could not have survived if Madison's view had been adopted. The fate of a food stamp program under Hamilton and Story's position is uncertain. The legislation is “general” in the sense that it applies uniformly across the country, but it is not general in the sense of providing a public good shared by all citizens alike. With the 1937 expansion of the commerce clause, the system of enumerated powers collapsed and with it any concern over the contours of the spending power. For a defense of the Madisonian view, see Currie, \textit{The Constitution in the Supreme Court: The New Deal, 1931-1940}, 54 U. Chi. L. Rev. 504, 529–36 (1987). For a discussion of that view in connection with unconstitutional conditions, see pp. 40–44 below.


\textsuperscript{6} The statute provides that when a worker has voluntarily quit his employment, the period of disqualification is only 90 days, and then only if the quitter is the head of a household as defined under the statute. See 7 U.S.C. § 2015(d)(1) (1982).

\textsuperscript{7} The phrase, for example, appears in Justice Bradley’s dissent in \textit{Doyle v. Continental}}
state has absolute discretion to grant or deny a privilege or benefit, it cannot grant the privilege subject to conditions that improperly "coerce," "pressure," or "induce" the waiver of constitutional rights. Thus, in the context of individual rights, the doctrine provides that on at least some occasions receipt of a benefit to which someone has no constitutional entitlement does not justify making that person abandon some right guaranteed under the Constitution. In other instances, the doctrine prevents the government from asking the individual to surrender by agreement rights that the government could not take by direct action. Thus, although a state may absolutely forbid foreign corporations from doing business within its borders, it cannot allow them in on condition that they waive their right to federal diversity jurisdiction, any more than it could divest them of this right by statute. In still other instances, the doctrine closely resembles equal protection, barring the state from making certain privileges available to individuals only if they consent to terms more onerous than those demanded when the same privileges are made available to others. Again, the state may prevent foreign corporations from doing business in the state altogether, but it may not allow them to do business only on condition that they pay higher taxes than their local competitors.

The problem of unconstitutional conditions arises whenever a government seeks to achieve its desired result by obtaining bargained-for consent of the party whose conduct is to be restricted. There is, for example, an ordinary first amendment issue when the government seeks to impose prior restraints on publication. That question is transformed into an unconstitutional conditions issue when a government benefit is conditioned upon acceptance of prior restraint. Similarly, there is only a traditional equal protection claim when the government imposes heavier criminal penalties on blacks than it does

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9 At the time of Doyle, states were allowed to impose such conditions. Doyle was significantly restricted, however, by Barron v. Burnside, 121 U.S. 186 (1887), which returned to the earlier position of Home Insurance Co. v. Morse, 87 U.S. (20 Wall.) 445 (1874), by striking down a similar condition. Doyle was definitively overruled, and the position of Morse and Barron reaffirmed, in Terral v. Burke Construction Co., 257 U.S. 529, 533 (1922). See infra p. 38.
on whites or vice versa. The unconstitutional conditions overlay comes into play only when the government sells goods or services to blacks on more onerous contract terms and conditions than those it offers to whites.

There is a special conceptual problem with the doctrine of unconstitutional conditions, however, that does not arise in connection with ordinary constitutional limits on government powers. Why does the doctrine exist at all? Why should there be any limitation at all on a system of government power that rests on the actual consent of the individuals whose rights are thereby abridged? To be sure, even the system of free markets recognizes some limitations upon the principle of consent in ordinary contracts between private individuals. Duress, force, misrepresentation, undue influence, and incompetence may be used to set aside contracts that otherwise meet the normal requirements of offer, acceptance, consideration, and consent. But none of these conventional grounds accounts for the doctrine of unconstitutional conditions, which comes into play only after all these conventional hurdles to consensual union have been overcome.

The analogies to ordinary contract law thus give rise to a persistent puzzle that can be formulated in both conceptual and practical terms. To revert to the foreign corporation cases, if a state can exclude a foreign corporation, why can it not admit the corporation subject to whatever conditions it wishes to impose? Sometimes the puzzle is stated in terms of a greater and a lesser power. The greater power to exclude might be said to include the lesser power to admit on condition. The objection to the doctrine of unconstitutional conditions can also be stated in functional terms. How can striking workers complain that they have not received benefits to which they have no absolute entitlement? The state has made an offer that any worker may choose to accept or reject. There has been no use or threat of force. As long as individuals know what is best for themselves, they can enter into only those bargains that leave them better off after than before. Some

10 Justice Holmes dismissed the entire doctrine of unconstitutional conditions as a logical and conceptual error: "Even in the law the whole generally includes its parts. If the State may prohibit, it may prohibit with the privilege of avoiding the prohibition in a certain way." Western Union Tel. Co. v. Kansas, 216 U.S. 1, 53 (Holmes, J., dissenting).

11 Cf. Posadas de Puerto Rico Assocs. v. Tourism Co., 478 U.S. 328, 345-47 (1986) (holding that "greater" power to ban gambling includes "lesser" power to ban advertising promoting gambling). The formulation is somewhat misleading, however, because greater/lesser problems can arise even when the issue of consent or the form of a conditional grant is far removed from a case. For example, any case of selective enforcement of criminal or civil sanctions might be said to give rise to a greater/lesser problem: if the state has the greater power to punish both blacks and whites, then it has the lesser power to punish only blacks or only whites. Although such cases do not give rise to an unconstitutional conditions problem as that term is used here, the greater/lesser language is still applicable.
workers have taken the bargain and others have cast it aside. All workers are free to make whatever decisions they choose, but must live with the consequences of their decisions once made. The same point could be made about the case of race. Blacks cannot complain, because they are better off with the bargains they made than they were before the state contracted with either blacks or whites.

These examples appear to justify the doctrine of unconstitutional conditions as a half-conscious adaptation of the classical Pareto superiority test used in modern welfare economics to evaluate alternative social states. As originally developed, the Pareto criterion attempted to make social judgments about alternative states of the world without resorting to problematic interpersonal comparisons of utility. It avoided the necessity and awkwardness of such comparisons by prescribing a test that allowed each person to compare his own private welfare before and after the legal change. Thus if no person in state A is worse off than he was in state B, and at least one person is better off in state A than he was in state B, then state A must be judged as superior to state B. The criterion of judgment is social in the sense that the welfare of every individual is taken into account, yet the stringent condition that no person be worse off in state A than in state B obviates the need for any comparison of welfare across separate persons.

The Pareto formula has often been attacked for being too restrictive of the type of social changes that it allows. Nonetheless, where the relevant universe involves only two self-interested parties, any voluntary agreement or grant satisfies the test, for the agreement is formed only if it makes both sides better off than before, given that each is the best judge of his own welfare. The use of this Pareto formula presupposes that the status quo ante is the baseline against which shifts in individual welfare are measured. Thus when people reject a bargain or grant offered by the state, they are no worse off than they were before. When they accept the bargain or grant on condition, they are better off. Either way, they are not in a position to complain. The state for its part is treated (and this assumption will become controversial) as though it were a single person that knows its own preferences, measured against the same baseline of the status quo ante. If its bargain or grant is rejected, then it will be no worse off than before; if that grant or condition is accepted, then it will be better off. Either way the stringent Pareto conditions are

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12 For a celebration of this bargain theory, see Merrill, Unconstitutional Conditions, 77 U. Pa. L. Rev. 879 (1929).


13 See, e.g., Coleman, Efficiency, Utility, and Wealth Maximization, 8 Hofstra L. Rev. 509 (1980).
satisfied so that there is no reason to worry about the terms and conditions that the government attaches to its bargain or grant. No matter what its outcome, the proposed transaction appears unassailable.

The implications of this reasoning for Lyng are clear: if Congress could grant or withhold food stamps at will, then it can do so on condition. Before the 1981 Amendments to the Food Stamp Program, Congress could have repealed the statute in its entirety, much the way a settlor can take back at will the property that he has placed in a revocable inter vivos trust. The baseline against which the conduct of individual union members must be measured, therefore, is not one in which they are entitled to food stamps as of right. Relative to the proper baseline, no worker can complain. A worker who bargains away his right to strike for food stamps does so because he values the latter more than the former; a worker who rejects that offer is no worse off than he would have been in the baseline situation. The situation is thus radically distinct from one in which the state uses force against any individual, for in that case one person is left worse off because of the application of state power and, at the very least, has a strong case to demand that the state justify its action.

At first blush, then, a categorical rejection of the doctrine of unconstitutional conditions seems to square with both traditional conceptions of sovereign power and modern tests of social welfare. A position with so strong an apparent pedigree should be hard to dislodge on any ground. Yet the doctrine of unconstitutional conditions tenaciously endures, notwithstanding charges by figures no less distinguished than Justice Holmes that it is both logically incoherent and corrosive of sovereign power. Originating in the nineteenth century, the doctrine of unconstitutional conditions is no new judicial concoction in the post-New Deal welfare state. Nor is the doctrine anchored to any single clause of the Constitution. Like the police power, it is a creature of judicial implication. It roams about constitutional law

14 Holmes' most famous statement of his position is found in McAuliffe v. Mayor of New Bedford, 155 Mass. 216, 29 N.E. 517 (1892):

The petitioner may have a constitutional right to talk politics, but he has no constitutional right to be a policeman. There are few employments for hire in which the servant does not agree to suspend his constitutional right of free speech, as well as of idleness, by the implied terms of his contract. The servant cannot complain, as he takes the employment on the terms which are offered him.

Id. at 220, 29 N.E. at 517–18.

A similar freedom of contract rationale is found in some of Holmes' tort opinions. See, e.g., Lamson v. American Axe & Tool Co., 177 Mass. 144, 145, 58 N.E. 585, 585–86 (1900) ("[The workman] complained, and was notified that he could go if he would not face the chance. He stayed, and took the risk. He did so none the less that the fear of losing his place was one of his motives." (citations omitted)). Justice Holmes reiterated these principles in the context of unconstitutional conditions in Western Union Telephone. See supra note 10.
like Banquo's ghost, invoked in some cases, but not in others. It has been used as an aid in construing the scope of Congress' spending power and of the states' police power. It has been engrafted onto substantive protections afforded to speech, religion, and property. It also has found expression in decisions under the equal protection and due process clauses. About a dozen cases in the past two terms testify eloquently to the diverse and thorny issues that the doctrine raises.

The importance of the unconstitutional conditions doctrine has brought forth an extensive array of academic literature to explain and justify it. The received writing sensibly recognizes the essential place that the doctrine occupies in modern constitutional law, but it makes far less sense when it attempts to explain how the doctrine arises or what it does. In part, the difficulties arise from the persistent efforts to make unconstitutional conditions cases resemble duress or coercion cases, as is made evident by the discussion of differences between "penalties" or "fines" on the one hand, and "subsidies" or "benefits" on the other. Yet if common law duress were present in these cases, the recipient of the grant would be able to attack the offending condition without resorting to any special doctrine of unconstitutional conditions. As long as the condition is obtained by coercion or duress, it can be set aside as a matter of right, regardless of its content. In contrast, the doctrine of unconstitutional conditions

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17 See, e.g., City of Lakewood v. Plain Dealer Publishing Co., 108 S. Ct. 2138 (1988); Arkansas Writers' Project, Inc. v. Ragland, 107 S. Ct. 1722 (1987). For discussions of these cases, see pp. 55-58 and pp. 76-77 below, respectively.
19 See, e.g., Nollan, 107 S. Ct. 3141; infra pp. 60-64.
20 See, e.g., Southern Ry. Co. v. Greene, 216 U.S. 400 (1910); see also infra note 65.
21 See Frost & Frost Trucking Co. v. Railroad Comm'n, 271 U.S. 583 (1926); Western Union Tel. Co. v. Kansas, 216 U.S. 1 (1910); infra pp. 47-54.
23 See, e.g., Child Labor Tax Case, 259 U.S. 20, 36-37 (1922); Van Alstyne, supra note 8, at 1445-49.
is directed toward the substance of various conditions, regardless of the course of negotiations between the individual recipient and the state.

The balancing tests commonly suggested by commentators show that the doctrine of unconstitutional conditions cannot be explained by analogy to common law coercion. This balancing is not evidentiary, as courts are not asked to weigh different sorts of evidence that might indicate whether a certain gesture is an implied threat of the use of force. Rather, its close involvement with the substantive terms and conditions of the statute — for example, whether the use of state highways is conditioned upon agreeing to service of process in all cases, or only in those arising out of use of the highways — distances us from the process-oriented issues that dominate ordinary duress cases. But without a strong substantive theory that explains both the use and the limits of individual consent, the use of balancing tests in this context leaves far too much room to the legal imagination. Balancing must be in service of a general theory. It cannot be a substitute for one.

Efforts to explain the doctrine on the basis of “dignitary” interests are also unsatisfactory, running into the same difficulties in this context that they do in all others. First, it is unclear how individual dignity is advanced when restrictions are placed upon the individual right to contract. Can one respect the dignity of the individual, and at the same time hold that a person, although of full age and competence, cannot make the decisions of greatest importance to his or her life prospects? How does one enhance dignity by restricting choice? Theories of dignity are often used to support notions of individual autonomy, yet here they are invoked to limit the ability of the individual to enter into desired agreements with the state. Second, the dignitary theories are undermined by their exclusive focus on the individual upon whom the condition is imposed. As far back as Hohfeld, if not before, it has been understood that the creation and recognition of a right or privilege in one person will impose correlative obligations on others. The art (or science) of government is to develop some social criterion, such as the Pareto test, that helps decide which interests, including dignitary interests, should be protected, and which not. In this inquiry, of course, it is useful from the individual’s perspective to identify the benefits of having certain conditions removed from state bargains or grants. But the analysis is incomplete.

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25 See Kreimer, supra note 22, at 1349–51 (criticizing attempts by Van Alstyne and others to defend this balancing approach).
unless the correlative costs to other persons of their removal are taken into account as well. So long as resources are scarce, individual rights, even constitutional rights, must have some correlative duties. Thus, any complete analysis must take both sides of the same problem into account, but dignitary theories generally fail to do so.

The most ambitious effort to organize the unruly law of unconstitutional conditions is that of Professor Kreimer, who recognizes that standard notions of coercion are unable to account for the doctrine. In Professor Kreimer's view, the greatest difficulty with the coercion question is to identify the appropriate baseline against which the possibly coercive effects of government action may be evaluated. When the baseline gives a right to the government, government may condition the benefits that it imposes. When it gives the right to the individual, then the government's extraction of a concession amounts to impermissible coercion. Kreimer proposes three baselines against which the constitutionality of any government bargain can be measured: history, equality, and prediction. Although an account of baselines is essential to any general analysis of unconstitutional conditions, Kreimer's inability to offer a single baseline for assessing conditional government benefits renders his account problematic. For example, the historical baseline may allow the states selectively to grant access to the public highways in a way that the equality norm prohibits. Consistent and determinate baselines can be generated only with aid of a theory that links the substantive guarantees provided under the Constitution to the set of government practices and processes that can undermine them. The theory, moreover, has to be functional, not intuitive: it must explain how some social improvement

28 Kreimer has also pointed out the limitations of simple contract models that focus exclusively on force and fraud. See Kreimer, supra note 22, at 1318 ("While there is a contemporary philosophical school that attaches unique status to rights of bodily integrity and freedom from physical force, it is hard to imagine any modern constitutional theorist taking the position that only a direct threat of violence would violate constitutional rights."). He attributes this model to Robert Nozick, Charles Fried, and me. See id. at 1318 n.77. In part, this Foreword is my effort to go beyond the simple libertarian model in the context of state grants and bargains. For my own concerns with the libertarian model, published after Kreimer's observation, see R. EPSTEIN, TAKINGS, 334-38 (1985), and Epstein, The Classical Legal Tradition, 73 CORNELL L. REV. 292, 298-99 (1988).

29 See, Kreimer, supra note 22, at 1352 ("My conclusion is that the distinction between liberty-expanding offers and liberty-reducing threats turns on the establishment of an acceptable baseline against which to measure a person's position after the imposition of an allocation.").

30 See id. at 1359-74. History refers to the use of tradition and the status quo ante as a baseline, so that coercion occurs when a previously enjoyed benefit is lost. See id. at 1359-63. Equality refers to equal treatment under the law, and invokes equal protection ideals generally. See id. at 1363-71. Prediction is the hardest baseline of all to grasp because it requires a counterfactual judgment of what a government would have done had it been asked to adopt a policy without reference to the constitutional rights that it is asking the individual citizen to waive. See id. at 1371-74.
is obtained by striking down the condition in question. So much at
least is demanded by any theory that treats the substance of bargains,
not the process of their formation, as its subject matter. What is
needed is a more systematic examination of the overall consequences
of certain bargaining strategies undertaken by government.

B. The Plan of Action

In this Foreword, I hope to explain why the divisions and confu-
sions in judicial and academic opinion on the subject of unconsti-
tutional conditions do not rest upon simple error or naïve misconcep-
tion of the legal doctrine, but upon deep structural problems associated
with both constitutional theory and the larger questions of proper
political governance. There are no shortcuts to this form of analysis.
In order to understand unconstitutional conditions, it is first necessary
to understand the function and limitations of consent, and the bar-
gaining processes by which it comes about.

Part II of this Foreword develops such a conceptual framework.
Its inquiry is overtly functional and utilitarian. Bargains are inter-
actions thought to advance some overall measure of social welfare.
They are not regarded as absolutes in themselves. Essentially, we
want to enforce bargains when and only when they satisfy two criteria.
First, does the bargain create joint gains for the contracting parties?
Second, does the bargain respect the interests of third persons who
are not parties to the bargain? Within a libertarian framework, the
first criterion is satisfied by refusing to enforce bargains induced by
force and fraud. Similarly, the second criterion is met by refusing to
enforce bargains that contemplate the use or threat of coercion or
fraud against third parties. As stated, these criteria account for many
of the necessary limitations on the common law regime of contractual
freedom. Although this model addresses some of the possible exter-
nalities that are created by contractual agreements, it ignores monop-
oly and collective action problems, which also induce individuals to
take actions that benefit their private, but not the social interest.31
Each of these phenomena offers compelling reasons why certain pri-
ivate bargains are not enforced. The problems each pose arise with
equal or greater intensity in the context of state bargains. The reasons
that lead us not to enforce some private bargains can thus explain
why certain bargains between the government and the individual are
not enforced. Once those reasons are explicated, we can provide a

31 The closest example of the general approach I am proposing is found in Easterbrook,
Sup. Ct. Rev. 309, 349. Judge Easterbrook presents a view of the doctrine of unconstitutional
conditions as part of an elaborate effort "to control cases of externalities and monopoly." See
id.
more systematic consequentialist argument for why the doctrine of unconstitutional conditions limits the ability of individuals to consent to the surrender of constitutional rights.

With this framework in view, the remainder of the Foreword shows how the doctrine of unconstitutional conditions does, and should, function in a variety of contexts as a check against the political perils of monopoly, collective action problems, and externalities. In principle there are two ways to organize the discussion. The first is to examine how the doctrine works with respect to its distinct limitations upon the "prices" people have to pay in order to obtain benefits from the government. Thus there could be a discussion of the first amendment protections of speech and religion, the takings clause, the due process clause, and the like. I have chosen not to follow that course, at least not fully. Instead, I have adopted an approach that first identifies the different heads of government power and then shows how the doctrine of unconstitutional conditions plays itself out with respect to their exercise. By beginning with the powers and not the limitations, it is easier, I think, to follow both the doctrine's historical development and its institutional framework.

Given this orientation, I begin with those areas in which the preservation of competitive markets has been regarded as an important social function. Part III thus concerns the use of the doctrine of unconstitutional conditions in the area of its birth, the nineteenth-century cases in which states sought to impose discriminatory taxes or regulations upon out-of-state corporations that sought to do business within their borders. Part IV pursues a question of federalism of great importance in the pre-1937 cases: how the doctrine of unconstitutional conditions might be used to ensure that the United States does not invade the area of powers reserved to the states. Part V then examines the role of the doctrine in limiting the power of the state to control access to public roads and highways. Part VI addresses the relationship between the doctrine of unconstitutional conditions and the police power, as it relates to the regulation of both property and commercial speech. Part VII then discusses the use of the doctrine in modern areas of tax benefits and welfare rights. It covers the receipt of conditioned exemptions for real estate and sales taxes, and the receipt of unemployment benefits, medical benefits, or, as was the case in Lyng, food stamp benefits for striking union workers. A brief conclusion follows.

II. THE CONCEPTUAL FRAMEWORK

In order to understand the limitations on bargaining, it is best first to sketch how bargains can lead to optimal social results. I thus begin with a brief discussion of perfect competition, and then move on to discuss monopoly, collective action, and externality problems as they
occur in private law contexts. Thereafter I shall show how these problems arise in the context of state power.

A. Private Transactions

1. Perfect Competition. — We begin with an idealized spot market that contains many buyers and many sellers. Fraud and duress are rendered illegal, as is the power of either sellers or buyers to contract among themselves over output or price. In this type of market an optimal social equilibrium emerges in the sense that all the possible gains from trade are exhausted by voluntary exchanges. Within the ideal competitive equilibrium, there will be a unique price at which all goods will be traded, and that price will be set equal to the marginal cost of the marginal producer. Accordingly, no seller and no buyer have any discretion over price. The seller who tries to raise his price above the market will find no takers. The seller who tries to lower his price below the market will find that he cannot make a profit on the sales that are concluded. A system of perfect economic freedom yields a set of rules in which no player finds it to his advantage to engage in any bargaining tactics at all. The ideal competitive market yields a situation in which all the gains from bargains are captured at zero bargaining costs.

2. Monopoly. — The polar opposite to perfect competition is monopoly. Here the market has a single seller who can set terms for sale that maximize his own profits. In general the monopolist will seek to maximize his own profits by selling a smaller quantity of goods at a higher price than is found in the competitive market. This private strategy yields lower total social output than is achievable under pure competition. The social losses in question arise from three distinct sources. First, when the monopolist raises his price, he prevents some mutually beneficial exchanges. Thus, if the competitive price of a good is eight and the monopoly price is ten, any consumer who values that good at more than eight units but less than ten will no longer purchase it. The benefits of that foregone exchange are thus one form of loss created by monopoly.

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32 In real markets, nonprice terms introduce additional complexity that must be taken into account. These terms — such as warranties and delivery provisions — usually are accounted for by adjustments in the price term. Also, in practice, firms seek supracompetitive returns by finding new "niches" for their products that, in the short run at least, give them some discretion over prices. The resulting monopoly gains are typically subject to erosion in the long run by new entry, a phenomenon generally inapplicable to political markets.

33 For an excellent general discussion of the differences between competitive and noncompetitive markets, see D. Friedman, Price Theory 215–61 (1986).
There is a second source of loss as well. With respect to transactions that do occur, the price increase of two units seems to result in a pure transfer of wealth from consumers to producers without any attendant social loss. Nonetheless, this transfer itself is not costless to achieve. Monopolies do not come down from heaven, but are acquired by purposive and costly human action. The prospect of obtaining increased prices is a private gain for which any prospective monopolist will pay. The costs of acquiring a monopoly, whether by buying out a competitor or obtaining government protection from competition, are real costs incurred to obtain simple wealth transfers. The result is that some fraction, and perhaps all, of the potential social gain from the transaction is always wiped out, creating a second form of loss.

Finally, there is a third source of loss associated with monopolies. Outside a regime of pure competition, there is no unique price at which goods can be bought and sold. The advent of a bargaining range — a series of prices at which both buyer and seller are willing to transact — gives rise to a problem of "strategic bargaining," or more generally, "strategic behavior." Parties now have a tendency to "act strategically," to conceal preferences, to lie, to haggle, to holdout, to dicker, to build coalitions, and to price discriminate, all of which cost money but which produce no real gain.

The losses that arise from strategic behavior can perhaps best be seen if we take an extreme situation, the bilateral monopoly, in which there is a single buyer and single seller. The buyer might be willing to pay 200 units to purchase, and the seller to accept 100 units to sell. A costless bargain at any price in the interval generates 100 units of total gain. If the price is 150, each side obtains 50 units of that gain. But 150 does not offer a stable resting point. The seller, for example, may be tempted to spend, say, 10, to sell at 170, while the buyer may be tempted to spend 10 to purchase at 130. Both strategies cannot be successful. If each side's efforts cancel each other out, then the sale is still at 150, but bargaining behavior reduces the total gain by 20 units, or 10 per person. Nor is the overall result changed by any shift in the contract price from the even division at 150. The total gain is still reduced by the level of bargaining costs, which could exhaust much of the 100 units of potential gain. Therefore, any set of institutions that could reduce the bargaining costs without defeating the bargain would generate important social benefits that could be shared by both parties to the transaction.

The dangers of monopoly have led to powerful legal restraints against freedom of contract. Thus, an aggrieved consumer may bring a private antitrust monopoly action. Such a consumer is better off having made a purchase from a monopolist than he would have been if he had done without the good. In the example above, he might
have valued at eleven units a good for which the monopolist charged ten, but for which the competitive price was eight. Nonetheless the antitrust damage action for two units (ignoring trebling of damages) is permitted, notwithstanding the consumer's consent to pay ten. The baseline norm is not the state of affairs before any contract, but the achievable state of affairs under the competitive equilibrium that is the social optimum. In effect, the plaintiff is regarded as a suitable private attorney general and can sue, notwithstanding his position as a willing party to the contract. Yet by the same token, the purchaser is not free of all obligations under the contract. He must, for example, treat goods with proper maintenance in order to maintain an action for breach of express warranty, just as he would in the competitive situation.

Similar limitations on consent are often found in cases of bilateral monopoly. A good illustration of the process is the common law response to private necessity, as it relates to the law of both tort and contract. For example, when a ship is caught in a storm and the crew can save itself only by docking at a single dock, there is a powerful bilateral monopoly problem that invites the use of strategic bargaining. The dockowner may be able to make a gain if he allows the use of his dock for any sum greater than 10 units, while the ship's crew may be willing and able to pay 1000 just for the temporary use of the dock. If the matter were resolved by a voluntary bargain, the price settled upon might be anywhere within the total range of 10 to 1000, leaving both sides better off. Worse still there might be no bargain at all, if the dockowner, who has so little to lose by holding out for a high price, refuses to accept a more reasonable offer.

The doctrines of "conditional privilege," developed at common law, are a response to bargaining problems created by the necessity situation. In essence they allow the shipowner to use the dock upon payment of compensation equal to the rental value of the dock, plus damages for any loss inflicted during the storm. The right to exclude, a normal incident of property, is suspended under conditions of necessity.

Modifications of the law of contract parallel those in the law of property. For example, it has long been the law in admiralty that a salvor is not allowed to take advantage of the position of a ship in distress at sea by driving a hard bargain. Even if such a bargain has

34 See Ploof v. Putnam, 81 Vt. 471, 71 A. 188 (1908) (recognizing a privilege to enter the land of another when acting under private necessity); Vincent v. Lake Erie Transp. Co., 109 Minn. 456, 124 N.W. 221 (1910) (requiring compensation to be paid for damage caused when using another's property under conditions of necessity). See generally Bohlen, Incomplete Privilege to Inflict Intentional Invasions of Interests of Property and Personality, 39 Harv. L. Rev. 307 (1926).
already been concluded, it will not be enforced, and compensation will be set in accordance with a formula that takes into account both the risk to the salvor and the gain to the rescued ship— a principle easily extended to contracts made in the dock case. What goes for price terms applies equally to conditions that might otherwise be set. Thus a contract that said, "I will rescue you only if you agree not to enter into competition with me in the real estate market and to vote Republican" would not be enforced either.

These limitations on contractual freedom could not be justified if the only reason to invalidate contracts were to counteract force and fraud, both of which are absent in the situations just described. Rather, the rules are a judicial effort to maximize the overall value of the dock or of salvage activities by preventing the gameplaying that parties might otherwise engage in, given the large bargaining range. The rules impose a single price at which the dock must be rented, or ships salvaged, which is set roughly to allow the rescuer a competitive return on his costs, while preserving the remainder of the cooperative surplus for the party subject to the external necessity. The legal rules are set in a way that best imitates the outcome that a competitive market would generate. The moment the crisis is over, the ordinary rules of property and contract are restored. The dock can be used by the shipowner only with the owner's consent; the salvage crew keeps full control over its equipment. Calm seas and safe journeys bring with them a return to the ordinary property rights regime.

3. Collective Action Problems. — The problem of monopoly is closely associated with the so-called collective action problem that has now been studied in many private law areas. A bankruptcy situation

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35 The Supreme Court has stated the rule as follows:

Courts of admiralty will enforce contracts made for salvage service and salvage compensation, where the salvor has not taken advantage of his power to make an unreasonable bargain; but they will not tolerate the doctrine that a salvor can take the advantage of his situation, and avail himself of the calamities of others to drive a bargain; nor will they permit the performance of a public duty to be turned into a traffic of profit. The general interests of commerce will be much better promoted by requiring the salvor to trust for compensation to the liberal recompense usually awarded by courts for such services.


36 In Calabresi's terms, the necessity situation reduces the dockowner's protection to that afforded by "liability rules" — a damage action against loss. "Property protection" means that control over the asset can only be lost by consent, the normal situation. See Calabresi & Melamed, Property Rules, Liability Rules and Inalienability: One View of the Cathedral, 85 HARV. L. REV. 1089, 1105-06 (1972).
illuminates the problem as well as any other. Suppose that there is a single common debtor with a large number of independent general creditors. Assume further that the debtor's business has a positive "going concern" value that could not be captured if its assets were sold off piecemeal in order to satisfy creditors' claims. If the business should become insolvent, the way to maximize the total return to the creditors would be to keep the business intact, and to provide each creditor with a portion of the earnings it generates prorated to his share of the debt. Nonetheless, any debtor has powerful incentives to take individual action that would defeat this ideal collective solution. Thus, creditor A may prod the debtor for full payment of his obligation by threatening suit. To stave off disaster, the debtor may agree to make this payment, even at the cost of the piecemeal sale of assets. Once any given creditor takes this course of action, other creditors will also move to protect their assets. Each creditor will therefore race for early payment and seek a "preference" from the debtor. The debtor, who might have survived if the creditors stayed their hand, can be brought down by the onslaught. Acting individually, the creditors will manage to destroy the going concern value of the business, probably ensuring that many creditors will receive only partial payment, and some none at all. Moreover, all of the jockeying consumes enormous resources, which could be spared if the creditors acted as a unit from the outset.

The difficulties of this collective action problem have long been understood to require some form of legal modification of the simple common law rules of property, contract, and tort. Because the debtor's property is a common pool asset, certain individual contracts or transfers between any single creditor and the debtor can be set aside to preserve the value of the whole. In essence, therefore, much of the bankruptcy law is designed to force otherwise independent actors to act together in a cooperative manner. Groups do not act in their collective interests in quite the same way that individuals act in their individual interests. The so-called problem of the prisoner's dilemma is a standard example of the problem of collective choice. The legal


38 The prisoner's dilemma arises when each of two prisoners acting alone finds himself driven to confess, even though both prisoners would be better off if they could coordinate their efforts and remain silent. To see how this situation might arise, assume the following sentences await each prisoner: if both confess, each gets a five-year sentence; if prisoner A confesses but prisoner B does not, A gets a one-year sentence and B gets a ten-year sentence; if B confesses but A does not, B gets the one-year sentence and A gets the ten-year sentence; if neither prisoner confesses, each gets a two-year sentence. If A and B could coordinate their behavior, both would remain silent, and each would escape with a light two-year sentence. Acting separately, however, each will confess and therefore receive a five-year sentence. Consider A's situation. If B confesses, A should confess in order to receive a five-year sentence instead of a ten-year
doctrines addressing this problem provide yet another powerful limitation on consent even in the absence of force and fraud that cannot be ignored in the constitutional context.

4. Externalities. — The last of the social problems that lead to limitations on freedom of contract is the need to protect strangers to the agreement. It is here that the libertarian prohibition against the use of force shows its greatest strength. Assume that A is not entitled to take the property of B without B’s consent. Any contract between A and C that allowed A to take B’s property would not be enforced, at least as against B. The prohibition is necessary in order to forestall destructive behavior that would otherwise undermine any stable system of social organization. If A and C could bargain away the rights of B, why would B and D not bargain away the rights of A? And so on ad infinitum. An unending series of costly bargains could be used to secure the transfer of wealth, but little would be done to secure the creation of wealth in the first instance. The legal rule allowing persons to exchange only those resources that they own creates powerful incentives for the creation of wealth, and with it the satisfaction of human desires. The rule that allows them to buy, sell, or consume resources owned by others only leads to the dissipation of wealth. Private law must therefore protect all individuals against the contractual machinations of strangers. The rights that A and B each have against C cannot be enlarged by an agreement between A and B alone. The temptations for strategic contracting would be too great.

B. The Political Context

The dangers inherent in a system of private contracting often carry over into the political arena. Thus, despite the traditional Hobbesian sentence. If B remains silent, A should confess in order to receive a one-year sentence instead of a two-year sentence. No matter what B does, therefore, A is better off confessing. Parallel arguments apply to B, so both A and B confess. A chart of the payoffs looks as follows, where the first entry in each box is A’s expected sentence, and the second entry is B’s:

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<thead>
<tr>
<th></th>
<th>Confess</th>
<th>Keep silent</th>
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</thead>
<tbody>
<tr>
<td>Confess</td>
<td>5,5</td>
<td>1,10</td>
</tr>
<tr>
<td>Keep Silent</td>
<td>10,1</td>
<td>2,2</td>
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The prisoner’s dilemma set out here is one that seems socially beneficial because it tends to forestall crime. But sometimes, as in the bankruptcy case, each creditor finds himself in a prisoner’s dilemma game with his co-creditors that leads to a negative social outcome, namely the destruction of the going-concern value of the business. For various articles discussing the prisoner’s dilemma, see RATIONAL CHOICE 34–107 (J. Elster ed. 1986).

insistence that the state must exercise a monopoly of force within its jurisdiction in order to prevent the war of all against all, the creation of that monopoly power in the hands of a few public officials itself poses a great danger of abuse. The major task of constitutionalism, therefore, has been to forge a system in which these government excesses are curtailed while leaving the state sufficient power to discharge the necessary tasks of governance. A system of unrestrained political power does a poor job in setting the right balance. In some markets the government has a high degree of monopoly power. It may be the only party that can operate the public roads, issue building permits, or allow firms to do business in corporate form. Unlike the private monopolist, its power cannot be eroded by the entry of new firms, but is perpetuated by a legal prohibition against entry by new rivals. The risks of resource misallocation identified in private transactions carry over to the political area as well. There is an obvious need for limitations on the direct use of coercion. By the same token, if the monopoly and necessity cases are any guide, there are obvious reasons to limit the capacity of the government to bargain with its individual citizens. Just as the dockowner in the private necessity case is limited to a fixed rate of return when the dock is used by others and forbidden from imposing collateral or unrelated conditions on that use, so too the state, when it provides resources of which it is the sole supplier, should be limited both in the concessions that it may exact from private owners and in the conditions it may impose on them.

Similarly, government action often creates the risk of collective action problems. As a single unified entity, the state may be able to make offers to widely dispersed individuals who find themselves faced with a prisoner’s dilemma game. Each person acting alone may think it in his interest to waive some constitutional right, even though a group, if it could act collectively, would reach the opposite conclusion. By barring some waivers of constitutional rights, the doctrine of unconstitutional conditions allows disorganized citizens to escape from what would otherwise be a socially destructive prisoner's dilemma game.

Finally, the problem of externalities as it arises from majority rule must be taken into account. The state is an association of a large number of individuals with diverse interests and inconsistent desires. Yet it must make decisions that bind them all. In principle it would be ideal if all collective decisions could be made by unanimous consent, which would forestall the problem of the majority exploiting the minority. But any unanimous consent requirement would lead to government paralysis, because any single individual would be in a position to bargain strategically by holding out for a lion’s share of the gain from social action. For better or for worse, some system of
majority rule is a necessary evil, and one that forces us to confront explicitly the expropriation problem in the political context.

Left unregulated by constitutional limitations, a majority could use a system of taxation and transfers to secure systematic expropriation of property. Taxes could be used to purchase property, which could then be conveyed to some preferred groups via "bargain sales," at a fraction of its true value. There would be no exploitation of the happy buyer, but there would be a risk that the state as trustee would have abused its power in relation to the other citizens it represents, all of whom received less than fair value in exchange for the property transferred. This pattern of abuse would result not only in a systematic deprivation of the interests of some citizens but also in an overall efficiency loss, as the controlling group will not only expend resources to obtain the transfer, but will be willing to acquire the property even when they value it less than the state did. To the legal system tries to combat this problem through the use of the public trust doctrine. Standing alone, the problem is not one of unconstitutional conditions because there is no effort to take advantage of the happy parties who prosper from doing business with the state.

Externalities, however, become entwined with the problem of unconstitutional conditions when the state seeks to grant benefits or make contracts subject to conditions that some individuals find far more onerous than others. To be sure, conditions will not be imposed if everyone is hurt equally by them, but they may become part of a system of contracts or grants if they work to the benefit of a dominant

40 To take a simple case, assume that there are five persons in the society at large, and that a majority faction of three arranges to buy a public asset worth $500 for $300. In a static analysis, the wealth of each of the two minority shareholders decreases by $40 (one-fifth of the state's $200 loss in the transaction), assuming that the asset has equal value for all concerned. The wealth of each of the three dominant shareholders, ignoring assets not involved in the transaction, increases from $200 before the transaction ($100 in cash, plus $100 for his interest in the public asset) to $227 after the transaction ($60, or one-fifth of the publicly held cash, plus $167, or one-third of the $500 asset). As a first approximation there is only a redistribution, not substantially different from that of an ordinary takings case. In dynamic terms, however, there will be not only a simple shift of wealth, but a total reduction as well. Not only are transaction costs incurred in making the shift, but the winning coalition may be able to profit from the public sale if they value the asset at more than $300, even if they value it at less than $500. Hence there is a systematic divergence between private and social costs, analogous to the one found in the monopoly case. The winning coalition forces the transaction even when the property is worth less in private hands than it was in public hands. The insistence that full value be paid for any transfer of property from the state is necessary to stop this problem. See Epstein, The Public Trust Doctrine, 7 Cato J. 411 (1987).

faction and against the interests of others. Assume, for example, that before the introduction of a government benefit program — say, the construction of a public highway — each of two factions has a welfare of 50 units. Construction of the highway can improve the position of each group from 50 units to 100, and thus advance aggregate welfare from 100 to 200. Thus far it seems that going forward with the project is entirely unproblematic.

Once use of the highway may be conditioned, however, the analysis becomes far more complicated. Consider two polar scenarios. Under the first, building the highway and conditioning its use advances total utility from 100 to 250 units, while that of each faction increases from 50 to 125. Here both sides are unambiguously better off with the imposition of the condition than they were without it, so that courts should accept the condition even if they could not compel its adoption.

The second scenario, however, is far more problematic. Suppose that the total welfare involved increases from 100 to 175 units, but that the position of the dominant faction moves from 50 to 120, while that of the weaker faction moves only from 50 to 55. In essence the imposition of the condition is designed to secure factional gains, which are costly to obtain, shrinking the total size of the pie even while the size of the slice enjoyed by the dominant faction increases. A third scenario is possible, but unlikely: a one-sided condition might advance the welfare of one group from 50 to 110 units, and that of the other from 50 to 120. In this case, the only inquiry is whether it is worthwhile to equalize the expanded gains from benevolent collective action.

The first two scenarios, then, are the ones that require closer attention. The doctrine of unconstitutional conditions is necessary to prevent the second alternative (unequal shares and smaller total gain) from prevailing over the first. Thus if the dominant faction cannot be prevented from conditioning use of the highway in the second scenario, other citizens will take the bitter with the sweet, and consent to the total package. Clearly, the world with the project and the condition is better than the world without any project at all. But, to use Kreimer’s language, we have selected the wrong baseline, for the world of the project without the condition is better than either of these two alternatives. In the case given, there is social loss in that the total size of the surplus produced by government action is reduced from 200 units, if the latter condition is not allowed, to 175 units, if the condition is allowed. If the legal system focuses only on the consent of the individual citizen, it will not distinguish between these very different kinds of conditions and their very different allocative effects. The doctrine of unconstitutional conditions offers a way to pierce the consent by using as the baseline, not the status quo ante, but an achievable state of affairs in which the program is put forward without the conditions attached.
At this point, it becomes difficult to use a simple Pareto test to make the applicable distinction, for the dominant faction is left worse off when the condition is rejected than when the condition is imposed. Now the object of the inquiry is to maximize the total cooperative surplus from the government action. Some effort must be made to compare the size of the gains obtained by each of the rival groups, and for this task one convenient approach is to accept only conditions that tend to advance the welfare of all groups pro rata, as opposed to those having a differential effect.

Given this complex inquiry, the trick is to fashion a test that can distinguish good conditions from bad ones. A rule that all persons on the highway must agree to answer for their torts seems to be the benevolent kind of condition.\footnote{See infra note 138 and accompanying text.} In imposing it the state acts as a mutual agent of all citizens in a way that advances their ex ante welfare. Alternatively, a condition stipulating that all commercial haulers who use the highway must agree to accept the restrictions of common carriers looks like the type of condition that reduces the total size of the social surplus, by allowing it to be redistributed through factional intrigue.\footnote{See infra pp. 47–54 (discussing Frost & Frost Trucking Co. v. Railroad Comm’n, 271 U.S. 583 (1926)).} A strong unconstitutional conditions doctrine, which like a strong equal protection argument insists that all parties be treated equally, is one effective way to control this public abuse and to ensure full preservation of the social surplus created from the use of highways.

In dealing with unconstitutional conditions, the stakes are not limited only to dollars and cents, or even to property and economic liberties. Conditions might impinge upon individuals’ political and religious liberties as well. It is therefore necessary carefully to examine the soundness of conditions for which consent has been obtained. Doing so once again requires the doctrine of unconstitutional conditions.

\textit{C. Citizen Misconduct}

Thus far, all attention has been directed toward potential misconduct by government officials. But there is no reason to assume that government officials are any more self-interested than are the citizens with whom they do business. Thus the risk of strategic behavior is \textit{bilateral}. In private dealings, any party to a complex transaction can engage in strategic behavior, and so too in the area of political action. Just as the government may seek to exploit the individual, so too a citizen may try to exploit the government. The flip-side, therefore, to the doctrine of unconstitutional conditions is the idea of “compelling
state interest," which appears throughout all constitutional analysis. Typically the doctrine of unconstitutional conditions does not interfere with government bargains designed to prevent individual exploitation of some common pool assets. To revert to the above example, a user of the public highways can be required to abide by the rules of the road as a condition of entry. The control of public nuisance is an end that the government can seek not only by direct regulation of private property, but as a condition on the use of public property as well.

D. Judicial Implementation of the Unconstitutional Conditions Doctrine

1. First Principles. — The analysis of any unconstitutional conditions problem requires an assessment of the relative strength of the three risks of abuse that can arise when the state bargains with its citizens. But even after the relevant factors are set out, several pieces of the puzzle must still be put in place.

The first piece concerns the extent to which the Supreme Court will undertake this review of government behavior. Here, as in other contexts, the answer is heavily dependent upon its attitude toward the behavior of government officials. The private law response to monopoly, collective action problems, and externalities reflects the assumption that individuals will seek to maximize their own private returns, given the external constraints under which they labor. Its legal rules therefore have been set to minimize the likelihood that they will be able to achieve some private gain at some net social cost. To be sure these assumptions are overdrawn. There are many individuals who will come to the aid of those who are in trouble, without so much as the thought of payment to themselves. Many people would never think of abusing their partnership control to cheat their partners. These cases are important for any overall assessment of human nature, but they are not the cases against which the legal rules are directed. Honest and honorable people do behave well regardless of the legal framework in which they act. The law must be directed against that fraction of the total population for whom self-interest is the sole beacon of conduct. For such people, the assumptions of the law fit all too well with the behavior that the law seeks to control.

The question what to make of human nature carries over to the constitutional context with equal significance. If it is assumed that government officials and the private parties who influence them are prone to the corrosive influence of self-interest, then the legal rules should strictly scrutinize whatever behavior they undertake. If the direct use of government coercion is subject to serious constitutional scrutiny, then government bargains should be subject to a similar level of scrutiny. The doctrine of unconstitutional conditions thus becomes an inseparable part of constitutional law, attendant to any
and all exercises of government power. Alternatively, if government officials are assumed to act with benevolent motives when they regulate, then they should be assumed to act with similar motives when they contract. The low level of scrutiny found under rational basis review would carry over from regulation to bargains, and the doctrine of unconstitutional conditions would play only a marginal role in our legal firmament.

There are today many competing general constitutional visions, which bear on the question of how courts should regard government figures. Some theories stress the virtues of republican self-government; others the satisfaction of "dignitary" interests; still others the protection of economic liberty or the niceties of utilitarian calculation. Other constitutional theories rest upon the sanctity of private property and the fear of the democratic excesses of the populist masses. For present purposes, the correctness of the basic orientations is not the critical point. The various theories only direct attention to those areas in which the political process is viewed with distrust. It is precisely in those areas that the doctrine of unconstitutional conditions will take root and flourish.

In this connection, the constitutional fault line of the post-1937 period poses the same problem for the doctrine of unconstitutional conditions that it does for direct forms of government regulation. The weak protection of property and contract is juxtaposed with a strong suspicion of government regulation of preferred freedoms, such as speech and religion, and the government use of suspect classifications, such as those based upon religious and political views. Today there remains, to a lesser degree than before, an erratic fear of political aggrandizement by one state at the expense of another, or of the states at the expense of the federal government.

This hierarchy of legal rights makes the doctrine of unconstitutional conditions especially difficult to apply to complex modern statutory schemes that implement explicit or implicit transfers of wealth for purposes now regarded as unquestionably legitimate — for example, to regulate land use, or to help the needy or unemployed. Yet these programs, whether by regulation or taxation, often effect such transfers along forbidden lines, such as political or religious affiliation. Frequently, the question arises how to disentangle these two distinct strands of a single statutory scheme, subjecting each to its appropriate


45 See, e.g., Mashaw, supra note 26.

level of review — minimal scrutiny for ordinary rights, strict scrutiny for fundamental rights and suspect classifications. The coerced transfer of property from A to B may be allowed today in general economic areas, but it will not be tolerated along (say) religious or political lines. Where the state seeks those forbidden objectives through contracting, its actions will be met with the same hostility as when it proceeds through direct regulation or taxation. In such contexts, we find the continued, indeed expanded, vitality of the doctrine of unconstitutional conditions in modern times.

2. Second Best. — The doctrine of unconstitutional conditions is also beset with the serious problem of being a “second best” approach to controlling government discretion. In many cases, the Supreme Court has held that Congress or the states have absolute discretion with regard to matters such as allowing foreign corporations to do business within the state or allowing commercial vehicles to use public highways. This discretion increases the risks associated with monopoly, collective action problems, and externalities in a wide variety of bargaining contexts. In some cases, the doctrine of unconstitutional conditions is used to “take back” some of the power which had been conferred upon government officials in the first instance. In principle, the doctrine’s application would be unnecessary if the Court had restricted the scope of the government power in the first instance.

Often the unsatisfactory nature of the doctrine of unconstitutional conditions arises from its status as a mop-up doctrine where other forms of constitutional restraint have been abandoned. Within these contexts, it is often very difficult to decide whether the doctrine does more harm than good. When the government is told that it cannot bargain with individuals, the empirical question arises whether government will deny them a useful benefit altogether, or grant them the benefit without the obnoxious condition.

III. THE STATE INCORPORATION POWER

A. Nineteenth-Century Special Charters

One of the most important powers of the state is to grant charters to those firms that wish to be incorporated within the state. Often since Chief Justice Marshall’s pronouncements in Trustees of Dartmouth College v. Woodward,47 the corporation has been said, somewhat misleadingly, to be an “artifical being” that owes its existence to the state. But behind the corporate form lie the desires of ordinary

47 17 U.S. (4 Wheat.) 518, 636 (1819) (“A corporation is an artifical being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly, or as incidental to its very existence.”).
human beings. Who receives the certificate, and on what terms, can raise all the potential for abuse associated with government discretion.

Consider what happens in a regime in which the state has complete discretion in awarding charters. First, state legislators will be able to extract enormous payments (including bribes) from the private parties who wish to obtain the benefits of incorporation. Second, granting a certificate of incorporation to one firm while denying one to its competitors creates enormous externalities. The public at large is denied the benefits of competitive product markets, while the rival firms are relegated to doing business in the inferior partnership form, with unlimited liability for members.

These two concerns are not simply hypothetical. One of the major political issues in the nineteenth century revolved around the once common practice of issuing individual, special charters of incorporation, the abuses of which have been well documented. The situation was corrected largely through competition between states in the chartering market, rather than through application of any constitutional principle. The result was a regime of general incorporation that essentially allows any group of individuals the benefit of the corporate form as long as they can meet certain minimum requirements designed to protect the public at large from abuse: minimum assets or insurance to protect tort creditors, and a willingness to accept service of process in the corporate name.49

Although not prompted by application of the doctrine of unconstitutional conditions, the shift in the method of chartering corpora-

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49 Even within this framework there are opportunities for abuse. Thus, in First National Bank of Boston v. Bellotti, 435 U.S. 765 (1978), the Supreme Court struck down a Massachusetts criminal statute that prohibited corporations from making contributions or expenditures "for the purpose of ... influencing or affecting the vote on any question submitted to the voters, other than one materially affecting any of the property, business or assets of the corporation." MASS. GEN. LAWS ANN. ch. 55, § 8 (West Supp. 1977). The statute also provided that matters concerning the general taxation of income or property shall be "deemed" not to affect the corporation. Here the restriction was struck down on first amendment grounds over the dissent of Justice Rehnquist, who argued, relying on Dartmouth College, that because the corporation is a creation of state law, the state can legitimately withhold from the corporation those liberties not "incidental" to the corporation's state-defined purpose. See 435 U.S. at 822–28 (Rehnquist, J., dissenting).

In a sense this restriction applies evenhandedly to all corporations. But it is selective among business entities as a larger class, exacting an implicit tax on speech by corporations that reduces the gains from incorporation that private parties otherwise would obtain. The statute is not designed to prevent any abuse of the corporate form. In my view it could be struck down not only on first amendment grounds, but as a differential tax that violates the takings clause. See R. ERSTEIN, supra note 28, at 283–305. The first amendment analysis in Bellotti is similar to that applicable in the highway cases, discussed below at pp. 47–58.
tions shows the social utility of limiting the state's discretion. It does make sense to say that the state may choose not to grant any individu-als a charter of incorporation, or may choose to grant it to all comers on equal terms, but cannot use the ostensibly lesser power of picking and choosing among applicants. To see the point, consider a very simple and stylized example. Assume two firms — firm A and firm B — desire corporate charters. If neither firm A nor firm B gets a charter, then each will have a value of $100. If firm A gets a charter and firm B does not, then A will have a value of $120 and B a value of $90. If firm B gets a charter and firm A does not, then B will have the value of $120 and A the value of $90. If both firms get the charter, then each will have a value of $115. These values do not reflect the costs of getting a charter. The payoffs of the various alternatives are put in tabular form in the notes.50

In a regime of selective incorporation firm A and firm B will both bid for a charter, and each would be prepared to pay up to $20 to the legislators to obtain an exclusive charter. If either party starts down this road then the other will have to respond because one rival's incorporation reduces its competitor's net worth from $100 to $90. There will be a complex political struggle, the outcome of which is quite unclear. What is clear is that these bargaining costs reduce the total gains from incorporation, both for the firms and the society at large, even if the fourth outcome is achieved. In an extreme case, dual incorporation with bargaining costs taken into account could leave both firms with a value of only $100. Political intrigue can wipe out the efficiency gains of incorporation for firm members, suppliers, and customers.

We can now see the value of a rule rejecting the argument that the greater power (to keep all firms from incorporating) includes the lesser power (to keep some firms from incorporating). If the state is forced to grant charters of incorporation to every firm if it grants a charter to any, then the second and third possibilities are eliminated. The state is forced to choose between scenarios one and four. The

<table>
<thead>
<tr>
<th>Structure</th>
<th>Value</th>
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<tbody>
<tr>
<td></td>
<td>A</td>
</tr>
<tr>
<td>1. No incorporation</td>
<td>$100</td>
</tr>
<tr>
<td>2. A only</td>
<td>$120</td>
</tr>
<tr>
<td>3. B only</td>
<td>$90</td>
</tr>
<tr>
<td>4. Both A and B</td>
<td>$115</td>
</tr>
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This chart underestimates the value of alternative 4 because it does not include the gains that the public achieves from general incorporation, including greater technical innovation and more competition in product markets. This point does not affect the analysis; if anything, these gains tend to show the greater social preference for alternative 4.
two firms will no longer be in a position to compete with each other for charters, so the level of intrigue will be diminished. In addition, political dynamics will tend to force the outcome to scenario four, as the legislators will be very hard-pressed to resist an outcome that benefits both firms and the public at large. The upshot is that the power of selective incorporation is the greater power, while the all-or-nothing choice is the lesser power.\(^5\) Whatever the formal appearances, selective incorporation gives political actors a greater opportunity to extract economic rents.\(^5\) The rule forcing the state to incorporate all firms or none is, as a first approximation, a better protection against individual and public abuse.

There is still one piece to the puzzle missing, for some conditions can and should be uniformly imposed upon all firms seeking incorporation, for example those requiring insurance or minimum capitalization to protect tort creditors, and those requiring firms to accept service of process. These requirements can be stated in a general form, however, so that public protection is possible without conferring enormous discretion upon state authorities.\(^5\) Within the context of local incorporation, then, rejecting the greater/lesser dogma prevents political abuse and advances the overall competitive situation.

### B. Foreign Incorporation

Although the battle over general incorporation laws during the middle of the nineteenth century showed the dangers of government discretion, it did not squarely raise the question of unconstitutional conditions. Rather, it was the conflict over whether a foreign corporation had a right to do business in a state under the same terms and conditions as a domestic corporation that gave birth to unconstitutional conditions doctrine. A state's power to exclude foreign corporations creates a monopoly situation, for no matter where a firm is incorporated, each state has the sole right to decide whether it can do business within its territory. The opportunities for political maneuvering should be evident. Firms will compete to gain entrance for themselves and to exclude rivals, just as they did when special charters for incorporation within the home state were the general rule.

The best way to combat this problem is through a strong, categorical rule granting foreign corporations the same right to do business

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\(^5\) Kreimer makes this point explicitly: "Often it is only by ripping a problem from its historical context that selective denial can be viewed as a lesser power. In reality, selective deprivation may be the less controlled and hence the more dangerous power." Kreimer, *supra* note 22, at 1313 (footnote omitted).


\(^5\) The conditions imposed in *Bellotti* do not address either of these concerns. *See supra* note 49.
in another state on the same terms and conditions available to its local corporations. In effect, the power to select between domestic and foreign corporations could be eliminated as long as no state would be prepared to disenfranchise its local firms in order to keep out foreign rivals. By forcing states to select between the first and fourth alternatives stated above, the doctrine of unconstitutional conditions, applied in this interstate context, again would result in the state choosing the fourth alternative.

The obvious — and correct — constitutional vehicle for reaching this position is the privileges and immunities clause, which provides that "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." That line of attack, however, was decisively foreclosed in Paul v. Virginia, which held that corporations were not "citizens" within the meaning of that clause. The position so adopted necessarily conferred a broad range of discretion upon the state, which Paul set out with extraordinary clarity:

Now a grant of corporate existence is a grant of special privileges to the corporators, enabling them to act for certain designated purposes as a single individual, and exempting them (unless otherwise specially provided) from individual liability. The corporation being the mere creation of local law, can have no legal existence beyond the limits of the sovereignty where created. As said by this court in Bank of Augusta v. Earle, "It must dwell in the place of its creation, and cannot migrate to another sovereignty." The recognition of its existence even by other States, and the enforcement of its contracts made therein, depend purely upon the comity of those States — a comity which is never extended where the existence of the corporation or the exercise of its powers are prejudicial to their interests or repugnant to their policy. Having no absolute right of recognition in other States, but depending for such recognition and the enforcement of its contracts upon their assent, it follows, as a matter of course, that such assent may be granted upon such terms and conditions as those States may think proper to impose. They may exclude the foreign corporation entirely; they may restrict its business to particular localities, or, they may exact such security for the performance of its contracts with their citizens as in their judgment will best promote the public interest. The whole matter rests in their discretion.

The Court thus took a very relaxed attitude toward the question of governmental abuse. The implicit repudiation of any form of judicial scrutiny in Paul carried forward the original argument in Dartmouth College that corporate privileges are the subject of legislative grace, and exposed the Achilles heel of that earlier decision which, in

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54 U.S. Const. art. IV, § 7.
55 75 U.S. (8 Wall.) 168 (1869).
56 Id. at 181.
protecting existing charters, expanded the power of the state to regulate business affairs of new corporations.\textsuperscript{57} 

\textit{Dartmouth College} necessarily rejected the theory that the welfare of a corporation is simply the welfare of its individual shareholders, all of whom are collectively prejudiced by the inability to do business in other states.\textsuperscript{58} The sharp disjunction between the right of individual traders to enter foreign states on equal terms with local citizens and the inability of foreign corporations to do the same constitutes a fundamental weakness in \textit{Paul} that was not lost on the leading commentators of the time, all of whom reverted to aggregate theories of the corporation to conclude, in the words of Victor Morawetz:

\[ \text{[T]he rights and duties of an incorporated association are in reality the rights and duties of the persons who compose it, and not of an imaginary being.} \]

\[ \ldots \]

\[ \ldots \text{[T]here is no reason of immediate justice to others, why a number of individuals should not be permitted to form a corporation of their own free will, and without first obtaining permission from the legislature, just as they may form a partnership or enter into ordinary contracts with each other.} \textsuperscript{59} \]

Even if a corporation is not a "citizen," its shareholders surely are, and it is they who are denied legal protection against selective exclusion.

Although \textit{Paul} prevented the privileges and immunities clause from ensuring nondiscrimination, other constitutional avenues that could have constrained the level of state discretion conferred by \textit{Paul} soon opened up.\textsuperscript{60} Most notably, the term "person" as used in the due
process clause had been construed to cover the same corporations deemed not to be "citizens" under the privileges and immunities clause.\textsuperscript{61} By the 1890's it had been held that the words "without due process of law" were to be construed in some contexts to mean at least "without just compensation,"\textsuperscript{62} so that takings jurisprudence, which often uses a disproportionate impact test to determine whether just compensation has been provided,\textsuperscript{63} now applied to the states. The disproportionate impact of a discriminatory tax seems clear enough. If the tax is a taking, then its discriminatory impact is clear evidence that the party so taxed has not received just compensation for the moneys paid to the state. The same kind of argument could be made in principle with respect to the equal protection clause. If foreign shareholders are entitled to the same rights as domestic ones, then any discrimination between them must be justified by the extra costs that foreign corporations impose on local governments, of which there seem to be none. Any sensible use of either due process or equal protection doctrine would have resulted in an end run around Paul, without recourse to the doctrine of unconstitutional conditions. Under this "strong rights" thesis, the state would not have the power either to exclude foreign corporations from doing business within its borders or to tax foreign corporations differently from local firms. The outsider comes in on equal terms, and nothing more need be said.

Because this position did not take hold in the late nineteenth or early twentieth century, however, the stage was set for the Court's use of the doctrine of unconstitutional conditions, under both the due process\textsuperscript{64} and equal protection\textsuperscript{65} clauses of the fourteenth

\textsuperscript{61} See Santa Clara County v. Southern Pac. R.R. Co., 118 U.S. 394, 396 (1886). Note that Congress could not have limited state discretion during this period, because Paul had also held that local insurance contracts were matters of local commerce (or more decisively that they were not commercial transactions at all) and thus beyond the reach of the commerce clause. See 75 U.S. (8 Wall.) 168, at 182–85 (1869).


\textsuperscript{63} See R. Epstein, supra note 28, at 204–09.

\textsuperscript{64} See Pullman Co. v. Kansas, 216 U.S. 56 (1910); Western Union Tel. Co. v. Kansas, 216 U.S. 1 (1910).

\textsuperscript{65} See Southern Ry. Co. v. Greene, 216 U.S. 400 (1910). Southern Railway acknowledged that the equal protection analysis follows a path similar to the earlier due process analysis. See id. at 413–18. There is good reason for the parallelism. Both the equal protection and due process clauses essentially follow the same path as the takings clause, as it applies to general taxation and regulation. In essence, it is virtually impossible to measure whether the benefits of taxation exceed the costs of the tax imposed. Hence unequal treatment or disproportionate impact should become the proxy by which to judge whether there is an illicit transfer of wealth between groups. Cf. Armstrong v. United States, 364 U.S. 40, 49 (1960) (holding that the takings clause was intended to prevent placing a disproportionate share of burdens on a few). For an extensive discussion, see R. Epstein, supra note 28, at 195–215. The equal protection clause emphasizes equal treatment; the due process clause emphasizes the loss of property without compensation. In essence, they both look at different ends of the same set of issues.
amendment as a "second best" means of controlling government discretion. In *Western Union Telegraph Co. v. Kansas*, for example, the Court struck down a discriminatory tax Kansas sought to impose upon Western Union, a New York corporation. The tax itself was based on the corporation's entire capital stock, not only on its local assets, and thus had a strong extra-territorial effect. Clearly, the due process clause would have struck down the tax if the firm had done no business in Kansas. The issue of unconstitutional conditions arose because the state conditioned its willingness to allow Western Union to engage in *local* commerce on its willingness to pay the discriminatory tax. Without the doctrine of unconstitutional conditions, the consent of the firm would have cured the defects in extraterritorial treatment; with the doctrine in place, however, consent of the corporation did not prevent it from challenging the disputed condition.

Important consequences flow from the choice of legal regimes. The key difference between the unconstitutional conditions argument and the strong rights argument set out above goes to the set of the choices left to the state. Under unconstitutional conditions doctrine, the state may choose either to exclude the foreign corporation altogether or to let it in on equal terms with the local corporations. By rejecting the greater/lesser analysis championed by Justice Holmes, the Court thus barred the state from allowing consenting foreign corporations to do business subject to a countless array of taxes or other burdens that did not apply to domestic corporations, although it did not prevent the state from exercising the "greater" power of excluding foreign corporations altogether.

The question arises how the state will behave under these two legal regimes. In order to answer that question, it is necessary to undertake a rough interest group analysis that takes into account three disparate sets of interests: local consumers, local businesses, and foreign corporations. When the state has complete power to admit, exclude, or admit subject to conditions, it is highly likely that the state will often choose the third path, which Kansas adopted in *Western Union*, even though it enjoys an absolute right to exclude under *Paul*.

Start with local consumers. These individuals both gain and lose from the admission of foreign corporations subject to the discriminat-
tory tax, when measured against the alternative of admitting them subject only to normal taxes. On the positive side of the ledger, more taxes might be collected from the out-of-state firms, thus reducing the local tax burden. (Either alternative is preferable on this measure to exclusion, which would result in no tax revenue.) On the negative side, the discriminatory tax imposes burdens on local consumers who are forced to pay higher prices for some goods and services, and to forego the benefits of other bargains the higher tax renders uneconomical — the so-called excess burden imposed by the discriminatory tax.\(^\text{71}\) (Again, either alternative is preferable to exclusion, which would result in no consumers' surplus from business with foreign corporations.) For local consumers as a group, it seems plausible that these effects will tend to offset each other. Local competitors for their part have far less ambivalence. They gain revenue and competitive advantages from the discriminatory tax and should support it strongly. While some might want total exclusion, the loss of both tax revenue and the opportunities to do business with foreign suppliers and customers make this an unlikely outcome. Given that political compromise is always possible on the level of discrimination embedded in the tax, discriminatory taxes such as found in Western Union should emerge.

This calculus changes radically when the doctrine of unconstitutional conditions puts the state to an all-or-nothing choice. Now local consumers must be asked to support a total exclusion of out-of-state firms. Under this rule, these citizens receive no revenue offset from the foreign tax, and they lose in addition the possibility of doing business with efficient out-of-state firms who are able to overcome the tax disadvantage. Consumer losses become very large, with no obvious offsetting gains. We should thus expect that they would strongly support a repeal of the special tax when the doctrine of unconstitutional conditions puts them to the choice of nondiscriminatory entry or total exclusion of foreign firms.

For their part, rival sellers of goods and services may well like the total exclusion, at least for their direct rivals, but they would not desire a similar exclusion for out-of-state firms that supply inputs that these firms purchase, or for firms that purchase their products. On balance, therefore, it will likely be difficult to assemble a broad in-state coalition of producers who will find it in their own self-interest to keep the outsiders out permanently, or even to impose taxes so high that most of them choose to stay out. The net result would be the

\(^{71}\) The term "excess burden" is applied to any tax in which the amount received from the taxing authority is less than the private parties so taxed lose. The deadweight loss associated with such excess burdens is analogous to that which occurs when the price set by a private monopolist exceeds the competitive price. See generally J. Gwartney & R. Stroup, Economics: Private and Public Choice 110–11 (4th ed. 1987).
desired one: out-of-state firms would be allowed to compete on even terms.

Still to be considered are the interests of the out-of-state firms. In principle they would always prefer the nondiscriminatory taxes to the other two choices. But the prospect of supracompetitive profits may induce them to pay a discriminatory tax for the privilege of doing business. Thus the legal regime of Paul, before its demise in United States v. South-Eastern Underwriters Association, created an extensive bargaining range between local governments and outside firms, with ample opportunities for strategic behavior on both sides. If the guess about local politics is correct, the use of unconstitutional conditions in this context would force the states to the proper social alternative — letting outsiders in on an equal basis — by precluding the use of discriminatory taxes. The doctrine cuts out all intermediate positions, leaving the state only the all-or-nothing alternatives of total exclusion or nondiscriminatory admission. Forced to either of the two edges of the bargaining range, the local interests are better off allowing out-of-state firms in on equal terms than excluding them entirely. The total exclusion option sanctioned by Paul is preserved, but as an empirical matter factional intrigue is forestalled, and the correct outcome of the ensuing political game is in most cases ensured. The subsequent histories of the decisions in both Western Union Telephone Co. v. Kansas and Southern Railway Co. v. Greene, both of which struck down discriminatory taxes, bear out this hypothesis, insofar as the modern versions of both statutes now apply nondiscriminatory rules to foreign corporations. It was simply not viable to exclude either foreign railroad or foreign telegraph companies from doing any portion of their business within any state.

This analysis applies not only to taxation of foreign corporations, but also to other kinds of regulation as well. Consider the common provisions that sought to restrict the ability of foreign corporations to

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73 See supra notes 71–72.

74 216 U.S. 1 (1910).

75 216 U.S. 400 (1910).

avail themselves of the federal courts' diversity jurisdiction. *Terral v. Burke Construction Co.* overruled several earlier cases by holding that:

a State may not, in imposing conditions upon the privilege of a foreign corporation's doing business in the State, exact from it a waiver of the exercise of its constitutional right to resort to the federal courts, or thereafter withdraw the privilege of doing business because of its exercise of such right, whether waived in advance or not.

The justification for this result is identical to that in the tax cases. Foreign corporations presumably want access to federal courts to escape the local bias of state courts. To prevent them from exercising this option is to subject them to a disguised differential tax equal to their estimated additional burdens of litigating in a hostile forum. If forced to choose between exclusion and admission on equal terms, the states do the latter, as happened after *Terral*, which is as it should be. As with taxes, the doctrine serves in this context as an effective constraint on arbitrary power found in the absolute authority to exclude foreign corporations. Again the proposition is not a necessary truth. The success of the doctrine rests solely on the empirical judgment that a state, when faced with the all-or-nothing choice, will choose to allow the outsider in on equal terms.

C. Overriding the Nondiscrimination Rule

Although use of the doctrine of unconstitutional conditions in state taxation cases is now well established, its success depends on the steadfastness with which it is applied. That level of resolve in turn depends upon what justifications are found appropriate to displace its underlying principle — an issue not raised in the earlier cases. In this regard, the recent taxation cases are unsatisfactory. In *Western

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77 257 U.S. 529 (1922).


79 257 U.S. at 532.


81 The result in the case has also been supported on the ground that it protects the jurisdiction of the federal courts from state encroachment, an argument invoked, but not explored at length, in *Terral*, see 257 U.S. at 532–33, and endorsed in Merrill, cited above in note 12, at 892. It was perhaps on this ground that Justice Holmes joined the decision notwithstanding his earlier dissents in *Western Union*, 216 U.S. at 52 (Holmes, J., dissenting), and *Southern Railway*, 216 U.S. at 418 (Holmes, J., dissenting).

82 See, e.g., Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981) (holding a severance tax on the coal production to be nondiscriminatory even though 90% of the coal was shipped under contracts shifting the tax burden to out-of-state utility companies). But see Epstein, *Taxation, Regulation and Confiscation*, 20 Osgoode Hall L.J. 433, 445–49 (1982) (criticizing the result in *Commonwealth Edison*).
& Southern Life Insurance Co. v. Board of Equalization, California imposed an overtly discriminatory tax on some out-of-state insurance companies. The tax was not a simple discriminatory tax like the one invalidated in Western Union. Rather, it was styled as a "retaliatory" tax that was imposed only when the state of incorporation of the foreign company, here Ohio, charged California companies higher tax rates for doing business in Ohio than the California companies paid in California. Ohio did not impose any discriminatory tax on California life insurance companies (which it could not do under Western Union). But Ohio did tax all insurance companies doing business in Ohio a premium tax at a higher rate (2.5%) than California charged for its local companies (2.35%). Thus, California's retaliation provision, in effect, imposed a 2.5% premium tax on the California revenues of Ohio corporations. The differential tax was justified as a way to pressure Ohio corporations to use their influence to lower the general premium tax in Ohio to California levels.

Despite the explicit discrimination revealed by these facts, Justice Brennan upheld the tax. He first made clear his unwillingness to reverse Paul's interpretation of the term "citizen" in the privileges and immunities clause. But he did accept — heartily, though without explanation — the unconstitutional conditions gloss used to mitigate the absolutism of that decision. The shift from the privilege and immunities analysis to an equal protection analysis, however, allowed Justice Brennan to place an elastic "rational basis" construction on the doctrine of unconstitutional conditions, as permissive as the rational basis review he had applied directly in equal protection cases.

Applying this standard, he found that California's tax was justified as a device to induce other states to reduce the amount of taxes imposed on California businesses, and that the life insurance industry itself had supported the tax in question. In so doing, he left ajar the door to politics that had been shut more tightly by the earlier and more categorical versions of unconstitutional conditions doctrine. As Justice Stevens' dissent pointed out, the decision allows California politicians to seek influence over the general level of taxes in Ohio. It is worth adding that the differential tax might be supported by

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84 See id. at 675 (Stevens, J., dissenting); OHIO REV. CODE ANN. § 5729.03 (Anderson 1973).
85 See 451 U.S. at 656-68, (endorsing the doctrine after reviewing the long line of confused precedent in the area).
87 See 451 U.S. at 677-78 n.7 (Stevens, J., dissenting).
insurance companies because of their determination to monopolize local markets. California's retaliatory statute is hauntingly reminiscent of New Jersey's effort, struck down in *Gibbons v. Ogden*,\(^8^8\) to get even with New York's restrictive steamboat monopoly. Its motivation also seems similar to the clearly protectionist sentiment underlying the system of retaliation in the trade legislation that Congress has just enacted.\(^8^9\) Ohio still keeps its old tax rate,\(^9^0\) so that the Supreme Court's decision allows discrimination to flourish across states in a short-run that lengthens as the shadows of the evening. As elsewhere, the rational basis test leads only to constitutional confusion and to the release of political forces far better kept in check. It is often said that the Constitution does not impose categorical restrictions upon inefficient or sneaky practices. But in hard cases, we can only make sense of the substantive provisions that it does contain in light of the social consequences generated by alternative interpretations of those provisions. We know that the creation of one national economic market was a major goal of the Framers, and it remains a goal worthy of our support. The per se rule of *Western Union* and *Southern Railroad* is superior to its watered-down modern alternatives.

**IV. TAXING, SPENDING, AND FEDERALISM**

The unconstitutional conditions doctrine also limits the scope of government discretion under the federal taxing and spending power. As is well known, taxation is an effective way for governments to secure implicit transfers of both wealth and power. These transfers can be implemented by imposing higher rates on some persons, granting exemptions to others, or by imposing conditions on the collection of taxes or on the grants of exemptions. The potential abuses in the taxing power are well captured by Chief Justice Marshall's famous dictum that the "power to tax involves the power to destroy."\(^9^1\) If this tendency had been countered by a broad reading of the takings clause, then all selective taxes, exemptions, preferences, and conditions would be struck down as impermissible redistributions, unless supported by a narrow police power justification.\(^9^2\) But even before the 1937 constitutional watershed, the Court had always taken a far more relaxed view on matters of selective taxation than Chief Justice

\(^{88}\) 22 U.S. (9 Wheat.) 1 (1824).


\(^{90}\) See *Ohio Rev. Code Ann.* § 5725.18(B) (Anderson 1986).

\(^{91}\) McCulloch v. Maryland, 17 U.S. (4 Wheat) 316, 427 (1819).

\(^{92}\) See generally R. Epstein, *supra* note 28, at 283–305 (applying takings analysis to taxation).
Marshall's dictum might suggest is appropriate. Only when taxation has been intimately tied, not to individual rights, but to the distribution of power within the federal system has this pattern of judicial deference been broken. In the context of federalism, the inquiry takes much the same form as it did with foreign corporations: does the doctrine of unconstitutional conditions operate as an effective "second-best" backstop to enforce constitutional limitations on congressional power? I shall address the use of the doctrine to limit Congress' power to regulate the states under the taxing and spending powers, both as they existed before 1937 and, in far less important form, today. I shall postpone a discussion of unconstitutional conditions and tax policy in the areas of individual liberties until Part VIII.

In the Child Labor Tax Case, Congress imposed a tax equal to ten percent of the profits of any firm that employed child labor in certain specified businesses. The tax imposed in this case raises the paradox of unconstitutional conditions in the following fashion: Congress has the power to impose a general income tax equal to ten percent of the profits of any business; why, then, does this greater power not entail the lesser power to forgive that tax to anyone who chooses not to employ certain forms of child labor?

The answer lies in concern over the distribution of power between the state and federal governments. Before 1937, the commerce clause was understood not to confer upon Congress the power to regulate the "internal affairs" of the states. Hammer v. Dagenhart had struck down a federal statute that forbade the shipment of goods in interstate commerce from any plant that had used prohibited forms of child labor, whether or not the labor was used on the goods so shipped. Hammer treated the regulation as invading the reserved powers of the states as delineated under the tenth amendment to the Constitution: "The powers not delegated to the United States by the Constitution, ...

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93 See, e.g., McCray v. United States, 195 U.S. 27 (1904) (upholding a tax that discriminated against yellow margarine in favor of white margarine); Alaska Fish Salting & By-Products Co. v. Smith, 255 U.S. 44 (1921) (upholding a tax on fish produce that discriminated against the use of herrings); A. Magnano Co. v. Hamilton, 292 U.S. 40 (1934) (upholding a tax on butter substitutes alleged to discriminate against the oleo industry). The tendency continues apace today. See United States v. Ptasynski, 462 U.S. 74 (1983) (sustaining a windfall profit tax on crude oil that contained a geographically defined exemption for certain Alaskan producers).

94 259 U.S. 20 (1922).

95 Persons under the age of 16 were not to be employed in mines and quarries. Persons under 14 were not to be employed in mills, canneries, workshops, factories, or manufacturing establishments. Persons between 14 and 16 could be employed in such outfits only if they worked less than a prescribed number of hours. The statute also provided protections to employers who hired underaged workers in good faith. See Title XII, Revenue Act of 1918, ch. 18, Pub. L. No. 65-254, 40 Stat. 1138, 1138-39 (1919).

96 247 U.S. 251 (1918).

97 See id. at 274-76.
nor prohibited by it to the States, are reserved to the States respectively, or to the people."

Although *Hammer* was explicitly overruled in *United States v. Darby*, I believe that *Hammer* was correctly decided, for reasons that rest on the doctrine of unconstitutional conditions. The ability to regulate the shipment of goods in interstate commerce is tantamount to holding vast monopoly power over all the means of transportation—highways, rails, sea, and, today, air. The analogy to the private necessity cases is thus compelling. In essence the federal government in *Hammer* tried to use its monopoly power to extract concessions from private firms to conduct their manufacture and mining operations in accordance with standards set by Congress, at a time when it was conceded that Congress could not set standards for local employment by direct regulation. The ability to close down all modes of interstate transportation threatened to work an enormous redistribution of wealth from firms that were unwilling to comply with the restrictions to firms that were not. The statute in *Hammer* certainly had nothing to do with covering the costs of operating the interstate transportation system. If a robust form of either the takings or public trust doctrine had been applied to highways, this restriction itself would have been found invalid, wholly without regard to the commerce clause, because of its disparate impact on the rights of individual citizens: some would have gained enormously from the use of public roads, while others would have had huge portions of their gains stripped from them. But these individual rights arguments would have failed even in 1918, because the prevailing account of the police power gave broad latitude to the states to impose child labor laws.

Nonetheless, because concerns of federalism were very much alive at the time of *Hammer*, a transfer of power from the state to the federal government was subject to far greater scrutiny. The effect of the child-labor restriction on the interstate shipment of goods, a subject admittedly within the scope of the federal commerce power, was to induce all private firms to abide by the federal regulation. The

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98 U.S. Const. amend. x.
99 312 U.S. 100, 116–17 (1941).
100 See generally Epstein, supra note 2, at 1427–32.
101 See id. at 1423–24 & 1429 n.109.
102 See supra notes 34–36 and accompanying text.
103 For another case concerned with the balance of state and federal power, see *United States v. E.C. Knight Co.*, 156 U.S. 1 (1895). I have defended that decision in Epstein, cited above in note 2, at 1432–35.
104 Cf. *New York Cent. R.R. Co. v. White*, 243 U.S. 188, 207 (1917) (recognizing state authority under the police power to enact workmen's compensation laws). All states did have child labor laws in 1917, so that the issue in *Hammer* was whether the more stringent federal standard was preferable to the lower state standard applicable in North Carolina. *See* Epstein, supra note 2, at 1430–33.
gains that any firm achieved from the interstate sale of its goods were far greater than the gains it could hope to achieve by hiring child labor in violation of the federal statute, especially in light of the applicable state restrictions. To enforce the statute, then, was necessarily to bring about a "voluntary" acceptance of federal power. The doctrine of unconstitutional conditions is the necessary counterweight to the federal government's exercise of its monopoly power. Congress has the greater power to regulate interstate commerce and indeed to prohibit certain items from passing in interstate commerce at all. But in this instance, the greater power should not include the power to admit goods into interstate commerce subject to conditions that drastically shift the distribution of power within the federal system. 

\textbf{Hammer} reached the right result in striking down this statute while leaving the federal government the power to regulate the instrumentalities of interstate commerce with regard to matters pertaining directly to their use: the weight of certain shipments and the like, which are designed to prevent abuse of common assets by private users.

The \textbf{Child Labor Tax Case} raises the identical federalism issue as did \textbf{Hammer}, as Chief Justice Taft well understood. The only difference is that in the \textbf{Child Labor Tax Case} the federal government sought to condition its coercive powers to tax instead of its coercive power to regulate interstate commerce. The offer made was one that no firm could refuse, given that the marginal gains from using child labor in violation of the federal norm were no doubt far smaller than the ten percent tax on profits imposed by the statute. If this tax could have been applied, then similar taxes, with higher rates if necessary, could have been used repeatedly, thus obliterating any limitation on federal power. Chief Justice Taft tried to capture these concerns in the proposition that the federal government had the power to impose "taxes" but not "penalties" upon activities within the states. The language of penalty is troublesome, however, because taxes are as coercive as penalties, given that both are backed by the use of force. The effort to distinguish between them is designed to cast the case back into the familiar libertarian mode in which only force and fraud can set aside bargains, a model that is inadequate because it does not

\footnotesize{\textsuperscript{105} See, e.g., Champion v. Ames, 188 U.S. 321 (1903) (lottery tickets); Hipolite Egg Co. v. United States, 220 U.S. 45 (1911) (adulterated foods). It seems clear that the power to regulate under the commerce clause allows Congress to prohibit the transfer of certain goods in interstate commerce, such as infected foods that threaten interstate commerce itself. But it is far more doubtful, even in these cases, that Congress can either regulate or prohibit the shipment of goods in interstate commerce in an indirect effort to seize the police power within any given state. See Epstein, supra note 2, at 1422-25.}

\footnotesize{\textsuperscript{106} Cf. infra pp. 51-52 (describing conditions intended to minimize abuse of public highways).}

\footnotesize{\textsuperscript{107} See 259 U.S. 20 (1922).}

\footnotesize{\textsuperscript{108} See id. at 38-39.}
take into account all of the risks associated with government discretion. An account of the line between penalties and taxes might delve into matters of motive — was the exaction designed to raise revenue, or to discourage primary activity, or to do both? Generally, one may conclude that a tax has some ulterior motive if its expected revenues are zero, as was the case with the child labor tax. But whether we call this exaction a tax or a penalty is quite beside the point. The federal power to tax can be used to the same end as its monopoly position over the public highways: to frame offers that extract a disproportionate share of the gain from some firms engaged in interstate commerce. Because this was the case with the child labor tax, it should have been struck down, even if someone could have argued that the penalty characterization was somehow mistaken.109 The greater power to impose a ten percent tax on all profits does not threaten the system of enumerated powers the way the "lesser" power to tax selectively does.

Today, with the passing of *Hammer*, the issue in both child labor cases is moot. Since 1937, Congress has been acknowledged to have plenary powers of regulation over all aspects of the economy. Thus, what Congress was barred from achieving by indirection in *Hammer* and the *Child Labor Tax Case*, it can now achieve through direct regulation without constitutional impediment.

One exception to Congress' plenary economic regulatory power, however, concerns the powers given to the states under the twenty-first amendment, which provides: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."110 On the plausible assumption that this amendment reserves to the states the exclusive power over the transportation and shipment of intoxicating liquors within their borders, there would remain, even after the revolution of 1937, an area of commerce within the exclusive power of the state.

Nonetheless, *South Dakota v. Dole*111 held, by a 7–2 vote, that Congress could work a statutory end run around the twenty-first amendment. At issue in the case was title 23, section 158 of the United States Code, which allowed the Secretary of Transportation

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109 The decision to strike down this tax lends support to Madison's construction of the "spending power." See supra note 3. In the *Child Labor Tax Case* the government could have argued that the power to tax for the "general welfare of the United States" covered more territory than the commerce clause, and could certainly include the protection of young workers across the United States. The failure of this argument makes sense only if the general welfare is limited to the other enumerated powers, which must have been Chief Justice Taft's assumption when he linked this case so closely with *Hammer*.

110 U.S. CONST. amend. XXI, § 2.

to withhold up to five percent of the otherwise allocable federal funds for highway construction from states "in which the purchase or public possession ... of any alcoholic beverage by a person who is less than twenty-one years of age is lawful." South Dakota's law allowed 19-year-olds to purchase 3.2% beer. Upholding the federal provision, Chief Justice Rehnquist, speaking for the Court, held that even if the twenty-first amendment prohibited Congress from directly regulating the age of beer drinking, Congress could do so indirectly through the use of its spending power.

Chief Justice Rehnquist's opinion is unsatisfying. The Court noted the many occasions on which Congress had been able to attach conditions to the receipt of federal funds. Where such conditions do not involve any efforts by Congress to expand its effective power, however, these provisions are easily distinguishable. Where the conditions involve powers reserved to the states under the tenth amendment, the Court has traditionally required that the federal government show a sufficiently compelling interest to override the state interest. The danger that Congress will leverage its broad spending

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112 23 U.S.C. § 158(a)(1) (Supp. III 1985). The five percent restriction was for fiscal year 1986. For succeeding years the figure was ten percent. See id. § 158(a)(2).

113 See 107 S. Ct. at 2796. Chief Justice Rehnquist then set out the rules determining the scope of Congress' spending power: that its “exercise be in pursuit of ‘the general welfare,’” (although courts should defer to Congress' determinations of what expenditures promote the general welfare); that the federal government give fair notice to the state of conditions attached to receipt of federal grants; and that such conditions not be “unrelated to the federal interest in particular national projects or programs.” 107 S. Ct. at 2796 (quoting Massachusetts v. United States, 435 U.S. 444, 461 (1978) (plurality opinion)). The first condition has been rendered trivial by the present broad construction of the "general welfare." See supra note 3. Nor is there any reason to give discretion to Congress in defining the scope of its own powers. The notice requirement is trivial because statutes can be made clear, although individual statutes may fall far short of the clarity required. See, e.g., Pennhurst State School & Hosp. v. Halderman, 451 U.S. 1 (1981) (holding that a grant of federal funds to state facilities for the disabled was not conditioned on the state's willingness to upgrade facilities). In this case, everything turns on the validity of the condition. All the other points are preliminary asides.

114 See 107 S. Ct. at 2796.


116 See, e.g., Oklahoma v. Civil Serv. Comm'n, 330 U.S. 127, 143 (1947). The applicable statute there provided that:

[N]o officer or employee of any State or local agency whose principal employment is in connection with any activity which is financed in whole or in part by loans or grants made by the United States or by any Federal agency shall ... take any active part in political management or in political campaigns.

powers to subvert the twenty-first amendment is as great as the danger that it will leverage its power to subvert the tenth amendment, and should be met with the same judicial response. The state, in its effort to decide whether or not to accept the condition, has to decide whether it values the loss in federal revenues more than it values its own independence in setting the minimum age for liquor consumption. In principle, if Congress has the power to reduce highway revenues to the states by five or ten percent, there is no reason why it could not exclude any state from participation in the program by cutting off its revenues entirely. The power of discretion therefore allows the federal government to redistribute revenues, raised by taxes across the nation, from those states that wish to assert their independence under the twenty-first amendment to those states that do not.

Chief Justice Rehnquist conceded in effect that the doctrine of unconstitutional conditions had to apply to the spending power when he noted that:

[A] grant of federal funds conditioned on invidiously discriminatory state action or the infliction of cruel and unusual punishment would be an illegitimate exercise of the Congress' broad spending power. But no such claim can be or is made here. Were South Dakota to succumb to the blandishments offered by Congress and raise its drinking age to 21, the State's action in so doing would not violate the constitutional rights of anyone.117

His defense, however, misses the essential point, because the doctrine of unconstitutional conditions is not limited to the protection of individual rights against encroachment by government power. So long as the twenty-first amendment identifies structural limitations upon federal power, the doctrine of unconstitutional conditions should ensure that these limitations as well are not overridden by the vast discretionary power of the federal government over the distribution of its general revenues. The need to control federal power is not limited to cases of common law coercion, given the risks of strategic behavior so evident in Dole. As with the Child Labor Tax Case, the relevant

Darby, 312 U.S. 100, 124 (1941), sustained the statute on the ground that the tenth amendment is a truism. See 330 U.S. at 143. The case is far harder if the tenth amendment is construed as an effective limitation on federal power. This particular statute should be sustained against the challenge of unconstitutional conditions because it is designed to protect the United States against abuses by recipients of federal moneys. It is therefore parallel to a rule preventing private parties from obstructing public highways. The case would be quite different, however, if the statute provided that all state officials had to abide by this restriction if any state program received federal moneys. Then the overreaching by the federal government would become the greater abuse. This "relatedness" requirement as a limitation on the scope of conditions that the federal government may impose also crops up in the police power cases, see infra pp. 63-64, and the employment cases, see infra pp. 69-70.

117 107 S. Ct. at 2798.
question is not the desirability of regulations the federal government seeks indirectly to impose. It is rather the proper demarcation of the division of powers between separate sovereigns.

V. PUBLIC ROADS AND HIGHWAYS

If the federal government has always had an "effective legal monopoly over the instrumentalities of interstate transportation, then similarly state governments have long enjoyed a powerful local monopoly over public highways and roads. It should come as no surprise, therefore, that the doctrine of unconstitutional conditions also emerged in cases where the state demanded the release of constitutional rights as the price of access to public highways. Frost & Frost Trucking Co. v. Railroad Commission118 shows the halting and ineffective development of the doctrine in the context of classic state economic regulation. City of Lakewood v. Plain Dealer Publishing Co.,119 decided this past Term, raises parallel issues in a first amendment context, thus resulting in a more forceful application of the doctrine. The framework of analysis is similar in the two areas, even if the protected constitutional rights differ. The first inquiry is to determine the extent of the government's monopoly power in its control of public highways. The second inquiry is to determine the extent to which the conditions imposed upon entry or use are designed to upset the competitive balance between rival users. The third inquiry, which is the flip side of the second, is to determine whether the restrictions in question are designed to control against opportunistic behavior by individual citizens in their use of the common pool asset, the public roads.

A. Economic Regulation and Frost Trucking

In 1917 the California Railroad Commission received the power to regulate the rates and charges of the common carriers who used California public highways.120 A common carrier — one who carried the goods of all comers over public highways for a fee — could gain access to the public highways only after first obtaining a permit from the Commission certifying that its business was for the "public convenience and necessity."121 In 1919 the Commission's statutory powers were extended to cover transportation companies that were not common carriers.122 Frost Trucking, which had a private contract to

118 271 U.S. 583 (1926).
121 Id. § 5, 1917 Cal. Stat. 333.
transport citrus fruit for a single supplier, fell into this last category, but it refused to apply for the required permit and was then ordered by the Commission to suspend its operations. The Commission's decision was upheld by the California Supreme Court. Justice Sutherland wrote:

That court, while saying that the state was without power, by mere legislative fiat or even by constitutional enactment, to transmute a private carrier into a public carrier, declared that the state had the power to grant or altogether withhold from its citizens the privilege of using its public highways for the purpose of transacting businesses thereon; and that, therefore, the legislature might grant the right on such conditions as it saw fit to impose.

In Justice Sutherland's words, the California court was willing to allow private carriers access to public roads only if they dedicated their property to the "quasi-public use of public transportation."

The stage was set for the familiar unconstitutional conditions argument. Justice Sutherland assumed arguendo that the state could admit or exclude persons at will from the use of public highways. Then, however, by analogy to the foreign corporation cases, he held "that it may not impose conditions which require the relinquishment of constitutional rights" — in this instance the right of a private carrier not to be compelled to assume the duties and burdens of a common carrier against its will. So stated, the argument proceeds at a very high level of abstraction and is subject to the standard objections based upon the "greater and lesser power" theory that lay at the root of Justice Holmes' general opposition to the doctrine, and to his dissenting opinion in this case. If an individual values his constitutional rights less than he does the privilege that the state is offering, then why not allow the bargain to go forward? Persons have a constitutional right to keep property, yet they surrender it all the time in order to obtain alternative goods that they value more highly. Why not here?

The proper analysis of the case begins with its historical context. The initial problem is the now familiar one of the adequacy of "second-best" response to government discretion. The doctrine of unconstitutional conditions becomes necessary only after it is settled that a state has the absolute right to exclude private firms from use of the high-

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123 See 271 U.S. at 590.
124 271 U.S. at 591.
125 Id.
126 Id. at 594.
127 See id. at 593.
128 See supra notes 10 & 14.
129 See 271 U.S. at 601 (Holmes, J., dissenting).
way. That conclusion was dictated by *Buck v. Kuykendall*, a precedent established one year before *Frost* was decided. *Buck* had invalidated, under a dormant commerce clause analysis, regulatory restrictions upon interstate service between Seattle and Portland. Nonetheless, this part of *Buck* did not apply to *Frost*, which concerned purely intrastate movement (as the words were understood before 1937) on state highways, and was therefore beyond the scope of the commerce power. Without the element of interstate commerce, *Buck* gave the states unfettered discretion to deny common carriers access to the highways:

The right to travel interstate by auto vehicle upon the public highways may be a privilege or immunity of the citizens of the United States. A citizen may have, under the Fourteenth Amendment, the right to travel and transport his property upon them by auto vehicle. But he has no right to make the highways his place of business by using them as a common carrier for hire. Such use is a privilege which may be granted or withheld by the State in its discretion, without violating either the due process clause or the equal protection clause. The highways belong to the State. It may make provision appropriate for securing the safety and convenience of the public in the use of them.

The phrase "a privilege which may be granted or withheld by the State in its discretion" recalls the assertion of state power over foreign corporations justified by the Court in *Paul v. Virginia*. So too does the short shrift given to the privileges and immunities clause. The bald conclusion that "the highways belong to the State" does not begin to address the question of how their use should be allocated among the various members of the public. Yet it is just that question that the doctrine of unconstitutional conditions must address. To allow the state the power to exclude or admit at will from public highways raises the problems of externalities and strategic bargaining with

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130 267 U.S. 307 (1925).
131 Justice Brandeis' reasoning in *Buck* was cryptic. See *id.* at 324 ("The federal-aid legislation is of significance not because of the aid given by the United States for the construction of particular highways, but because those acts make clear the purpose of Congress that the state shall be open to interstate commerce."). Nonetheless, the result was correct, for the alternative opens up enormous potential for strategic behavior by the states, which would be able to prevent all out-of-state common carriers from using any in-state road built without federal support. Had *Buck* gone the other way, then, short of congressional intervention, interstate business would be subject to all the intrigue and retaliation that surrounded the legislation at issue in *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 4-5 (1824), and that finds expression today in the politics of landing rights in international aviation. *Buck* and its companion case, *Bush Co. v. Maloy*, 267 U.S. 317 (1925), which held that states could not exclude interstate commerce even from roads constructed solely with state funds, are thus uncelebrated but critical decisions that preserved a unified national market after the coming of automotive transportation.

132 267 U.S. at 314 (citations omitted).
133 75 U.S. (8 Wall.) 168 (1869); see *supra* p. 32.
which the doctrine is concerned. Those whose entry is subject to selective conditions are at a competitive disadvantage to their rivals, while the bargaining range for use of the roads between the state and any individual citizen is very broad. Political discretion over licenses can only encourage the dissipation of valuable resources to achieve partisan advantage. The same numerical illustrations presented in discussing the foreign corporation cases apply without change in this context.\textsuperscript{134}

The object of a sound highway system is to maximize the gains that are attainable from use of the public roads. That goal is attainable only if the selective power of admission to the roads is curtailed — an equal protection concern — and if the state revenues from the highways are limited to its costs of running the system — a takings or due process objective. What should be flatly prohibited is the covert redistribution of wealth between private parties in the funding and utilization of public roads by imposing unequal exactions for equal benefits. These rules are hardly novel, even at the constitutional level, for they found expression in the special assessment cases for funding local improvements, including roads and sewers, that routinely came before the Supreme Court under the due process clause between the end of the Civil War and the beginning of World War I.\textsuperscript{135}

Although the proper doctrinal rules here would deny the state the absolute power to admit traffic to or exclude it from the public road, Justice Brandeis' dictum in Buck set the stage for Justice Sutherland in Frost to use the doctrine of unconstitutional conditions as the next-best alternative. To his great credit, Justice Sutherland recognized the importance of market structure even in this context and accepted the dominance of the competitive equilibrium as a constitutional principle, despite the state's monopolistic control over the roads:

It is very clear that the act, as thus applied, is in no real sense a regulation of the use of the public highways. It is regulation of the

\textsuperscript{134} See supra note 50 and accompanying text.


These cases held that the due process clause imposed some limitations on the funding devices that the state could use to finance local improvements, including local roads. In each case the total sum to be raised by taxes was limited to the cost of building the road in question: excess moneys could not be siphoned off into general revenues. The difficult question was finding the right formula to match costs with benefits once redistribution was in principle ruled out of bounds. Individualized (plot by plot) assessments of benefits were costly to make, and unreliable to boot. Yet automatic rules — such as assessment by front footage — could be unreliable because they missed large pockets of subjective gain in individual cases. In large measure this choice between rival benefit rules asks which set of errors is more debilitating, so that the state has some discretion in the choice of benefit formula as long as a consistent formula is used throughout.
business of those who are engaged in using them. Its primary purpose evidently is to protect the business of those who are common carriers in fact by controlling competitive conditions. Protection or conservation of the highways is not involved.\textsuperscript{136}

Justice Sutherland therefore struck down the condition that the state tried to attach to the use of the roads. California could exclude Frost from the use of the highways altogether, but it could not condition its entry upon the company's willingness to assume the burdens of a common carrier. Here the right in question might have one of two sources. First, the right to enter into ordinary contracts for the carriage of goods could be regarded as a form of property protected by the takings clause. Alternatively, the right protected could be regarded as falling within the fourteenth amendment right to engage "in the common occupations of the community."\textsuperscript{137} The doctrine is of broader scope in the first instance than it is in the second, but both apply to the instant case. The effort to condition entry to the highways on the sacrifice of the right to remain a private carrier imposed a disproportionate burden on Frost, and would have worked an implicit transfer to the common carriers with which it was in competition.

The decision in \textit{Frost} gives some indication of the type of conditions the state might be able legitimately to impose upon highway use. The clue comes from Justice Sutherland's reference to the "protection and conservation of the highways," and builds upon concerns about externalities and strategic behavior. Thus, the state can impose taxes and rules that are designed to promote the smooth flow of traffic, to prevent accidents, to resolve tort actions, and to ensure that individuals have to answer for their wrongs. These rules are necessary to prevent the exploitation of a common pool resource by its users. To be sure, these rules condition access to the roads upon the consent of the users, but the consent is for conditions that are justified by the need to curtail opportunistic behavior by the road users.\textsuperscript{138} Similarly

\textsuperscript{136} 271 U.S. 583, 591 (1926).
\textsuperscript{137} See, e.g., \textit{Truax v. Raich}, 239 U.S. 33, 41 (1915) ("It requires no argument to show that the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was the purpose of the [Fourteenth] Amendment to secure.").
\textsuperscript{138} Cf. \textit{Hess v. Pavloski}, 274 U.S. 352 (1927). The statute at issue in \textit{Hess} allowed out-of-state individuals to be sued for accidents that they caused within the state. Under the statute the implied consent is limited to proceedings growing out of accidents or collisions on a highway in which the non-resident may be involved. . . . It makes no hostile discrimination against non-residents but tends to put them on the same footing as residents. Literal and precise equality in respect of this matter is not attainable; it is not required.

\textit{Id.} at 356. The case is an easy one, given the user exploitation that the statute seeks to curtail. However, the opposite result would be required if users of the state's roads were required to submit to the jurisdiction of the state's courts in any case brought by the state's residents.
the state should be able to impose a system of weight restrictions (to control wear and tear), or tolls (to alleviate congestion). These are the kinds of conditions that would be imposed by the private owner of a road for his own benefit and for that of his customers. Such conditions closely parallel the incorporation rules on service of process and capitalization.\footnote{See supra p. 29.}

It still remains to inquire how successful Justice Sutherland's invocation of the doctrine of unconstitutional conditions proved in controlling abuses of the state's power to control public highways. In order to answer that question, it is necessary to distinguish between two sets of cases. The first class involves situations like \textit{Frost}, in which the state seeks to limit access to the system of public roads through general economic regulation. The second involves the potential release of certain constitutional rights, such as the right to vote, to speak, to practice one's religion, to resist unreasonable search and seizures, and (perhaps) even to hold property without fear of confiscation.

On the economic issues, the unconstitutional conditions doctrine of \textit{Frost}, in sharp distinction to the foreign taxation cases, has had little favorable effect in practice. Initially, Justice Sutherland regarded \textit{Frost} as a kind of takings case (for a quasi-public use), because private carriers were subject to the regulation thought appropriate to common carriers.\footnote{See 271 U.S. at 591.} But even as he applied the doctrine, he gutted its power. Justice Sutherland allowed the possibility that private carriers should themselves be "subject to regulations appropriate to that kind of carrier,"\footnote{Id. at 592.} without indicating what they might be or what ends they might serve. It hardly seems worth the fuss to invoke the doctrine at all if private carriers can be regulated by independent commissions and forced to endure conditions and restrictions so onerous that they cannot compete with common carriers.

\footnote{Today private carriers, called "contract carriers," are regulated in much the same fashion as common carriers. They are, for example, subject to regulation on maximum and minimum rates, \textit{see}, e.g., \textit{CAL. PUB. UTIL. CODE} §§ 3501–3800 (West 1975 & Supp. 1988), and to strict licensing requirements, \textit{see}, e.g., id. § 3571.}

The standard for obtaining a permit in California is no longer based on public convenience and necessity, but upon a showing of financial responsibility satisfactory to the public utilities board. Moreover, "[t]he commission may attach to the permit such terms and conditions as, in its judgment, are required to assure protection to persons utilizing the operations." \textit{Id.} § 3572. In practice \textit{Frost} seems to have been read so narrowly as to have no practical effect on the course of the process of regulation. One California court, for example, declared: "It is obvious that the interests of the general public, as well as those of the trucking industry, are promoted by the establishment of fair and uniform rates which tend to give stability to the industry, and to protect operators against unfair and destructive competition." \textit{Orlinoff v. Campbell}, 91 Cal. App. 2d 382, 387, 205 P.2d 67, 70 (1949). The case then quoted from the California decision in \textit{Frost}, without referring to the Supreme Court case that reversed it.
If this regulatory option remains, then the state will not respond to the all-or-nothing requirement by choosing all, as it would in the foreign incorporation cases. Local political considerations are such that total exclusion of many potential commercial users of the highway often will prevail. We need think only of the airport transportation monopolies that are jealously protected by state regulations, or of private buslines and jitneys that have routinely been kept off city streets. The power of state selection within classes of carriers and between classes of carriers was hardly curtailed at all by Frost. The right expression of the unconstitutional conditions doctrine would be far more restrictive: the state is under no duty to build public highways, just as it is under no duty to charter corporations; if it does build public highways, however, then all persons should have equal access to them, and the state powers of regulation and taxation should be directed to the sole end of preventing particular users from externalizing the costs of their own operations upon the other users of the system. Frost provided a weak imitation of the desired rule, because it did not attack head-on, under either a takings or public trust rationale, the state's claim of absolute ownership of the highway.

Nonetheless, Frost created a valuable legacy in the second class of cases, which involve the kinds of suspect classifications and fundamental rights that are now closely scrutinized under the footnote-four rule of Carolene Products v. United States. In principle the state could bargain for any number of ends. Justice Sutherland recognized that each person acting by himself would have a strong incentive to sacrifice other protected rights in order to get the greater short-term benefit of being able to use the roads. He thus invoked in Frost earlier language from Western Union Telegraph Co. v. Foster, to the effect that a state could not use its control over public streets to regulate the messages that telegraph companies wished to send. He also worried about the parade of horribles that might arise if the state could use its power to:

impose conditions which require the relinquishment of constitutional rights. If the state may compel the surrender of one constitutional right as a condition of its favor, it may, in like manner, compel a surrender of all. It is inconceivable that guaranties embedded in the

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143 304 U.S. 144 (1938). See generally Ackerman, Beyond Carolene Products, 98 HARV. L. REV. 713 (1985) (dissecting the naïve interest-group politics behind footnote four); Miller, The True Story of Carolene Products, 1987 SUP. CT. REV. 397 (giving the unhappy special interest history of the actual restrictions on filled milk upheld by the Court).
144 247 U.S. 105 (1918).
145 See id. at 114.
Constitution of the United States may thus be manipulated out of existence.\textsuperscript{146}

Justice Sutherland's concern is proper, even though his use of the term "compel" obscures the difference between the state's bargaining strategies and the state's outright use of force. The real danger is not coercion, but a collective action problem, hinted at by the word "manipulated." Voting rights, for example, may be of little value to any given individual, who would surrender them gladly for a right to do business on public highways. If many individuals did so, the combined effect would be to ensure a structural tyranny and the loss of many other liberties. State officials who push this deal are not selling things that they own. They are selling "things"—for example, access to roads—that belong to the public at large. Their success may be aided by the classical prisoner's dilemma, in which many unorganized users of the public highways find themselves. If all users could contract in advance, none would release his right to vote. The imposition of a rule that prevents the state from making certain bargains limits the power of the dominant coalition or faction within the state to engage in strategic threats to capture the private surplus from the use of the public highways. Although public officials may still act in breach of trust, they cannot obtain as much for their pains, because they possess fewer credible threats against citizens. Once the state cannot impose restrictions on fundamental rights upon those who want to gain access to the highways, then, in this context at least, it cannot impose them at all, for any such restrictions imposed directly would fall before particular constitutional commands. It makes no difference whether we talk about the state's threats to remove access to the roads ("coercion") or its promises to grant access to them ("benefit"). Whatever the nominal baseline, the strategic games are always destructive of the social fabric. The potentially catastrophic holdout problems of treating the state as the absolute owner of the public highways are dramatically moderated even by a restricted doctrine of unconstitutional conditions.

B. Freedom of Speech and the Highways: Lakewood

The doctrine of unconstitutional conditions as generalized in \textit{Frost} involved access to public highways for economic uses. \textit{Frost} was decided when the Court still afforded moderately strong constitutional protection of economic liberties, as shown by its willingness to probe into the state's asserted police power justification. With the waning of judicial concern with economic affairs, the regulatory issues raised in \textit{Frost} dropped out of later cases. At the same time, \textit{Carolene}
Products and its progeny dictated a higher level of scrutiny for legislation impinging upon fundamental rights or employing suspect classifications. The doctrine of unconstitutional conditions migrated with the flow, and thus became entwined with modern issues of religion, speech, and equal protection.

The public highway cases were thus transformed into the "public forum" cases, and the renewed level of higher scrutiny once again proceeded from a presumption of distrust of legislative and executive behavior. Before this new orientation was adopted, there was some judicial support, again voiced by Justice Holmes, for the categorical position that the state owns the highway or park and therefore can exclude speakers at will. But this absolutist position quickly fell when it was decided that state title to the public highways did not allow it to bar the distribution of literature, or to subject it to any special prior restrictions, license tax, or permits. The end run tolerated in the context of economic regulation would not be allowed here.

This welcome retreat from the principle of absolute public ownership limits the need for the doctrine of unconstitutional conditions, but does not render it entirely unnecessary. There is often a capacity limitation — if not for lonely leafleters on public roads and streets, then surely on public fairgrounds — that becomes critical as the demands on public space rise. Someone has to decide who will gain access and who will not. Given the level of scrutiny applied to such decisions, the issue of unconstitutional conditions should have been expected to reappear in the modern context of the public forum, and it did, in last Term's decision in City of Lakewood v. Plain Dealer Publishing Co.

Lakewood's ordinance gave the town mayor the discretion to decide which newspaper companies would receive annual, nonassign-
able permits to place its newsracks on public property. The decision was to be made after considering a range of factors, including the approval of the rack's design by the Architectural Board of Review, the willingness of the permittee to obtain insurance that would hold the city harmless for all liability arising from the use of the newsrack, and "such other terms and conditions deemed necessary and desirable by the Mayor." The issue of unconstitutional conditions arose when it was urged that the City was under no obligation to allow any newsracks at all on public streets, and could therefore make the right to place racks on public roads subject to whatever conditions the City wished to impose.

*Lakewood* differs from *Frost* in two ways. First, in this context city ownership of the public streets gives government far less monopoly power than was involved in *Frost*. While the public roads are the only available means of transportation, newspapers can be sold by subscription or in stores. The government power therefore is somewhat attenuated. Yet by the same token, it is by no means trivial, especially because some papers (such as those distributed without charge) rely heavily upon newsrack distributions. The scope of government power, although not absolute, is still large enough to give it substantial monopoly power. There is reason therefore to invoke the doctrine of unconstitutional conditions. Second, unlike the statute in *Frost*, Lakewood's ordinance contained no explicit requirement that the newspaper waive any constitutional right. It was not asked to agree to mayoral censorship as a condition for placing its racks on the public streets. Nonetheless, the wide level of discretion conferred upon the mayor raised the possibility that he would seek to impose a condition that would require the waiver of first amendment rights, such as softening opposition to one of the mayor's pet projects. The possibility that some papers might consent to this *sub rosa* condition could induce others to follow suit. The power to select who shall stay and who shall go made it possible for the mayor to prefer newspapers that supported his policies and to deny permits to those that opposed them, and the prospect of such mischievous behavior was far more troubling than a simple rule totally banning newspaper racks from the public street.\(^{153}\)

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\(^{153}\) Cf. Police Dep't v. Mosley, 408 U.S. 92 (1972) (invalidating a city's ban on all forms of picketing except those regarding a labor dispute). The case did not explicitly rest on the doctrine of unconstitutional conditions, and indeed the Court attached little weight to the fact that the Mosley's picketing took place on the public highways. Instead the Court undertook a combined first amendment and equal protection analysis which attacked the ordinance because it distinguished among different types of speech by subject matter. See *id.* at 95–96. The subject matter distinctions gave the state officials more discretion than the simple all-or-nothing ban on picketing, but far less than that contemplated by Lakewood's statutory scheme. *Mosley* thus
The sound first amendment limitations on discretion do not, however, answer all the questions of what newsracks, if any, must be placed upon public property. Surely the first amendment does not require that any newspaper company be allowed to place its racks on public property at will, without paying any fee at all. Public streets and roads are still a form of commons, and one risk associated with the maintenance of any commons is its overexploitation by private users who do not fully take into account the costs that their own behavior imposes upon other members of the public. Strategic behavior by the mayor is only one form of abuse; excessive use by the newspaper companies must be reckoned with as well, which is why decisions preventing excessive noise and other similar nuisances have survived to the present day, under the rule that allows for appropriate "time, place and manner" restrictions.154

Because of this dual hazard, there is surely some reason to allow the City to restrict the number of newsracks on public property, and perhaps even to confine them to certain locations within the town. Lakewood did not pass, for example, on whether a total ban on newsracks in residential areas would be constitutional. There is, of course, the risk that restrictions on the locations and number of newsracks could also be more severe than appropriate. Such a restriction might be attacked in extreme cases — for example, if the ordinance restricted all newsracks in order to punish one particular newspaper. Yet a facial attack on such a statute is surely out of place; some concrete evidence of official misconduct should be required. More generally, there comes a point at which the capacity to control government abuse diminishes, while the gains from controlling that abuse are small. Then it is time to quit, under the first amendment just like anywhere else. The simple rule that the town can determine the number and location of newsracks, but must allocate them by some nondiscretionary means goes a very long way toward controlling the most obvious forms of abuse.

It is instructive to note that the first amendment principles applicable in this case are drawn from those developed in connection with the economic liberties cases. The concern with conditional admission to the roads that animated Frost had to do with implicit redistribution represents the hard intermediate case. The strongest argument for sustaining the Court's position is that there is so little that can be offered to justify the ban. See generally Stone, Restrictions of Speech Because of Its Content: The Peculiar Case of Subject-Matter Restrictions, 46 U. Chi. L. Rev. 81 (1978) (exploring the relationship between subject-matter based and viewpoint-neutral regulation of speech). Note that Mosley becomes an unconstitutional conditions case if the use of the public road is conditioned on the willingness not to picket in nonlabor cases. Similar issues arise in the veterans' exemption context. See infra pp. 77-79 (discussing Regan v. Taxation with Representation, 461 U.S. 540 (1983)).

154 See, e.g., Kovacs v. Cooper, 336 U.S. 77 (1949) (plurality opinion).
of wealth among separate common carriers, and across different sectors of the trucking business. The restrictions against excessive weight and the like were routinely allowed in order to control against the exploitation of a common resource by a single user. If that economic model had applied, *Lakewood* would have come out the same way even without resort to first amendment principles. Indeed under the economic liberties framework, it would not be enough to guard against the possibility of favoritism to firms within the class of newspapers. It would also be necessary to worry about a reciprocal risk: whether newspapers as a class received a subsidy from the rest of the public at large in the form of below-market rents of public space. That additional constraint would be very hard to administer because there is no strong economic theory that determines the optimal level of newsracks to be allowed on public property. The theory would, however, suggest that once the number of spaces was determined by political means, their allocation to individual newspaper companies would have to take place by bid, just as in the common carrier case. Within the first amendment framework, the bid system seems clearly acceptable. But now other systems may be allowed as well. A lottery may not guarantee the most efficient use of public space, but it does eliminate (ex ante) redistribution among newspapers. A system that takes the total number of spaces and divides it by the number of applicants does the same thing, but may give a boost to papers with smaller circulations that a bidding system would not. The critical point is that the first amendment analysis of highway use generally, and the unconstitutional conditions analysis more concretely, proceed on identical terms as the previous analysis of *Frost*. The demise of economic liberties means in essence that we have to worry about only one form of error, the imposition of undue restrictions, but can ignore implicit subsidies to the newspaper companies. Government misconduct probably has far greater impact in the context of road regulation than it does in the context of speech. But whatever the Court's shortcomings in its protection for economic liberties, *Lakewood* itself is a welcome and correctly decided case.

VI. THE POLICE POWER

Skirmishes over the doctrine of unconstitutional conditions have recently arisen in connection with the state police power, most notably in *Posadas de Puerto Rico Associates v. Tourism Co.* and *Nollan v. California Coastal Commission*. In order to set the stage for its

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use in this context, it is necessary first to give some brief account of the police power generally.\textsuperscript{157} The police power addresses the set of justifications that the state must put forward in order to override any of the substantive protections of the Constitution. Some recognition of the police power justification seems to be necessary if we are to make any sense of the Constitution at all. It is difficult to conceive of a defense of private property so absolute that ownership of a handgun allows its owner to kill or maim at will, or a defense of freedom of speech so pure as to countenance securities fraud or perjury. One possible account of the police power therefore allows the state to override explicit constitutional guarantees when necessary to protect other persons from the threat or use of force or fraud. The relevant restrictions are often prospective in application, like a ban on the sale of firearms or the ban on printing a false prospectus. Typically, the states and their subdivisions have a monopoly over the use of the police power, creating a risk that exercise of this power will go beyond its stated purpose, and will be used to cloak protectionist efforts to raise the cost of entry of firms and individuals into what would otherwise be competitive markets. The effort to sort out appropriate police power measures from inappropriate ones typically requires an analysis of the "fit" between the ends to be served and the means to be used. The effective scope of the state power depends heavily, therefore, on the applicable level of scrutiny. So long as the perils of both overregulation and underregulation are about the same level of magnitude, some "intermediate" level of scrutiny seems appropriate.\textsuperscript{158} This analysis is perfectly general, and explains why in practice limitations on the police power must arise from the property, speech, contract, religion, and equal protection guarantees of the Constitution.

Under current doctrine, the police power is typically afforded a construction that covers far more than the suppression of force and fraud, especially in land use cases, and, to a lesser extent, in commercial speech cases. In essence, the state is allowed to regulate in ways that are thought generally to advance the public good, and a very low level of scrutiny is applied both to the ends sought and to the connection between means and ends. In land use cases, the police power was extended far beyond the nuisance control rationale at least as early as \textit{Euclid v. Ambler Realty Co.}\textsuperscript{159} Today, it has been broadened still further to allow states to regulate levels of population growth, to force towns to provide some minimum percentage of low-

\textsuperscript{157} For a longer discussion, see R. \textsc{Epstein}, cited above in note 28, at 107–45.


\textsuperscript{159} 272 U.S. 365 (1926).
income housing, to set rents, or to pursue aesthetic ends. Yet even this broad construction of the police power does not give the state ordinary ownership rights over the property that it may restrict or regulate. Even today, the state could not pass a statute making it the owner of all development rights in property, which it could then turn around and sell for cash. But even subject to this important caveat, the use of the relaxed, rational basis standard of review necessarily increases the scope of government discretion, and thus opens the door to the perils associated with government monopolies. As before, the question arises whether the doctrine of unconstitutional conditions can control the risks of so expansive an account of government power. We turn first to land use, and then to commercial speech.

A. Land Use

Nollan v. California Coastal Commission illustrates how the generous contours of the police power in the land use context usher in a discussion of unconstitutional conditions as a second-best measure. The Nollans owned a small, dilapidated beach house that they wished to tear down and replace with a larger home. Under the prevailing construction of the police power, the Court assumed, the state could have prevented the construction of the new house absolutely, in order to preserve the public's "viewing access" over the Nollans' land from the public highways to the waterfront. The Commission announced that it was prepared to grant the Nollans the right to build on their land, and consequently the right to obstruct that view, if the Nollans would surrender a lateral, beachfront easement over their land for the benefit of the public at large. If the Nollans had accepted the deal, then the state would have gotten the easement without having to buy it for cash. However, it was also settled that this easement would have had to be purchased if taken by the government in a separate transaction. Similarly, it seems clear that the Coastal Commission, having only limited powers, could not have simply declared itself the owner of the development rights over the Nollans' land solely to sell it back to them for cash.

Within these contours, the question raised in Nollan was whether the state could force the Nollans to choose between their construction permit and their lateral easement. Justice Brennan argued that it could, resting his dissent on the model of the private bargain and

160 See, e.g., Agins v. City of Tiburon, 447 U.S. 255 (1980) (holding that a zoning ordinance restricting development of land to open space or low-density residential use is a valid exercise of police power).


162 See id. at 3147.

163 See id. at 3145.
implicit rejection of the unconstitutional conditions doctrine.\textsuperscript{164} If the state could ban construction of the new house entirely, then it could grant permission to construct on condition that the lateral easement be deeded over to the state.\textsuperscript{165} Justice Scalia, writing for the majority, invoked (in all but name) the doctrine of unconstitutional conditions to hold that this particular bargain between the state and two of its citizens was impermissible because the condition imposed — surrender of the easement — was "unrelated" to the legitimate interest used by the state to justify its actions — preserving the view.\textsuperscript{166} The question is who is right, and why.

One way to avoid the problem is to recognize that the scope of the police power gives the state far too much discretion even when it does not wish to bargain with citizens. Restrictions on height and bulk are unrelated to the prevention of any ordinary, common law nuisance, and can be obtained by neighbors (many of whom have built for themselves the very type of structures that they are trying to prevent others from building) only if they are able to purchase a restrictive covenant. There seems no reason why the state should be able to take for the public at large the same type of property interest that neighbors must buy. If so, then \textit{Nollan} need not even reach the unconstitutional conditions question. The state cannot force a citizen who owns two plots of land to choose which one to keep and which to surrender to the state, for imposing such a choice amounts to taking property without just compensation. The issue is no different when the landowner is put to the choice of encumbering his land with a restrictive covenant or a lateral easement. The choice the state puts to the citizen is no better than one which an uncommonly fastidious gunman puts by allowing his victim the choice between his watch and his wallet. Any sound delineation of property rights thus would vindicate the Nollans before even reaching the unconstitutional conditions question.

Once this first line of defense has been overcome, why the doctrine of unconstitutional conditions? Here its use is best explained by re-

\textsuperscript{164} Justice Brennan argued that:

The Coastal Commission, if it had so chosen, could have denied the Nollans' request for a development permit, since the property would have remained economically viable without the requested new development. Instead, the State sought to accommodate the Nollans' desire for new development, on the condition that the development not diminish the overall amount of public access to the coastline.

\textit{Id.} at 3152 (Brennan, J., dissenting) (footnote omitted). The clear implication is that the greater power of preventing development altogether includes the lesser power of allowing development subject to surrender of the demanded easement. Note, however, that Justice Brennan accepts the unconstitutional conditions doctrine in the speech and religion contexts. \textit{See infra} pp. 75–76 (discussing \textit{Speiser v. Randall}, 357 U.S. 513 (1958)); pp. 80–86 (discussing \textit{Sherbert v. Verner}, 374 U.S. 398 (1963)).

\textsuperscript{165} \textit{See 107 S. Ct.} at 3152 (Brennan, J., dissenting).

\textsuperscript{166} \textit{See 107 S. Ct.} at 3148.
verting to the basic social purpose behind the takings clause: to ensure that an interest in private property will pass into government hands only if it is worth more to the government, as representative of the public, than its market value in private hands.167 If the state has to purchase the lateral easement, this purpose is satisfied, because public officials have to raise the money to make the purchase. The protection so afforded is imperfect, however, because there is always the risk that one group (beach users) will be able to purchase the easement with money raised by taxes imposed upon the public generally. While the takings prohibition (unless extended to taxation)168 does not stop this particular form of political externality, it does at least ensure that a separate constraint against resource misallocation is observed. Making the payment requires an imperfect set of political institutions to take into account the very large losses that the single owner will suffer, losses that can be downplayed or ignored when payment is not required.

These institutional constraints against misbehavior tend, however, to break down if the state can link the fate of the lateral easement to the issue of visual access, as the Coastal Commission tried to do. The threat to impose development restrictions on the landowner does not require any budget appropriation by either California or the local municipality. If the losses that state regulation could inflict upon the owner are (as seems probable) far greater to the owner than the loss of a lateral easement, then there seems little prospect that the state's offer will be declined. Landowners will sacrifice an interest worth $1000 in order to preserve development rights that are worth a hundred times as much.169 Once this sequence runs its course, therefore, all we know are the relative values that the landowner attaches to his two separate interests. We do not know whether the value of the lateral easement to the state is greater than its value to the owner, because no accountable political party has been forced to make that explicit judgment. One central allocative function of the eminent domain clause is effectively bypassed by allowing the state to couple the lateral easement with the construction permit.

In this context, the doctrine of unconstitutional conditions limits the abuse of government discretion by severing the denial of the

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167 Ideally, the state should be required to pay not the market value, but the subjective value that the individual attaches to the property. Because the latter is difficult to determine, courts have moved to the market value standard. See, e.g., United States v. 546.54 Acres of Land, 441 U.S. 506, 511 (1979). The argument in the text, however, does not depend on which standard of private valuation is used.

168 See R. Epstein, supra note 28, at 283–305.

169 The point is not one of idle speculation, for the Nollans were the only parties to fight the Commission, while 43 other landowners had capitulated. See 107 S. Ct. at 3158 n.9 (Brennan, J. dissenting). The number would have been 44 if this constitutional challenge had not appeared viable.
construction permit from the taking of the lateral easement. This course of action is not without its dangers. It is quite possible that the easement will be purchased for cash (which is appropriate if the compensation levels are rightly set, although they often are not when severance damages are involved). It is also possible that the permit would be denied outright, so that people like the Nollans would be left worse off than they were when they could bargain away their rights. But in this case the empirical guess is that the government, as in the foreign incorporation cases, will choose not to exercise its greater power. Imposing the building restrictions necessarily deprives the community of the increased taxes generated by his new residence, which probably will not increase the demands on public facilities by the same amount. The groups who are interested in lateral access may be far less interested in visual access, so that the coalition pressuring for visual access will disintegrate when the two issues are separated. Chances seem good that the "public" at large would not want this permit restriction in and of itself. The severance therefore calls the bluff of the Coastal Commission by preventing it from parlaying a threat of something that interest groups do not want into the acquisition of something they do want — for free. The "relatedness" requirement imposed by Justice Scalia thus has powerful functional roots, for it narrows the size of the bargaining range and hence reduces the state's ability to extract concessions from individual owners by coordinating separate types of government initiatives.

The necessary prerequisite for undertaking this inquiry is that the takings clause limits the permissible level of redistribution between the public at large and landowners. Under the traditional rational basis test, that concern is so weak that state power (including the power to bargain) would remain unbridled. It is therefore no accident that Justice Scalia's implicit invocation of the doctrine followed a more general assertion that the deferential rational basis review does not carry over from equal protection to takings cases. Even within Justice Scalia's formulation of the problem, the government's broad discretion over the nature and type of height, square footage, and exterior design regulations introduces various opportunites for abuse that a more rigorous account of the police power would preclude. But within very rough limits this invocation of unconstitutional conditions does have bite. With Nollan in place, the state cannot insist that the landowner deed over an easement in order to get an electrical hook-up for his house. In a cautious second-best sense, Nollan is a fit case for using the doctrine. But it is a far cry from the best

170 See supra pp. 35-38.
171 See 107 S. Ct. at 3147 n.3 (contesting Justice Brennan's advocacy of a rational basis test).
solution, which is a return of the police power to its traditional confines.

B. Commercial Speech and the Morals Head of the Police Power

A similar police power problem can arise in the first amendment context. In *Posadas de Puerto Rico Associates v. Tourism Co.*, Puerto Rico wished to encourage tourists to come to Puerto Rico to gamble. It did not make gambling illegal for local citizens, but it did prevent any local advertisement of gambling on the island proper, leaving Posadas, a Holiday Inn franchisee, free to advertise its gambling facilities on the mainland. It was conceded that the control of gambling fell within the traditional "morals" head of the police power of the state, so that the state could have made gambling illegal had it so chosen. In upholding the statute, Justice Rehnquist implicitly rejected the doctrine of unconstitutional conditions when he argued that Puerto Rico's plenary power to ban gambling itself gave it the lesser power to license gambling, subject to the condition that the licensee accept a ban on local advertisement — itself a limitation on a first amendment right. Do first amendment principles require that such advertisements be tolerated, given the decision to allow the gambling itself? Where the advertising was neither misleading nor fraudulent, the canonical version of the constitutional inquiry is that "the speech may be restricted only if the government's interest in doing so is substantial, the restrictions directly advance the government's asserted interest, and the restrictions are no more extensive than necessary to serve that interest." Justice Rehnquist's deferential exploration of these issues upheld the restrictions, which Justice Brennan, who championed the greater/lesser logic in his *Nollan* dissent, would have struck down.

For our purposes, the central question is whether the doctrine of unconstitutional conditions, as applied in this context, effectively checks government misbehavior. The picture is decidedly murky. In one sense it does. The Puerto Rican policy is cynical: gambling has terrible consequences for the social fabric, so Puerto Rico attempted

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173 See id. at 346.
174 Id. at 340 (citing Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n, 447 U.S. 557, 566 (1980)).
175 See id. at 350 (Brennan, J., dissenting). Although he employed a high level of scrutiny, Justice Brennan claimed that he would have struck down the law even under the Court's more permissive standard. See id. at 350–51. For a spirited denunciation of Justice Rehnquist's opinion for its application of low-level scrutiny, see Kurland, *Posadas de Puerto Rico v. Tourism Company: "'Twas Strange, 'Twas Passing Strange; 'Twas Pitiful, 'Twas Wondrous Pitiful."
to externalize its costs by taking the money of tourists, who will take their social and psychological problems home with their other belongings. The possible interests of other states, which cannot prevent their citizens from gambling outside their borders, are not registered in the local political calculus, and in all likelihood are of faint importance in the Congressional politics over Puerto Rico's status and preferences. On the domestic front, the ban on casino gambling does not extend to such noble pastimes as horse racing, cockfights, and the Puerto Rican lottery. In essence this exercise of the police power has a clearly anticompetitive component, for as Justice Brennan, writing in the spirit of a public choice economist, suggested, “it is surely not far-fetched to suppose that the legislature chose to restrict casino advertising not because of the ‘evils’ of casino gambling, but because it preferred that Puerto Ricans spend their gambling dollars on the Puerto Rico lottery” — which, it might be added, tourists are not very likely to play.

Posadas is extremely difficult to make sense of because the statute, as applied to both Puerto Ricans and to visitors, can plausibly be characterized either as a traditional exercise of the police power or as an attempt by Puerto Rico to exploit those within its borders. The unconstitutional conditions inquiry in Posadas is in a sense the opposite of the one in Nollan: should the Court require the bundling of the two issues — casino gambling and casino advertising — in order to forestall the political abuse that threatens commercial speech?

Perhaps it should. One advantage of the bundling is that the advertising ban, permissible only if gambling itself is banned, is of no consequence: who would advertise what he could not sell? This means that governments and citizens would not become comfortable with large bureaucracies whose sole function is to suppress or regulate speech. Yet in another sense this linkage is very hard to sustain. One reason to legalize gambling is simply damage control. It is better that people not gamble, not only for their own personal character, but also for the corrosive effect gambling has on family and business obligations. Nonetheless, it is just too costly to try to control gambling by criminal sanctions. Better therefore to legalize the “disfavored” activity, which can then be taxed to keep participation within reason. Disfavored activities, moreover, need not be treated like all other business activities. Advertisement stimulates business, so it might be proper for a state to decide that, while it should not ban gambling, it should nonetheless moderate its growth by banning advertising. Surely if the issue were the legalization of marijuana and other drugs, a respectable argument could be made to allow their sale, subject to

176 See 478 U.S. at 342.
177 Id. at 353–54 (Brennan, J., dissenting).
a general tax and to prohibitions or restrictions on advertising, which, because of advertising's public visibility, should be reasonably easy to enforce. In effect we have adopted such a strategy with respect to cigarettes, which are sold, heavily taxed, and subject to advertisement restrictions, at least on television and radio.\textsuperscript{178} Given the absence of any coherent social attitude toward gambling (or toward drugs, alcohol, tobacco, or prostitution), courts should exercise some deference to state restrictions on such activities, which fall within the traditional "morals" head of the police power as it relates to both property and speech.

Nonetheless there are reasons to doubt that the regulation at issue in \textit{Posadas} meets that test. The social disruptions of gambling, if real, should be manifest in all its forms. When the state seeks to divide markets — with local customers directed toward the state's own lottery, and well-heeled out-of-state customers toward its posh casinos — it looks as if the anticompetitive motives dominate the protective motives. Forcing an all-or-nothing choice between banning all advertisement or banning none allows the state to pursue its legitimate police power objectives without running the risk of rigging local markets. If total bans are thought to be too damaging to the pocketbook, then it is still possible to have a rule that allows all forms of gambling to use print, but not media advertising, or perhaps the reverse. Perhaps the state should be able to disengage the decision to allow gambling from its decision to ban its advertisement, but some very powerful justification must be offered to show why different forms of gambling should operate under different regulatory regimes. Justice Rehnquist might have been correct in insisting that the doctrine of unconstitutional conditions is inapplicable to the connection between gambling and advertising. But the explicit discrimination between government-run and privately run gambling raises the prospect of abuse that calls for a stronger use of unconstitutional conditions in its equal protection guise.

There is a second element of \textit{Posadas} that is still more disturbing. Present law freely allows general economic regulation of all sorts and descriptions.\textsuperscript{179} Under Justice Rehnquist's logic, the power to ban an activity implies the power to ban its advertisement. It follows, therefore, that first amendment protections afforded commercial speech can be no greater than the meager protections given to economic liberties. In order to provide adequate protection for speech, then, it becomes necessary to build a Maginot line between the relaxed attitude toward

\textsuperscript{178} In my view, the justification for these restrictions should rest on the externalities these activities impose on third parties.

economic liberties and the stricter scrutiny on matters of speech. The doctrine of unconstitutional conditions again serves as a second-best tool to limit the ominous implications of the modern economic liberties cases. But this larger problem, and the horribles it suggests, would disappear if we returned to the older cases on occupational freedom, requiring the state to show a strong justification before banning any ordinary commercial activity.  

Even if we do not take that hard line, it is still possible to limit Posadas, which should be understood not as an ordinary commercial speech case, but as a police power morals case. Constitutionally, it should be a close question whether gambling may be banned, and hence a close case whether advertising of gambling can be banned, even if the gambling is allowed. The difficulty of these questions thus weakens the constitutional protection for gambling and its advertising alike. But these substantive doubts do not eliminate the equal protection dimension of the case. It is still imperative that the state treat all forms of any suspect activity such as gambling under the same standard unless some powerful justification for differential treatment can be demonstrated. By this logic, Posadas should stand only for the proposition that constitutional protection of speech is at its lowest ebb in the morals cases. It need not overrun the constitutional protection of commercial speech generally.

VII. EMPLOYMENT CASES

The doctrine of unconstitutional conditions can also be applied to contracts of employment between the state and private individuals. In this context, application of the doctrine should generally be restricted. The doctrine of unconstitutional conditions is most imperative when the risk of government abuse is greatest, and least attractive when the risk of citizen abuse is greatest. If the state were to condition employment on the willingness of an employee to contribute a portion of his salary to the dominant political party, that condition would be struck down because of the systematic distortion that it would work upon the political process. The case is scarcely different from a direct transfer of public funds into party coffers. The worker may be better off with the job subject to the condition, but, as in the standard monopoly case, additional social gains are obtainable if the job is offered without the condition.

Fortunately, such extreme abuses of government power are relatively infrequent, so that today unconstitutional conditions issues tend to be raised with respect to restrictions relatively germane to the work at hand: the terms and conditions of individual employment contracts.

180 See, e.g., Truax v. Raich, 239 U.S. 33, 41 (1915).
The very statement of the doctrine suggests that most cases in this area satisfy the "relatedness" requirement that Justice Scalia spelled out in *Nollan*. Nonetheless, it is important to ask in each individual case whether the restriction in question represents a strategic gambit by the state, or whether it is designed to counter a parallel gambit by the individual worker. In order to decide which form of opportunism is dominant, a ready test is at hand: a court can simply ask whether the kinds of restrictions that the government seeks to impose on its own employees are similar to those that private firms in competitive labor markets impose on employees engaged in similar activities. Perhaps some positions in government are so unique that no private analogue applies, but even in this context, the large number of government employers may help to create a competitive labor market.\footnote{This theme is developed in Williams, *Liberty and Property: The Problem of Government Benefits*, 12 J. LEGAL STUD. 3, 27-31 (1983).}

For the general range of office workers, executives, policymakers, and bureaucrats the connections are very close indeed. It is very hard to create monopolies in labor markets without explicit government intervention to block free entry. It follows therefore that the law should find fewer occasions to invoke the unconstitutional conditions doctrine in the context of government employment than in other contexts, and it does.

In *Snepp v. United States*,\footnote{444 U.S. 507 (1980). The analysis given here is similar to that provided in Easterbrook, cited above in note 31, at 339-52.} the Supreme Court held that the United States could hold Snepp, a CIA agent, to the terms of an employment contract in which he agreed, first, that he would "not . . . publish . . . any information or material relating to the Agency, its activities or intelligence activities generally, either during or after the term of [his] employment, without specific prior approval by the Agency," and second, that he would not "disclose any classified information relating to the Agency without proper authorization."\footnote{444 U.S. at 507-08 (quoting Appeal to Petition for Certiorari at 58a-59a, *Snepp* (No. 78-1871)).} Snepp published his book without the contractually required clearance, and the book may or may not have contained classified information — an issue that the CIA had a strong incentive to keep out of court. But wholly apart from the disclosures contained in the book, there was an evident breach of contract, assuming that the state could impose the contract condition consistent with the free speech clause. The case thus raises again the question of unconstitutional conditions, for the issue becomes whether the greater power not to hire at all includes the lesser power to hire subject to this condition on publication.\footnote{See generally Easterbrook, *supra* note 31, at 349 (arguing against the Court's use of unconstitutional conditions doctrine in *Snepp*).}
Why shouldn’t it? Any breach of the system of prior clearances creates the risk of improper disclosure, which can only undermine the ability of the CIA to obtain needed information from sources that rely on the review process for their protection. Thus the relatedness requirement seems met. More generally, the operation of any government agency requires the sharing of restricted information, which will be inhibited if personnel can obtain information for one purpose only to turn around and use it for another. The restriction in question is no doubt similar to ones private employers impose upon employees entrusted with sensitive information, and it is difficult to see how the public is ill-served by ensuring the confidentiality of its intelligence agents. Should the government through pre-publication review seek to stifle political criticism of the agency that does not rest upon classified information, then the problem can be handled on a case-by-case basis, by in camera hearings if necessary, without disturbing the basic structure of the statute. As in the highway cases, one must worry about abuse not only by the government, but also by parties doing business with it. The bargain here does not seem to be a cloak for any hidden government abuse, and it thus should be sustained, as the Court held, absent some specific showing of misbehavior.

Other cases reveal the same pattern. In Connick v. Myers, the plaintiff, an assistant district attorney in New Orleans, protested her transfer to another division and circulated questionnaires inside the office concerning office morale, the need for grievance committees, and the alleged misconduct of her supervisors. She was then dismissed

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185 This same concern explains why the Supreme Court was also correct not to apply the doctrine of unconstitutional conditions in Seattle Times Co. v. Rhinehart, 467 U.S. 20 (1984), in which the Court held that parties able to obtain discovery of sensitive documents under the Washington Superior Court Rules (identical to the Federal Rules of Civil Procedure) did not have a first amendment right to disclose those documents to the public at large. In essence the limited use imposed upon the discovery recognizes that there are powerful reasons to limit the dissemination of information by protective orders, as provided for in rule 26(c). As elsewhere, doctrines of unconstitutional conditions have to be sensitive to strategic behavior by private parties as well as by government. The prospect of filing a weak lawsuit in order to obtain documents for publication should not be dismissed in this age of high-stakes litigation. If the information obtained in discovery is relevant to the case at hand, it can be introduced at trial, where its dissemination can be assured. Note too that the party resisting the discovery has no obvious manipulative strategy at its disposal, so that the law should work to control the behavior of the party seeking discovery, which has all the discretion.

186 See 444 U.S. at 509 n.3. There is the further issue of damages. The Court imposed a constructive trust and required Snepp to disgorge his full profits from the book. See id. at 515–16. The remedy is probably excessive if looked at from the point of view of the harm to the CIA in the individual case, but it has the desired institutional feature of ensuring compliance with the government procedures in cases where damage remedies calculated on actual loss from a given disclosure will not deter agents whose gain from publishing confidential information exceeds the actual loss they cause the Agency.

for leading a "mini-insurrection" in the office.\textsuperscript{188} Here the question is whether the first amendment allows limitations on speech about office management. The government does not have anything like a monopoly position over the district attorneys it employs, for both local governments and private firms hire criminal lawyers. These conditions are similar to those private firms impose on the protests that their employees can make. As in \textit{Snepp}, the need to control employees' abuse must be weighed against the need to control official abuse. As long as the district attorney's office remains subject to external scrutiny and criticism, including criticism from Myers after her dismissal, the normal rules of employment contracts should apply, as the Court held.

In a more current vein, the issue of drug testing raises the question whether the government can require persons to "waive" their fourth amendment rights against unreasonable searches and seizures as a condition of employment. Here the risks that prompt application of the unconstitutional conditions doctrine do not seem to apply. The use of drugs is related to performance on the job, and private firms that have to operate within competitive labor markets insist on similar conditions. The conditions imposed do not seek to constrain private practices and relations of employees that are unrelated to their employment. Nor do these cases involve the hypothetical danger of the government using taxpayer money generally to pay people to release their fourth amendment rights in general. That practice could not be tolerated precisely because, under the guise of multiple, separate private contracts, it would work a fundamental change in overall government structure.\textsuperscript{189} But the close connection between employment and testing seems to preclude any system-wide loss. The doctrine of unconstitutional conditions has no obvious role to play in the context of drug-testing.

The doctrine of unconstitutional conditions might also be invoked in the employment context to protect procedural rights. Assume that the government has offered an individual an at-will employment contract which by design provides the employee with no procedural protections against government dismissal. The question is whether this

\textsuperscript{188} \textit{See id. at 141.}

\textsuperscript{189} Taken to the limit, moreover, no cash compensation would be paid to any person in society. If the government pays $100 to each person to waive his fourth amendment rights, it must raise those revenues from general taxes of an equal amount. Thus, what one person receives in direct payment has already been lost in taxes. Once the cross-payments are netted out, the compensation that is received is strictly in-kind. In exchange for the release of my fourth amendment rights, you hereby agree to release your fourth amendment rights. It is not clear that one person should regard the release of fourth amendment rights by others as a benefit to him, given its tendency to increase government powers. Clearly, if some system-wide shift is to be taken with search and seizures, an explicit amendment to the Constitution and not covert transfers should be required.
form of contract infringes the constitutional guarantee that no person shall be deprived of property without due process of law. In an early foray into the issue, Justice Rehnquist in *Arnett v. Kennedy* adopted a view containing strong freedom-of-contract strains: "where the grant of a substantive right is inextricably intertwined with the limitations of the procedures which are to be employed in determining that right, a litigant in the position of appellee must take the bitter with the sweet." In one sense this statement is surely too broad, for the government is surely not in the position of an employer under a contract at-will. If it is clear that the government cannot condition its offers of employment on the willingness of workers to support one political party or the other, then surely it cannot invoke those same reasons when it decides to fire. In both cases, the random use of power does not tend to distort or skew the political process in favor of entrenched interests, but appointments or dismissals with political (or religious) conditions attached will have just that impact. Nonetheless, despite the many sustained attacks on this position, Justice Rehnquist's contractual logic is far stronger once cases involving forbidden motives are put aside. *Arnett* itself involved the most attractive facts for the dismissed employee, insofar as he was fired for allegedly defaming the very government official who was supposed to render an initial judgment on his case. Justice Rehnquist deliberately sidestepped the thorny constitutional question whether some independent party would be required to make the initial hearing determination.

Whatever the right result in cases of this sort, the basic logic of *Arnett* seems unassailable. The government here hires workers in an intensely competitive environment, which is why its own rules and procedures do in fact contain fairly extensive procedural protections for them, including the possibility of back-pay awards after an evidentiary trial-type hearing on appeal. Given the wide range of possible employment opportunities outside the government, there is little danger of state monopoly power in this context, but considerable concern with substandard government service by lax, incompetent, or dishonest employees. The decision to steer clear of constitutional

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191 Id. at 153-54. *Arnett* is one of many cases that raise this issue. See, e.g., Bishop v. Wood, 426 U.S. 341 (1976); Board of Regents v. Roth, 408 U.S. 564 (1972).
193 See 416 U.S. at 155 n.21. The issue is difficult because the presence of bias could, but need not, coincide with dismissal for the class of reasons prohibited to government officials.
194 See id. at 145-47. Because the plaintiff in *Arnett* chose not to participate in the hearing process at all because of his objections to the initial proceeding, it is unclear whether the procedural safeguards that the statute did contain could protect against abuse.
entanglements in the employment area removes a host of thorny issues from the judicial agenda, freeing the Court from having to determine what kind of hearing is required and when it should be offered. There are quite enough political pressures to turn government employment into a civil service sinecure without the Court placing its own unsteady thumb on the scales.

The sound logic of *Arnett*, of course, has been soundly repudiated by the subsequent decision in *Cleveland Board of Education v. Loudermill*. Loudermill, a security guard who had been dismissed from his job on charges that he had dishonestly filled out his employment application, challenged the constitutional adequacy of the city's procedures. His claim was sustained, 8 to 1, with only Justice Rehnquist dissenting.

Speaking through Justice White, the Court first noted that no one disputed that Loudermill's contract created the necessary "property right," because all state employees were allowed to retain their position "during good behavior and efficient service." Justice White then concluded that the procedures necessary to protect this substantive right could not be determined solely by the Ohio statute, but had to be tested against constitutional requirements. He curtly rejected Justice Rehnquist's "bitter with the sweet" rationale:

> The point is straightforward: the Due Process Clause provides that certain substantive rights—life, liberty and property—cannot be deprived except pursuant to constitutionally adequate procedures. The categories of substance and procedure are distinct. Were the rule otherwise the Clause would be reduced to a mere tautology. "Property" cannot be defined by the procedures provided for its deprivation any more than can life or liberty.

Justice White's argument may capture the state of current doctrine, but it misses the point. The reason why life and liberty are not "defined by procedures" is that they are not, in any system of limited government, acquired by grant from the state. Property, to the extent that it is acquired by first possession or private purchase, should stand in exactly the same position as life or liberty. Because

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196 Ohio Rev. Code Ann. § 124.34 (Anderson 1984). The statute in fact provided for a review procedure under which grievances could be filed with the state personnel board of review. The board could appoint a trial board to hold a hearing, from which appeals could be taken to the State Court of Common Pleas. The statute did not provide for a pretermination hearing.
197 470 U.S. at 541.
none is a grant from the state, ordinary procedural guarantees must be met before any may be taken away. In this context, it is imperative that the state not be allowed to "redefine" the private interest so as to remove constitutional protections. But contracts for public employment do have their origins in transactions with government. So long as private contracts can specify both the terms of employment and the terms of their dismissal, public contracts should be able to do the same, absent the threat of abuse of government monopoly power. In this context, substance is not separate from procedure. Both are part of a complex package of contractual benefits that an employee receives in exchange for services rendered.

The doctrine of unconstitutional conditions should not apply solely because the attached condition is important, or because it is good policy for the state to keep an employee on the job until the charges against him are fully resolved,199 or because dismissal will impose some measure of hardship upon the worker.200 Nor does the validity of the condition turn upon some effort to advance individual dignity.201 The state does not need judicial oversight to make its own prudential judgment whether it is riskier to keep workers suspected of improper conduct on the job pending hearings, taking into account the costs of hiring substitutes or training replacements. Likewise, individual employees are capable of deciding whether procedural benefits are more important than the wage and other benefits provided by the job. Unconstitutional conditions doctrine should be invoked only when there are structural concerns relating to monopoly power, collective action problems, and externalities suggesting that individual consent will generally be an insufficient check against systematic government misbehavior. Loudermill therefore is a case in which freedom of contract should have prevailed.

VIII. Government Benefits

Each of the previous five Parts has examined the doctrine of unconstitutional conditions in connection with those types of government action routinely undertaken by the traditional minimal state. The New Deal has vastly expanded the catalogue of permissible government functions. As if to celebrate that development, Professor Charles Reich, writing in 1964, spoke of the new role that government had taken, not only in protecting traditional interests in contract and

199 See 470 U.S. at 543. The same theme is echoed in Justice Marshall's partial concurrence. See id. at 549 (Marshall, J., concurring in part and concurring in the judgment). Justice Marshall would have required a full-dress evidentiary hearing before any stopping of an employee's wages. See id. at 548.

200 See 470 U.S. at 544.

201 For an attempt to develop such a dignitary theory, see Mashaw, cited above in note 26.
property, but also in creating various kinds of government "largess" in the form of "money, benefits, services, contracts, franchises, and licenses." That increase in state power translates into an increase in official discretion, which in turn expands the scope of the principle of unconstitutional conditions. This Part traces that development in five celebrated areas of government benefits. The first section discusses the use of tax exemptions conditioned on the content or subject matter of speech. The second section addresses the connection between unemployment benefits and the constitutional guarantees under the religion clauses. The third section examines the relation between welfare benefits for medical services and the prohibition against use of public funds for abortions — an issue with heavy religious overtones. The fourth section turns to the intersection of tax policy and religious liberty, and asks the extent to which Congress can condition tax-exempt charitable status on the willingness of private universities to adhere to the commands of the antidiscrimination laws. The last section returns to the issue with which this Foreword began, the relationship between the food stamp program and the labor strikes under the National Labor Relations Act. Throughout these cases it becomes necessary to analyze in close detail the claim that the refusal to provide some government benefit is tantamount to imposing a "fine" or "penalty" that the government could not impose by direct action.

A. Tax Exemptions and Freedom of Speech

One way for the government to influence the pattern of private activities is through the imposition of selective taxes. People are less willing to engage in those activities that are taxed than in those that are not. The flip side of this power is the provision of tax exemptions, which have the reverse effect upon the pattern of activities. People are more likely to engage in activities that are exempt from taxes than in those that are not. The incentive effects of tax rules are evident across the entire spectrum of economic activities, although they normally receive almost no constitutional examination under the prevailing rational basis test. If direct regulation proceeds largely without constitutional interference, then there is no reason to subject taxation to any higher level of review. The situation is quite the opposite when speech is affected. Here taxation and exemptions have the same effect as they do in other contexts, and are subject to the same high levels

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202 Reich, The New Property, 73 Yale L.J. 733, 733 (1964); see also id. ("Increasingly, Americans live on government largess — allocated by government on its own terms, and held by recipients subject to conditions which express 'the public interest'.") Reich's category of largess includes many of the traditional functions of government, such as licensure and regulation of highways, along with their modern counterparts in the welfare state. In this Part the greater emphasis is upon a subclass of the new property that is tied to the welfare state.
of scrutiny imposed on direct regulations generally. What is true of taxes is also true of exemptions.

*Speiser v. Randall*\(^{203}\) is an early manifestation of the problem, and it shows how the conditions attached to a tax exemption can properly be struck down on first amendment grounds. The California Constitution provided that World War II veterans were entitled to property tax exemptions only if they signed an oath stating that they did not advocate the overthrow of the governments of the United States or California by force or violence, or aid of hostile foreign states in time of war.\(^{204}\) The state argued that it could give its "privilege" or "bounty" to whomever it saw fit.\(^ {205}\) On this view, the exemption would withstand constitutional challenge even if a statute that sought to punish the same conduct by fine or imprisonment did not. Justice Brennan characterized the statute as though it was tantamount to a "fine,"\(^ {206}\) and struck it down accordingly, for the want of the proper procedural protections.\(^ {207}\) The doctrine of unconstitutional conditions is implicated because the benefit conferred by the exemption is conditioned on the willingness of individual taxpayers to adhere to certain political views. The selective tax exemption, no less than a selective tax, necessarily results in a redistribution of wealth and political influence from those who are unwilling to sign the oath to those who are. It may well be that the general property tax exemption for veterans is proper,\(^ {208}\) but redistribution on grounds of political belief generally is not. Coercive tax burdens cannot be waived selectively for those whose views conform to the dominant political position, any more than additional taxes can be imposed on those whose views do not. State gifts work as much of an illicit redistribution of wealth and power as state fines.

The California Supreme Court recognized the point when it held that the exemption could be denied only for speech or advocacy that could be punished directly, thereby mooting the objection that the State was punishing indirectly what it could not punish directly. But

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\(^{203}\) 357 U.S. 513 (1958).

\(^{204}\) The full oath read: "I do not advocate the overthrow of the Government of the United States or of the State of California by force or violence or other unlawful means, nor advocate the support of a foreign government against the United States in event of hostilities." *Id.* at 515.

\(^{205}\) See *id.* at 518.

\(^{206}\) See *id.*

\(^{207}\) See *id.* at 520-29.

\(^{208}\) Cf. *Regan v. Taxation with Representation*, 461 U.S. 540 (1983) (upholding against first amendment and equal protection challenges a statute that exempted from taxation charitable contributions to support lobbying by veterans groups but not to support lobbying by other groups); *Personnel Adm'r v. Feeney*, 442 U.S. 256 (1979) (holding that a statute giving preference to veterans in awarding civil service jobs does not discriminate against women in violation of the equal protection clause).
once the statutory exemption received that construction, it was then fair to ask whether the statute afforded the same procedural protections as an ordinary criminal trial, which it did not. Hence the statute was rendered vulnerable to attacks on procedural due process grounds, as Justice Brennan’s opinion demonstrates.\textsuperscript{209} Speiser involved excessive reliance upon an unexplicated idea of fines or coercion.\textsuperscript{210} But its result is correct when tested against a theory of unconstitutional conditions designed to thwart the abuses arising from unchecked government discretion.

The question of tax exemptions came up in a somewhat more difficult form in the recent case of \textit{Arkansas Writers’ Project, Inc. v. Ragland},\textsuperscript{211} a case decided in the 1986 Term. Here the statutory structure was more complicated. Arkansas exempted from its general sales tax the “[g]ross receipts or gross proceeds derived from the sale of newspapers” and from certain types of magazines, including “religious, professional, trade and sports journals and/or publications printed and published in this State.”\textsuperscript{212} The plaintiff’s general-purpose magazine fell into neither of these two categories, and hence had to pay the tax.

\textit{Arkansas Writers’ Project} again raises the problem of unconstitutional conditions because Arkansas did not have to give any publication an exemption. Thus, the sole issue was whether the state could condition the exemption on the willingness of a magazine to publish material of a particular subject matter. The statute would have been a manifest violation of the first amendment if it had tied the exemption to the adoption of any particular viewpoint, which it did not. Nonetheless, the statute did single out certain types of publications for benefits that other types of magazines were denied. By changing the relative costs of producing various kinds of magazines, the statute in effect brought about a mix of publications different from the one that would have arisen under either a tax-free world or one with a uniform tax on all types of publications. As a matter of marketplace economics, these distortions deviate from the competitive ideal, and could be condemned on those grounds alone. But with the waning of economic liberties as a constitutional doctrine, this argument can be directed

\textsuperscript{209} See 357 U.S. at 520–29.

\textsuperscript{210} See id. at 518 (“To deny an exemption to claimants who engage in certain forms of speech is in effect to penalize them for such speech.”).

\textsuperscript{211} 107 S. Ct. 1722 (1987).

\textsuperscript{212} \textit{Ark. Stat. Ann.} § 84-1904(f), (j) (1947), \textit{quoted in} 107 S. Ct. at 1724–25. This statute seems unconstitutional in its explicit discrimination against out-of-state newspapers. The issue, however, is more complicated, because it now seems that states may provide differential subsidies for local firms, but not impose differential taxes. \textit{See} New Energy Co. of Ind. v. Limbach, 108 S. Ct. 1803 (1988) (disallowing a discriminatory tax while appearing to tolerate discriminatory subsidies).
only to the legislature, not to the courts. Indeed, Justice Scalia would have upheld the tax because he regarded *Arkansas Writers' Project* as an economic regulation case,213 scarcely distinguishable from other cases of selective exemption that have thus far survived constitutional attack.214

Nonetheless, the evident connection between the exemption and speech makes this clearly a first amendment case. In this context, it is hard to demonstrate how any economic misallocation leads to an unwanted distortion in the marketplace of ideas, especially one that could be seized upon by political actors to advance their own interests. Still, the Court was correct to strike the statute down because there was so little to be said on its behalf. A uniform system of exemptions could end all objection to the statute without requiring a detailed analysis of its content, while still allowing the state to advance newspapers and magazines as against other activities. In the unlikely event that a uniform exemption created a budget shortfall, the state could adopt a partial uniform exemption as necessary to meet its revenue requirements. Finding the condition attached to the exemption unconstitutional thus achieves the right result, even in a case that seems to present only limited opportunities for government abuse.

The same analysis yields different results in the earlier case of *Regan v. Taxation with Representation*215 (*TWR*), in which a system of charitable exemptions was challenged on the ground that it could not be applied to moneys raised for lobbying activities. The taxpayer in *TWR* was a political organization that attacked two provisions of the Internal Revenue Code that failed to grant it tax-exempt status, and that failed to grant deductions to its contributors.216 The unconstitutional conditions challenge came in two parts. The first was that it was impermissible to attach any limitations restricting the ability of otherwise exempt organizations to participate in lobbying. The second

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213 See 107 S. Ct. at 1730 (Scalia, J., dissenting).

214 Thus, Justice Scalia pointed out the special mail rates given to religious, educational, scientific, philanthropic, agricultural, labor, veterans', and fraternal organizations. See id. at 1732. These classifications are broader than those involved in *Arkansas Writers' Project*, and thus they probably would, and should, survive challenge.


216 The two provisions involved were § 501(c)(3) and § 501(c)(4) of the Internal Revenue Code. Both provide tax-exempt status for various kinds of charitable organizations. The Court specified two principal differences between organizations receiving § 501(c)(3) status and those receiving § 501(c)(4) status: Taxpayers who contribute to § 501(c)(3) organizations are permitted by § 170(c)(2) to deduct the amount of their contributions on their federal income tax returns, while contributions to § 501(c)(4) organizations are not deductible. Section 501(c)(4) organizations, but not § 501(c)(3) organizations, are permitted to engage in substantial lobbying to advance their exempt purposes.

461 U.S. at 543.
part was that it was impermissible to permit veterans' organizations to operate free of the restrictions made applicable to other political groups.

Justice Rehnquist, speaking for the majority, rejected both challenges, relying heavily upon the norm of "broad discretion" in taxing matters.\(^{217}\) "This Court has never held that Congress must grant a benefit such as TWR claims here to a person who wishes to exercise a constitutional right."\(^{218}\) But this account suppresses the equal protection component of the argument. The objection is not to the failure to grant the subsidy, as such, but to granting the subsidy to charitable organizations while denying it to lobbying organizations.

Properly formulated, the critical question is whether this broad type of condition creates any distortion in the political process. It is doubtful that it does, even when the statute is tested against the more demanding first amendment standards of scrutiny. The religious, political, and educational activities exempted under the statute cover the full range of activities without subject matter or viewpoint discrimination, and the ban on lobbying is imposed at the same high level of generality. The differences in tax treatment may well induce some moneys to go into, say, academic work that would otherwise go into direct lobbying, but it is hard to see what political groups, if any, would gain systematic advantage from this effect. Here, unlike the tax exemption situation posed by *Arkansas Writers'*, there seems to be a powerful government counterweight on the other side. One great peril in political life today is that the broad discretion of federal and state government over economic affairs increases the potential gains to partisan activities, of which lobbying is only the most visible. Why that conduct must be subsidized, even if charitable organizations are subsidized, is therefore something of a mystery. The doctrine of unconstitutional conditions should be invoked precisely when the conditions attached to government action increase the risk of political polarization, the opposite of the case when lobbying efforts proceed without tax dollars. The distinction between lobbying and charitable activities thus survives even a higher level of constitutional scrutiny.\(^ {219}\)

The standard of review becomes far more important on the second question: whether veterans' organizations alone should receive preferred tax status for their lobbying activities. Justice Rehnquist, still employing a degree of judicial deference, simply noted that all veterans organizations qualified regardless of their views.\(^ {220}\) If veterans

\(^{217}\) Id. at 547.

\(^{218}\) Id. at 545.

\(^{219}\) It is therefore unnecessary to adopt Justice Blackmun's position. Justice Blackmun, using a high level of scrutiny, allowed the denial of exemptions for lobbying organizations under § 501(c)(3), but only because of the ability of affiliate organizations to use tax-exempt funds to lobby under § 501(c)(4). See id. at 552–53 (Blackmun, J., concurring).

\(^{220}\) See 461 U.S. at 548.
groups only had disagreements among themselves on issues of no concern to others, a tax subsidy to them might not affect the denial of a parallel subsidy to other organizations. But although these groups may differ among themselves on some issues, they must surely act in concert on others, where they operate in direct competition with unsubsidized lobbying groups. In these cases the differential tax treatment does distort the outcome of the political process in ways that the first amendment and the equal protection clause should preclude. It appears therefore that Congress at least should be put to the all-or-nothing choice of granting exemptions to all lobbying organizations or to none.

I reach that conclusion with a fair bit of trepidation, lest Congress take the bait and extend the tax benefit to all lobbying groups, including the vast number that are totally unconcerned with veterans' activities. The unconstitutional conditions doctrine again achieves only a second-best goal. The grant of universal tax exemptions to lobbying organizations subsidizes all special-interest groups at the expense of the general public, introducing yet another set of tax distortions. There is a prisoner's dilemma game here, in which all persons can be made better off if no lobbying group receives a tax subsidy. Perhaps the proper response is to treat all tax subsidies of political lobbying as beyond the power of Congress to grant, in order to control not only tax distortions between lobbying groups, but tax distortions between lobbying and socially productive activities.\textsuperscript{221} Lobbying may well be a protected constitutional right,\textsuperscript{222} but in a system of limited government it is not one that is either deserving of or entitled to a political subsidy.

\textbf{B. The Religion Cases}

Unemployment compensation programs typically limit their benefits to people who are unemployed through no fault of their own and remain available for work. One question is whether the state can deny these benefits to people who will not work because the only jobs available require them to violate their religious beliefs. Can the state refuse to provide unemployment benefits to persons unwilling to take these jobs? The current answer is no. The major decision was \textit{Sherbert v. Verner},\textsuperscript{223} which was followed in the 1980 Term by \textit{Thomas}

\textsuperscript{221} It would of course be irresponsible for the Court to take such an extreme step in any case where veterans' organizations did not have a chance to present their side of the argument. Indeed the best justification for \textit{Regan} is prudential: the Court did not want to resolve the various difficult issues that would have arisen if the veterans' tax exemption had been found unjustifiable.

\textsuperscript{222} \textit{See}, e.g., Eastern R.R. Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127, 138 (1961) ("The right of petition is one of the freedoms protected by the Bill of Rights.").

\textsuperscript{223} 374 U.S. 398 (1963).
v. Review Board of the Indiana Employment Security Division,\textsuperscript{224} and in the 1986 Term by Hobbie v. Unemployment Appeals Commission.\textsuperscript{225}

Sherbert illustrates the basic pattern in all these cases. Mrs. Sherbert, a Seventh-Day Adventist, was dismissed from her job because she refused to work on Saturday, in conflict with her religious convictions. The state system of unemployment compensation restricted payments to persons who were unable to work through no fault of their own.\textsuperscript{226} The state employment board decided that Mrs. Sherbert had quit for personal reasons, and that jobs were “available” to her within the region. Accordingly her claim for compensation was denied.\textsuperscript{227} The Supreme Court was then forced to decide whether the refusal of the state to pay her benefits constituted a limitation on the free exercise of religion, or, alternatively, whether the decision to pay unemployment compensation would be a de facto establishment of religion. The case raised an unconstitutional conditions question because it had been settled both that a state need not have any system of unemployment compensation at all and that any government system of unemployment compensation is unquestionably constitutional, at least since Carmichael v. Southern Coal & Coke Co.,\textsuperscript{228} which permitted redistributive policies aimed at promoting the “common good.”

Sherbert v. Verner brings to a head the tension between the religion clauses in the Bill of Rights on the one hand and one common form of “new property” on the other. In a world of limited government, each of the two religion clauses operates within a relatively self-defined sphere. The free exercise clause guarantees that the government cannot interfere with the “negative liberties” of the citizen with respect to religious practices. It cannot prohibit religious worship, and it cannot fine, license, tax, or punish religious practices in any way. The obligation of the state is to leave people alone. The establishment clause governs the other side of the line, prohibiting the state from going into the business of religion. Certainly it cannot support one religion to the exclusion of the others. In the modern view, neither can it give aid to all religions equally, if nonreligious groups are excluded.\textsuperscript{229} In a world of limited state and federal power, the pressures on each of the religion clauses is tolerably small, and the possibility of their collision reduced, being limited primarily to cases in

\textsuperscript{224} 450 U.S. 707 (1981).
\textsuperscript{225} 480 U.S. 136 (1987).
\textsuperscript{226} See 374 U.S. at 400–01.
\textsuperscript{227} See id. at 401.
\textsuperscript{228} 301 U.S. 495 (1937). For my criticisms of that decision, see R. Epstein, cited above in note 28, at 309–12.
\textsuperscript{229} See, e.g., Everson v. Board of Educ., 330 U.S. 1, 15–16 (1947).
which the government is forced to reconcile the religious interests of its employees with the requirements of public service.\textsuperscript{230}

The situation becomes far more difficult once the government goes beyond its role as an enforcer of private rights to create and administer a system of positive welfare rights. The greater scope of government action necessarily makes it easier for the state to offend either or both of the religion clauses. Moreover, as long as the government remains in the business of managing all phases of the economy, a simple line that requires government "nonfeasance" in certain areas or a "strict separation" between the state and religion becomes indefensible. Some more sophisticated test to distinguish among government actions is needed. In 1961 Professor Kurland proposed the following standard:

\begin{quote}
the thesis proposed here as the proper construction of the religion clauses of the first amendment is that the freedom and separation clauses should be read as a single precept that government cannot utilize religion as a standard for action or inaction because these clauses prohibit classification in terms of religion either to confer a benefit or to impose a burden.
\end{quote}

Reduced to a single catchword, "neutrality" becomes the guiding principle in religion cases.

In \textit{Sherbert} no Justice was able to give a satisfactory account of the clash between the religion clauses and the unemployment benefit programs. The Court, speaking through Justice Brennan, recognized that the state did not seek to impose "criminal sanctions,"\textsuperscript{232} but held in essence that the elimination of the unemployment benefits was a form of coercion:

\begin{quote}
Here not only is it apparent that appellant's declared ineligibility for benefits derives solely from the practice of her religion, but the pressure upon her to forego that practice is unmistakable. The ruling forces her to choose between following the precepts of her religion and forfeiting benefits, on the one hand, and abandoning one of the precepts of her religion in order to accept work, on the other hand. Governmental imposition of such a choice puts the same kind of
\end{quote}


\textsuperscript{231} Kurland, \textit{Of Church and State and the Supreme Court}, 29 U. CHI. L. REV. 1, 5–6 (1961); see also Katz, \textit{Freedom of Religion and State Neutrality}, 20 U. CHI. L. REV. 426, 429 (1953) (noting the tension between the two clauses "where the state takes over the ordering of the lives of groups of citizens, as in the armed forces, in prisons, and in institutions to which delinquent or dependent children are committed. Here the effect of strict separation would be seriously to limit the religious freedom of the citizens concerned."). For a more modern treatment of the same issue, see McConnell, \textit{Neutrality Under the Religion Clauses}, 81 NW. U.L. REV. 146 (1986).

\textsuperscript{232} 374 U.S. at 403.
burden upon the free exercise of religion as would a fine imposed against appellant for her Saturday worship.

Nor may the South Carolina court's construction of the statute be saved from constitutional infirmity on the ground that unemployment compensation benefits are not appellant's "right" but merely a "privilege." It is too late in the day to doubt that the liberties of religion and expression may be infringed by the denial of or placing conditions upon a benefit or privilege.233

Thus the doctrine of unconstitutional conditions surfaced to fill the void in Mrs. Sherbert's case. It is clear that the state need not provide any benefits at all. The "fine" becomes a measure of relative deprivation: if the government chooses to provide those benefits at all, it cannot condition them upon the willingness of people to work in ways that contravene their religious beliefs.

Justice Stewart's concurrence shows that Justice Brennan's "fine" analogy is far from dispositive. In Justice Stewart's view, any effort to apply the free exercise clause to these facts would conflict with the court's own establishment clause jurisprudence:

If the appellant's refusal to work on Saturdays were based on indolence, or on a compulsive desire to watch the Saturday television programs, no one would say that South Carolina could not hold that she was not "available for work" within the meaning of its statute. That being so, the Establishment Clause as construed by this Court not only permits but affirmatively requires South Carolina equally to deny the appellant's claim for unemployment compensation when her refusal to work on Saturdays is based upon her religious creed. . . . The Establishment Clause forbids the "financial support of government" to be "placed behind a particular religious belief."234

In this passage, Justice Stewart treats the unemployment program as a subsidy to religion because people who do not work on Saturday for religious reasons obtain a benefit that other non-Saturday workers do not receive. Justice Brennan finds a penalty by comparing the claimant to other persons who actively seek work but cannot find it, while Justice Stewart identifies a subsidy by looking to the universe of persons who do not seek work on Saturdays. Justice Brennan's "penalty" suggests free exercise difficulties in upholding the statute as applied, while Justice Stewart's "subsidy" suggests establishment clause difficulties in striking it down. The neutrality principle could

233 Id. at 404 (footnote omitted).
234 Id. at 414–15 (Stewart, J., concurring in the result) (quoting Engel v. Vitale, 370 U.S. 421, 431 (1962)). Justice Stewart concurred in the Court's result because he thought that "the Court's mechanistic concept of the Establishment Clause is historically unsound and constitutionally wrong." Id. at 415. His concurrence reflects his treatment of the free exercise clause as the dominant member of the partnership, see id. at 415–16; Braunfeld v. Brown, 366 U.S. 599, 616 (1961) (Stewart, J., dissenting), a view that makes Sherbert a relatively easy case.
be invoked to support both positions or neither. Clearly something has to give. What?

It is necessary again to return to fundamentals. Notwithstanding their differences, Justice Brennan and Justice Stewart share two premises. Both start from the assumption that the unemployment compensation programs are constitutionally sound, for otherwise the unconstitutional conditions issue could never arise. Both then explore the limitations that the state might place upon receipt of the benefit. While they disagree about the proper analysis in *Sherbert*, neither Justice would tolerate a program that provided public unemployment compensation programs only to those who agreed to practice Judaism or Christianity, or only to those who agreed not to observe one of those faiths. They thus agree on the vital issue. They both reject the now familiar argument that because the state need not establish an unemployment compensation program at all, it can therefore choose the objects of its affections, for such selection confers too much power on the state. Thus the doctrine of unconstitutional conditions is not a point of contention between the two Justices. It is in fact their second common premise.

The question arises, however, as to its scope. Here *Carmichael*'s acceptance of redistribution through employment compensation is important because it marks a clear break from *Frost*, whose imperfect efforts to preserve competition had an explicitly antiredistributive bias. Once general takings and public trust arguments are no longer sufficient to forestall any form of covert redistribution between A and B, then additional pressure is placed upon the religion clauses to forbid redistribution both from or to religion. Within this framework, I believe that the idea of neutrality can now be usefully reformulated into its more precise economic analogue: the government cannot engage in activities that either penalize or subsidize the practice of religion. Judicial scrutiny is high, for whether the government program is sustained or struck down, there is a substantial risk of constitutional error. This test is more stringent than that found in the

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235 For a further discussion of the same point, see McConnell & Posner, *Neutrality Toward Religion: An Economic Approach*, 56 U. Chi. L. Rev. (forthcoming 1989). Once this reformulation is made, it no longer follows that Kurland's test, see supra note 231 and accompanying text, is the best way to eliminate subsidies in either direction. There is always the risk that formally neutral rules will have powerfully disparate effects — for example, a rule that all soldiers must eat standard army rations, regardless of their religious dietary restrictions. It may well be possible to introduce explicitly religious distinctions into the law in ways that benefit both religious and nonreligious people, by a practice of "accommodation," which allows religious people to take certain types of employment, as long as they bear the additional costs that their religious practices impose on the system at large. In effect there may be deviations from a strictly neutral (or separationist) baseline that improve the welfare of all concerned, as in Goldman v. Weinberger, 475 U.S. 503 (1986). For a general discussion of the relationship between neutrality and accommodation, see McConnell, *Accommodation of Religion*, 1985 Sup. Ct. Rev. 1.
speech area, where only restrictions that burden private speech are suspect, while those that subsidize it are not. In contrast, every form of error in the religious context is subject to constitutional scrutiny, for to avoid the perils of free exercise may be to land in the thicket of establishment, and vice versa. The question of subsidy or penalty then requires the selection of the right baseline, but that in turn is possible only after careful treatment of the insurance and funding issues in Sherbert.

This approach allows us to go beyond the metaphor of the “fine” that appealed to Justice Brennan. The state does not take Mrs. Sherbert’s money when she quits work. It refuses to pay her “its” money. Therein lies the rub. The state is not a person, but a complex network of arrangements among people, of which only some are voluntary. As with public highways and foreign taxation, the state does not spend its own money. It spends money that it raises from private individuals, including this plaintiff. To make the analysis tractable, assume that all the funds to the unemployment system are collected from a tax imposed directly or indirectly on the workers and the firm. Assume further that random redistributions of wealth between, say, plumbers and pipefitters, are permitted under Carmichael. Divide the world now into two classes of people, those who might quit jobs for religious reasons and those who would not. The question that the religion clauses ask is whether there is an implicit redistribution of wealth across those two classes — either way. If the redistribution runs from religious persons to nonreligious persons, then we have a free exercise clause violation. If it runs in the opposite direction, then we have an establishment clause violation. Which is it?

At first blush, the argument seems to be that there is an implicit subsidy conferred upon Mrs. Sherbert, and hence an establishment clause violation. She is entitled to recover for all the normal cases of unemployment specified in the statute, plus one additional type of case: not working because of religious conflict. If she pays the same premium as everyone else, but receives more extensive insurance coverage in exchange, then she looks like the net recipient of a forbidden state subsidy.

This argument, however, is wrong, or at least incomplete. The proper insurance inquiry is whether Mrs. Sherbert is, other things equal, in the same risk classification as other people within the state. Thus, suppose it could be shown that people with religious beliefs have steadier work habits and therefore quit jobs far less frequently than those whose work habits are inferior in part because they are

236 The case of government-sponsored speech is far more difficult, because it requires taking into account the roles of political leaders, program officers, and ordinary employees. The exact contours of this problem are beyond the scope of this Foreword. See generally M. Yudof, WHEN GOVERNMENT SPEAKS (1983); Shiffrin, supra note 22.
not anchored in religious beliefs. If Mrs. Sherbert is denied benefits, then she is forced to subsidize nonreligious workers. Indeed, even after she is allowed to obtain coverage when she refuses to work on Saturdays, it remains unclear whether that subsidy is fully reversed. It could be that the additional coverage afforded her is quite negligible,\(^{237}\) given her other personal characteristics, so that on balance she contributes far more to the unemployment fund than her expected payout from it. Alternatively, it may well be that the coverage for her refusal to work on the Sabbath gives her a better than expected deal from the fund. If one considers the religious benefit in isolation, then it looks as though there is an establishment clause violation. If one considers that benefit in the context of the entire program, then (combining effects) the outcome is unclear. It may well be that the plan is skewed against Seventh-Day Adventists. The only way to find out is to check the collections for and payments from the fund. Justice Stewart's establishment clause view is more defensible on the view that each item of coverage should be considered in isolation. Justice Brennan's is more defensible on the aggregate view. The problem simply could not arise if all premiums paid to any state unemployment compensation system reflected the risk of each covered worker accurately, for then any elements of systematic redistribution already would have been squeezed out of the system.

What should be done when, as is now the law, one form of redistribution (between or within occupational groups) is allowed while another form of redistribution (between religious classes) is prohibited? The simple solution would be to create two separate risk pools at the outset.\(^{238}\) But how? One possibility is that individuals who want to have coverage against Sabbath layoffs can pay an additional premium with respect to that risk. The insurance should be viable because they can still be required to conduct a search for other employment. And they will be able to escape the terrible dilemma that Justice Brennan described, of having to choose between economic welfare and their religious beliefs. The small extra premium to cover this second class of risk can be imposed only upon those workers who think it important to get it, and the economic biases otherwise built into the system can continue apace.\(^{239}\)

\(^{237}\) The Court noted that of the 150 Seventh-Day Adventists in Spartanburg only two were unable to find non-Saturday employment. See 374 U.S. at 399 n.2.

\(^{238}\) This approach was implicitly rejected in United States v. Lee, 455 U.S. 252 (1982), in which the Amish were required to contribute to the social security system, with its separate funding, despite a free exercise claim that any payment to or receipt of benefit from the system violated their religious beliefs. For a further discussion of Lee, see pp. 87–89 below.

\(^{239}\) Another possibility is to place all such workers in a separate risk pool, with their own insurance premiums. This prospect is far more radical, and it might well result in a radical revision of premium payments for workers in both classes. There would still be some redistri-
This system of separate charges costs money, if only to administer the proper "pass-throughs" to individual employees. With modern actuarial and payroll techniques the costs should be small, but the cost of setting and collecting the premium might still exceed the premium itself, if that too is small. Even private insurance markets do not have perfect calibration of risk groups, because the costs involved in separating them are too high. If that situation exists, we are forced to decide which distortion, Justice Brennan's on the decision frontier, or Justice Stewart's on the equalization of covered events, appears the more serious. Justice Brennan's conclusion seems to be correct. The amount of redistribution from a failure to subdivide this risk pool is small, given the infrequency of unemployment payments necessitated by a recipient's religious beliefs. On the other hand, the ex post dilemma of religious people — who are forced to participate in this system against their will in the first place — seems palpable. Where some imperfection must be tolerated, better to choose the smaller, as Justice Brennan did.

Even if it were feasible to charge Sabbatarians separate premiums for religious layoffs, or even to place them in their own separate risk group, one problem would remain. Suppose a worker takes a job when she has no religious convictions; she then acquires religious convictions only to be dismissed promptly because she will not work on Saturday. Does this case differ in any degree from Sherbert? The Supreme Court in Hobbie, following its earlier decision in Thomas, held that this new circumstance was immaterial. Justice Brennan's opinion is perfectly conclusory: "The First Amendment protects the free exercise rights of employees who adopt religious beliefs or convert from one faith to another after they are hired. The timing of Hobbie's conversion is immaterial to our determination that her free exercise rights have been burdened . . . ."

From an insurance point of view, however, the difference between the two cases is critical. In a world in which conversions are random, it may make more sense to allow unemployment compensation benefits to people who convert after they were hired. If, when employment was undertaken, all persons had an equal chance of converting, then there would be no redistribution ex ante. In contrast, the redistribution problem in Sherbert arose precisely because the risk of Sabbath employment was known before employment had begun, when the separate premium could have been collected. Still, Hobbie is problematic. Allowing the benefits may not work a redistribution across members of the nonreligious pool, but it will necessarily work a redistribution from nonreligious people (who pay into the system) to

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religious people (the only ones who collect) in the way the establish-
ment clause prohibits. One way to solve that problem is to have the
premium that covers this case paid for by persons who have signed
up for the additional religious coverage, for now there will be redis-
tribution across employees (which is allowed) but not across religions
(which is prohibited).

Admittedly, this approach to interpreting the religion clauses
quickly becomes very technical, and it may seem odd that resolving
particular religion clause cases should turn on the fine points of in-
surance contracting as applied to unemployment compensation or so-
cial security benefits. But this conclusion is really inescapable. To-
gether the religion clauses function to prohibit redistribution, in either
direction, between religious and nonreligious persons. Skewed insur-
ance contracts and massive welfare systems offer almost unlimited
opportunities for implicit redistribution, which must be policed if both
clauses are to be given their full effect. In the days of limited gov-
ernment action, the somewhat stricter separation of religious and
government activities reduced the possibilities of redistribution. Now
with the pooling of resources through government ventures, combat-
ting redistribution on religious lines is far more difficult, for the ben-
efits and burdens to both groups must be both identified and mea-
sured. Even so, with the major normative premise set by the religion
clauses, the rest is economic technique, for which a knowledge of
insurance contracts and plans is indispensable. The simpler rhetoric
of freedom, fines, and coercion must be replaced with a closer analysis
of whether this state system of forced contribution and disbursal works
implicit transfers along religious lines.

This way of construing the religion clauses suggests that the Court
made a serious mistake in United States v. Lee.241 In Lee, the ap-
pellee, a member of the Old Order Amish, refused to file the appro-
riate social security returns or to withhold social security payments
from his employees' paychecks. His argument, not contested, was
that the Amish religion requires its followers to look after their own
elderly and sick and considers it sinful either to pay any funds into,
or to receive any benefits out of, the social security system. The
statute is thus a more massive infringement on religious liberty than
the unemployment statute in Sherbert because the social security tax
means that the Amish can hire workers, and remain in business, only
if they are prepared to violate their religious beliefs.

The entire case for the statute therefore turns on the strength of
the government interest in the social security system. The traditional
requirement calls for the state to demonstrate an "overriding govern-
mental interest,"242 but no reader of Lee can escape the impression

242 See id. at 257-58.
that the Court applied this ostensibly rigorous standard in a very relaxed fashion. The Court was content to quote a congressional report to the effect that mandatory participation was “indispensable” and that the social security system would collapse if participation were made “voluntary.” Its argument, however, is woefully weak in this context.

First, the concern with a voluntary social security system rests upon the obvious conclusion that younger workers (among others) will abandon a system in which the present value of their contributions is greater than the present value of their expected receipts. If everyone did this, the system would collapse, leaving the federal government unable to pay off benefits to present and future recipients without resorting to general taxation. But even if the Amish could opt out of the system as a group on religious grounds, all persons whose religious beliefs were not affronted would remain. The massive amounts of redistribution within the social security system could continue apace, without making the Amish be part of it. Indeed it is unclear whether the system would be stronger or weaker unless some detailed accounting were made to determine whether the Amish as a group were net payors or recipients. (Because of their refusal to accept the money to which they are entitled, they are at present clearly net contributors to the system.)

To be sure, the case would be different if the Amish wanted the benefit of the social security system without having to bear any of its costs. A religious belief that it is blessed to receive but sinful to pay need not be funded by those who disagree. Similarly, the Amish claim would be suspect if some Amish opted into the system while others did not. But there is no hint of any selective participation designed to wring dollars from the system. Indeed, all self-employed Amish are already out of the system by virtue of a specific statutory exemption from Congress. Because the benefits received under social security are all separable, this issue is sharply distinguishable from the hypothetical cases put by the Court, in which tax funds are used to purchase public goods, such as defense and public order,

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243 See id. at 258.
244 Lee is thus distinguishable from Bowen v. Roy, 476 U.S. 603 (1986), in which two applicants for welfare benefits claimed that their religious beliefs prevented them from having their two-year-old daughter's social security number used in processing their claims. That free exercise claim was rightly rejected. The applicants in Roy were seeking the benefits of the system without assuming its burdens, which in this instance were designed to prevent fraud. In Lee, the Amish made no effort to capture the sweet without the bitter.
245 See 26 U.S.C. § 1402(g) (1982). The Court in Lee refused to reach the question whether the free exercise clause compels this exemption, or whether the establishment clause forbids it. See 455 U.S. at 260 n.11.
246 See 455 U.S. at 260 ("If, for example, a religious adherent believes war is a sin, and if a certain percentage of the federal budget can be identified as devoted to war-related activities,
from which the Amish benefit whether they contribute or not. By contrast, there is no free-rider problem in Lee at all.

In sum, the Amish's case regarding social security is compelling because as a group they are willing to disaffirm both the benefits and the burdens of the social security system. The analysis of Sherbert showed that the best way to fend off both establishment clause and free exercise claims is to adopt a set of rules whereby religious groups neither receive a net subsidy nor suffer a net tax from participation in collective financing plans. In Lee, it was possible to guarantee that result by having a complete separation between social security and the Amish system of self-help for their own elderly. Why the Court should have found any overriding governmental interest in preventing this arrangement remains a mystery.

C. Medicaid Benefits and Abortions

The Medicaid program established by the Social Security Act in 1965 is generally designed to provide medical benefits for needy persons. Since 1976 the Hyde Amendment to the statute has provided, subject to narrow exceptions, that Medicaid benefits could not be used to reimburse otherwise eligible women for the costs of obtaining abortions, which had become constitutionally protected by the Court's 1973 decision in Roe v. Wade. The Hyde Amendment was spurred on by the widespread opposition to Roe, and represented an undisguised legislative effort to limit Roe's impact by changing the rules for funding medical care. Roe manifestly prohibits any explicit fines or penalties to be placed upon a woman's right to have an abortion.


248 The amendment provides that:

[N]one of the funds provided by this joint resolution shall be used to perform abortions except where the life of the mother would be endangered if the fetus were carried to term; or except for such medical procedures necessary for the victims of rape or incest when such rape or incest has been reported promptly to a law enforcement agency or public health service . . . .


249 410 U.S. 113 (1973). For the record I should note that I view Roe as incorrect largely for the reasons that I set out in 1973. See Epstein, Substantive Due Process by Any Other Name: The Abortion Cases, 1973 SUP. CT. REV. 159. The literature on Roe of course continues to be produced at a fever pitch, but I do not wish to reargue any of the merits here. Instead the material that follows assumes that Roe is rightly decided and only asks about its implications for the abortion funding cases insofar as they depend upon the doctrine of unconstitutional conditions.
The Hyde Amendment sidesteps the obvious by offering the indigent woman a clear financial inducement to carry the fetus to term.

The constitutional challenge to the Hyde Amendment, rejected in *Harris v. McRae*,\(^2\) presents the issue of unconstitutional conditions in yet another guise. The greater power is that the state can decide to have no Medicaid program at all, as was the case before 1965. The lesser power is that the state can exclude certain procedures — abortions — from coverage under the program. The question is whether, once Congress decides to commit itself to a Medicaid program, it must also commit itself to the funding of abortions. If one treats the state, as the Court did, like a private person, then the case becomes easy — too easy: there is no "coercion" in the form of either force or fraud. Those women who want to get an abortion can still do so, even if they do not receive the "subsidy" from the state. Those who now think that the provision of external benefits makes bearing a child worthwhile have their opportunities expanded, not contracted. While their choices may be shifted, as a group they are better off because they have received options that previously they had been denied; so too are the fetuses that survive. The fact that the public at large has to bear the costs of running a medicare system remains beyond constitutional scrutiny, given the explicit constitutional approval of redistributing income and wealth to improve the health of the public at large.

The hurdle faced by the dissenters is to show that the special powers of the state present prospects of illicit behavior sufficient to displace this simple model of the socially useful bargain. In his dissent Justice Brennan in effect relied upon two familiar strands of the unconstitutional conditions doctrine: *Frost*\(^2\) and *Sherbert*.\(^2\) *Harris* is critically different from both cases, however.

In *Frost*, the unique power of the state lay in its ability to exclude everyone from the public highways, instrumentalities of commerce for which there are no clear substitutes — arguably no substitutes at all. The unconstitutional conditions doctrine was used, albeit ineffectively, to constrain that substantial monopoly power. But there is no monopoly in the abortion market, for *Roe* in effect established a rule of free entry that ensures that indigent women, like all others, can receive abortions at a competitive price. The only pull the Hyde Amendment gives the state over the Medicaid recipient is its ability to withhold funds for an otherwise readily available abortion. The cost of an abortion, moreover, is relatively low, at least in comparison with

\(^{250}\) 448 U.S. 297 (1980).

\(^{251}\) See id. at 336–37 (Brennan, J., dissenting). I do not discuss the dissents of Justices Marshall, Blackmun, and Stevens because they do not expressly address the unconstitutional conditions aspect of the case.

\(^{252}\) See id. at 334–36.
aggressive neonatal care, and there is nothing to prevent other private individuals or charitable organizations from making up the shortfall, and doing so in today's world with an implicit tax subsidy. We are far removed from a world in which private charity would have to construct an entire rival highway system in order to escape the clutches of the state monopoly.

Sherbert poses the much closer challenge, for it too involved the provision of state financial benefits without the powerful monopolistic structure of the state. Read in one sense, Sherbert treats the differential benefits between what one gets if she is willing to work on the Sabbath and what she gets if she is not as though it were a "fine." Analogously in Harris, the failure to provide medical payments for abortions also could be regarded as a "fine," bringing the case within the general prohibition of Roe, insofar as the state will pay in full for the alternative medical procedures.

Yet the differences are also critical. Sherbert was decided within an extraordinarily strict constitutional framework, where the free exercise and the establishment clauses worked as powerful pincers to constrain government action. The full analysis of Sherbert showed the weakness of the "fine" metaphor and required that one take into account both the incentive effects and the insurance consequences of the unemployment compensation system. That same analysis should be brought to bear here, where it points, cautiously but clearly, against the case for invalidation.

Start with the problem of differential incentives. The winning argument in Sherbert was that the promise of unemployment benefits induced the applicant to behave in a manner that necessarily violated her religious convictions. The right to an abortion may be subject to constitutional protection, but having an abortion is not a religious or moral obligation. The state may have given the woman an incentive to do what she would otherwise not choose to do. But it has not forced her to sacrifice religious scruples in order to retain financial benefits, as happened in Sherbert. Can the two choices be regarded as the same?

The answer, if at all, must come from what we think of as the constitutional status of the woman's choice to the abortion. It is here that the counterargument gains strength. Justice Brennan correctly insisted that Roe does more than just decriminalize abortion. Rather, Roe works a double transformation at a single leap: abortions move from the status of criminal acts into "fundamental rights," which are as strongly protected as religious beliefs. "It would belabor the obvious to expound at any great length on the illegitimacy of a state policy that interferes with the exercise of fundamental rights through the selective bestowal of governmental favors."253

253 Id. at 334.
This elevation of the abortion right must go down very hard with foes of abortion who believe both that the Constitution does not prevent abortions from being criminalized and that those who perform abortions should be punished criminally. These beliefs are critical to the funding side of the analysis, which was ignored by Justice Brennan, who silently assumed that government money is like manna from heaven: no individual has to pay for it. But once we pierce the government veil, it becomes necessary to examine what correlative duties that this expanded fundamental right of abortion may properly impose upon the opponents of Roe.

On this side of the issue, we must confront the free exercise of religion. Suppose that a special tax to fund Medicaid abortions were placed upon only those individuals who opposed abortions for religious reasons. In principle, these people should be entitled to object to the tax on much the same ground that union members can object to dues payments that are used to support political programs and candidates to whom they are personally opposed. The free exercise of religion, like the free exercise of speech, can be limited as much by direct taxation as it can by prohibitions.

Recalling the analysis of Sherbert (and the intellectual bankruptcy of Lee), one can see the overwhelming free exercise objection against taxing religious people to pay for abortions. These people, whether few or many, are forced to fund programs that they oppose on religious grounds. The right to escape this coercion seems as "fundamental" as the woman's right to have the abortion in the first place: to put the claim in the baldest way possible, who wants to be coerced into paying for the murder of unborn children? Thus the flip side of the "fundamental right" claim is far more powerful in McRae than the parallel establishment clause argument in Sherbert, for no one thinks that the modest subsidy, if any, to individuals like Mrs. Sherbert affronts the core religious beliefs of the persons who are made to pay it. Pushed to the limit, this free exercise argument would make it unconstitutional for the government to use public funds to fund abortions. Thus the unconstitutional conditions argument suggests that the Hyde Amendment is unconstitutional, given Roe, while the free exercise argument suggests that it is constitutionally mandated. Neither argument allows a middle ground.

Are there also, however, religious grounds on which to oppose the Amendment? The argument, here under the establishment clause, seems to turn on motive, and no one can deny the importance of

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255 For examples of taxes found to violate the free speech clause, see Minneapolis Star and Tribune Co. v. Minnesota Commissioner of Revenue, 460 U.S. 575 (1983), and Grosjean v. American Press Co., 297 U.S. 233 (1936).
motive in establishment clause cases. Many of those who oppose the funding of abortions do so on religious grounds. When they turn their preferences into law, they have established, at least in part, their religious beliefs under the Medicaid statutes. This argument, however, seems more strained in this context than does its free exercise alternative. If the foes of abortion were able to exclude both abortion funding and all pregnancy and neonatal care from Medicaid solely for religious reasons, would federal funding of abortion (and other pregnancy and neonatal care) then be required because of the motive behind its opposition, even with the entire issue of differential incentives no longer in the case?

The funding issue thus reveals a house divided. Some substantial fraction of taxpayers objects to abortions on religious grounds. Other taxpayers strongly support abortion funding for indigent women, and counter the free exercise claim with an establishment claim of their own. The obvious lesson is that it is troublesome to use extensive government power to force collective decisions in the teeth of these wide and wholly irreconcilable divergences of opinions: any such decision leaves a minority, or perhaps a majority, deeply disaffected with the collective outcome. The deep moral and political divisions over abortion cannot be papered over simply by writing, as Justice Brennan did, solely about the differential incentives the Hyde Amendment places on Medicaid recipients.

One problematic line of escape, analogizing to the proper treatment of unemployment benefits in Sherbert, would segregate contributions to the Medicaid program. The state could determine in advance its budget requirements for Medicaid abortions, and then allow individual taxpayers to decide whether or not they wished their moneys spent on abortions. It could further insist that only those opposed to abortions on religious grounds may refuse to contribute to the fund. If the budget target were met without the contributions of those opposed to abortions, then the program could go forward. If not, then the program would have to cease, or operate on a reduced basis.

The suggestion presents some serious internal difficulties of its own. It would be difficult to determine who refused to contribute out of sincere religious conviction and who simply wanted others to bear that portion of their social burden. Free-riding could thus distort collective choice. On the other side, if the abortions were so funded, then something would have to be done with the tax revenues from those people opposed to the program on religious grounds. If these moneys were simply put into general revenues, then nothing would

256 See, e.g., Wallace v. Jaffree, 472 U.S. 38, 55–56 (1985) (discussing the permissible degree to which a statute can be motivated by a religious purpose).

257 See supra pp. 79–86.
really have changed at all. If any substantial fraction of the population supported abortions, then all federal programs, whether for abortions or anything else, would be funded exactly as if no one were opposed to abortions for religious reasons. Perhaps money is too fungible for such a separation to work. Even if these difficulties could be addressed, one problem would remain: what is to be said to people who are opposed to their government paying for something that they find morally reprehensible?

In the end, therefore, it seems quite difficult to protect the free exercise rights of opponents of abortion under a system that involves any affirmative government support of abortions. In this context, the funding of abortions through charitable contributions has at least the modest advantage of keeping the government from the middle of the abortion battle. Yet charitable deductions still make religious people bear part of the costs of the abortions, in effect, to which it can be said only that the current tax system uses charitable deductions that allow religious people to fund their institutions and practices at the expense of nonreligious ones. The only way to avoid these problems is to get the government out of both medicine and religion, which, although the only principled answer, is unlikely to be done in the near future. Until that day, however, the unconstitutional conditions question in Harris is far closer than the one in Sherbert, and far more divisive. The claim of indigent women to be free of financial incentives not to abort cannot be ignored. But it is not as important as a state policy offering a financial inducement to have an abortion inconsistent with her religious beliefs — which would be the precise Sherbert analogue. On the other side, the use of public moneys to support abortions taxes, and therefore coerces, other individuals to support practices that are against their religious convictions. As with Sherbert, none of these problems could arise in a constitutional order that imposed restrictions upon redistribution through taxation and state welfare benefits. Once that redistribution becomes part and parcel of the system as we know it, the proper strategy should be to choose the lesser of two evils, a very hard call here. On that uneasy note, the unconstitutional conditions challenge to the Hyde Amendment should fail — but perhaps only by a bare 5–4 vote.

D. Tax Exemptions, Free Exercise, and the Antidiscrimination Principle

The most recent free exercise tax-exemption case, Bob Jones University v. United States, is at sharp variance with Sherbert and Hobbie, but all too harmonious with Lee. In Bob Jones, the constitutional issue was whether Bob Jones University should be able to

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keep its charitable tax exemption, even though it had adopted, for genuine religious beliefs, a ban against interracial dating and marriage for its students.259 For the Court, the case was easy. It started with the premise that "there can no longer be any doubt that racial discrimination in education violates deeply and widely accepted views of elementary justice,"260 and cited its decision in Brown v. Board of Education261 to show its opposition to any system of state-sponsored segregation. Set against this background, the free-exercise objection to the statute under the religion clauses received short shrift, given that "the Government has a fundamental, overriding interest in eradicating racial discrimination in education."262 The Court concluded that "[d]enial of tax benefits will inevitably have a substantial impact on the operation of private religious schools, but will not prevent those schools from observing their religious tenets."263

The decision in Bob Jones has generally received a warm response,264 but is nonetheless clearly incorrect, once the problem of unconstitutional conditions is forthrightly considered. The initial inquiry is whether the state could decide that its "compelling interest" in eradicating racial segregation in education is sufficiently strong to allow the state to impose a direct fine or criminal punishment on the school for imposing those conditions on its students. The answer, I take it, is no. The free exercise clause of the first amendment does not pertain only to the liturgy but to the full range of religious activities, of which schooling is most definitely a part.265 Indeed, if Bob Jones is correct, then the government could claim that it has a "compelling state interest" to condition tax exemptions to religious institutions on their adherence to title VII prohibitions against gender discrimination, as practiced by Roman Catholics and Orthodox Jews, in the selection of religious leaders.266 Even if it is assumed that the

259 See id. at 580–81, 602–03. Also at issue in the case was whether the university's discriminatory practices disqualified it from tax exempt status under the "public policy" doctrine, a question that the Court answered affirmatively. See id. at 592–96.
260 Id. at 592.
261 See id. at 593 (citing Brown, 347 U.S. 483 (1954)).
262 Id. at 604.
263 Id. at 603–04.
266 The tension between title VII and the religion clauses did surface in Corporation of Presiding Bishop v. Amos, 107 S. Ct. 2862 (1987), in which the Court held that the exemption from title VII for religious organizations, see 42 U.S.C. § 2000e-1 (1982), did not offend the establishment clause. The Court did not ask the harder question whether the exemption was
denial of a tax benefit does not operate like a "fine," there still remains the question whether the government can deliver its economic benefits in ways that favor one religious set of beliefs over another, given its obligation not to use its coercive powers to advance or retard religion. Under Bob Jones, the University and its supporters are forced to bankroll in part the subsidies provided for other institutions, without receiving any parallel subsidy of their own, thereby skewing the relative power of the two sets of institutions from what it would be in the tax-free world. The use of selective grants on matters of religious belief shows government power at its most dangerous. In this context it becomes idle to say that the greater power of withholding tax exemptions includes the lesser power to condition an exemption on the sacrifice of the prospective recipient's own religious convictions. As is usually the case, the setting of conditions on government grants is the result of powerful political pressures against which the Bill of Rights was designed to guard. Bob Jones University may be unfashionable and perverse in its religious beliefs and practices, but it is entitled to the same level of constitutional protection as everyone else.

E. Food Stamps

We are at last in a position to reconsider the paradox of unconstitutional conditions as it applies to the case with which this Foreword began: Lyng v. International Union, UAW. In Lyng, it will be recalled, the union argued that the legislative decision to exclude striking workers from the food stamp program constituted an impermissible "burden" upon their first amendment rights of association, while the disparate treatment between these striking workers and other workers eligible for food stamps constituted an impermissible classification that offended equal protection guarantees. Stated otherwise, the union's claim is that the state uses impermissible "coercion" when it denies a benefit to striking workers that it grants to others. The rival position is that the state has chosen to "subsidize" certain kinds of workers, and is not duty-bound to extend that subsidy to workers who have chosen to strike. The case thus raises the unconstitutional conditions question whether the greater power — to eliminate the entire food stamp program — entails the lesser power — to exclude striking workers from the receipt of this set of government benefits.

required by the free exercise clause, to which I would answer in the affirmative. If that conclusion is correct, then Bob Jones must be clearly wrong. If the state cannot coerce compliance with the antidiscrimination norm against religious organizations by the use of force, then it cannot discriminate against them in the receipt of tax benefits.

267 For a parallel discussion of the more difficult case of Sherbert, see pp. 79–86 above.
269 See supra p. 6.
As before, the plaintiff's claim can be evaluated only if this legislative decision is placed within its larger constitutional context. The initial point of departure involves the National Labor Relations Act (NLRA). The statute itself represents a conscious program to displace market mechanisms with a system of collective bargaining, under which the majority of workers within a given bargaining unit are able to require their employer to negotiate with them in good faith. The central feature of this statute is that it explicitly repudiates the competitive norm and substitutes in its place a monopolistic structure whereby the employer is required to negotiate with the workers as a group. Ironically, the major historical opposition to the NLRA was that its duty to bargain in good faith violated the employer's right to freedom of association, by denying him the right to do business with whomever he saw fit. The inevitable consequence of the present labor statutes is to block free entry and exit, and thereby to increase the role of strategic behavior, given the attendant expansion in the size of the bargaining range. Hard, protracted negotiations over the division of the gains from trade become the rule, with strikes resulting from breakdowns in negotiations that both create private losses for the parties and inflict extensive social costs on third parties. In my opinion, the pre-1937 law on the subject was sound: the NLRA should have been struck down on both commerce clause and takings grounds, in which case the entire issue in Lyng quickly disappears. However, for present purposes, my views are quite irrelevant. The important point is that the explicit rejection of a strong system of property rights made possible a level of government discretion that had not previously existed. The question then becomes whether the doctrine of unconstitutional conditions can sensibly cabin the use of that power.

Probably not, at least in this case. The doctrine of unconstitutional conditions was used in the contexts just considered to forestall redistribution of wealth along forbidden dimensions. In the foreign incorporation cases and the early highway cases, the competitive ideal forbidding economic redistribution by government still held sway. In the religion and speech cases, the marketplace of ideas is more than an idle economic image, as redistribution along political or religious lines continues to be prohibited even though economic redistributions are allowed. However, once redistribution of wealth and power is tolerated under the rational basis test in all relevant dimensions, then there is no forbidden use of government power to which the doctrine of unconstitutional conditions could respond. The search for some

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fundamental right or freedom falls short on both the question of economic liberties, given the NLRA, and of welfare benefits, given the food stamp program. The intersection between two programs over which Congress has an acknowledged broad discretion does not yield any principle under which the discretion over the whole is less than the discretion over the parts.

Start with the legacy of the NLRA. The chief significance of the constitutional decisions in this area was the repudiation of the system of private property and competitive markets as the baseline against which permissible legislative enactments were measured. Without accepting that baseline, the shift from competitive markets to cartel arrangements cannot be regarded as a "penalty" or a "taking" from employers made subject to the new restrictions. By the same token, the legal structure of the original Wagner Act was held constitutionally permissible, although not constitutionally required. As long as union members have no "fundamental right" to the protection of labor statutes, then the current statutory framework, however well-established, does not establish any new definitive constitutional baseline against which subsequent legislative decisions must be tested. One immediate result was that the Taft-Hartley Act, which prohibited a category of union unfair labor practices, could not be regarded as a penalty or a taking from workers that must be subjected to any form of heightened constitutional scrutiny. Any number of structural permutations have equal constitutional dignity. There is no impediment against oscillating back and forth between different economic orders, just as there is none against the repeal of Taft-Hartley in its entirety. In response, it might be suggested that the collective interest of the workers presents a fundamental claim of associational freedom that requires continuation of the system of collective bargaining. Yet under present law it is impossible to see how that might be done without repudiating the modern understanding that the state's police power trumps all economic liberties. Unions are large and complex organizations, making it implausible to claim that their members enjoy an "intimate" right of association such as that found in marriage and perhaps certain other highly personal forms of association.

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274 Cf. Roberts v. United States Jaycees, 468 U.S. 609, 620 (1984) (noting that "[a]s a general matter, only those relationships" that are "distinguished by such attributes as relative smallness, a high degree of selectivity in decisions to begin and maintain the affiliation, and seclusion from
economic considerations that govern ordinary business firms. In ad-
dition, unions themselves are not organizations formed by unanimous
consent, but they have the power to bind individual dissenters by
their decisions. Even if economic liberties were protected, freedom of
association for some would not make it onto the list.

The new constitutional order thus comes to us bereft of the old
common law baseline, and without a new baseline to replace it. Given
this legal void, it is quite impossible to say that a certain reform
introduces either a subsidy or a penalty that needs to be constitution-
ally justified. Rather, it is just a change among the class of equally
permissible permutations. Once all baselines are extinguished, the
doctrine of unconstitutional conditions has nothing on which to anchor
itself, for there remains no dimension along which strategic behavior
or the redistribution of wealth is forbidden. If the state can limit the
power of unions under the Taft-Hartley Act,275 then it can also do so
under the food stamp program. Neither side in Lyng mastered the
appropriate constitutional discourse. The Court was wrong to de-
scribe the food stamp program as a "subsidy."276 By the same token,
the dissent improperly called the exclusion of striking workers from
the program a "penalty."277 Strictly speaking, both sides are wrong
because the statutory changes, in the present constitutional setting,
are neither.

The two errors are not, however, of equal magnitude. Justice
White, writing for the Court, need not have shown that the provision
of food stamps to striking workers is a subsidy in order to sustain the
statute's constitutionality. Rather, the burden was on Justice Marshall
in dissent to show that the withholding of the food stamps is a
forbidden "penalty" — that is, that it works some redistribution of
income or wealth along some forbidden dimension. The obliteration
of all constitutional landmarks in the labor relations area therefore
does no damage to Justice White's majority position, but is fatal to
Justice Marshall's dissent.

Justice Marshall tried to escape this problem by arguing that the
mirage of government "neutrality" cannot possibly be used to uphold
the statute.278 After all, employers themselves receive many benefits
from the welfare state that are in no way conditioned upon their
behavior in labor disputes. To hit union workers with an exclusion
from this program fits poorly with the maintenance of government

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275 Labor Management Relations Act of 1947, ch. 120, § 8, 61 Stat. 136, 140 (codified as
amended at 29 U.S.C. § 158 (1982)).
276 See 108 S. Ct. at 1190.
277 See id. at 1198 (Marshall, J., dissenting).
278 See id. at 1197–98.
benefits on the other side. But the argument about "neutrality" fares no better in this context than the argument about either penalty or subsidy. The complete response to Justice Marshall's point is that in the present constitutional world of labor relations, Congress could exclude employers from a wide variety of economic benefits, whether or not they were enmeshed in a labor dispute, without fear of overstepping constitutional limitations. In this case, for example, the statute places heavy pressure on employers not to lock out workers, who would then be able to receive their food stamp benefits, but surely no one would say that this provision is unconstitutional because it "coerces" employers (who have long been forced to surrender their freedom of association) to abandon their rights not to do business with the union. The conscious, systematic elimination of all recognizable baselines makes the idea of "neutrality," powerful in a common law world as an argument against the NLRA, as empty as that of "penalty" and "subsidy." Again this absence of constitutional principle presents no obstacle to the party that wants to sustain the statute. It is fatal only to the party, be it management or labor, that wants to strike it down.

One must reach the same conclusion starting at the opposite pole with the food stamp program. Here too we have a system of in-kind benefits provided to recipients by the public at large. Yet there is a long line of Supreme Court cases holding that poverty is not a suspect classification, and that the state is under no duty to redistribute wealth from rich to poor. Again there is no right to which the doctrine of unconstitutional conditions may be anchored. The decision to exclude striking workers from the program is based upon the sensible notion that the removal of payments to striking workers reduces the incidence of strikes. In turn, reducing the incidence of strikes is an end the state could pursue directly (as, for example, by repealing the collective bargaining rules), so it becomes one that the state may pursue by indirection as well. Looked at in retrospect, the exclusion of striking workers from the food stamp program may well treat persons with equal need differently, but it is hardly an instance of failing to treat "like cases alike," as Justice Marshall suggested. There is still the question of incentives to be considered, and here Congress has decided that it is willing to suffer some inequality after the fact in order to reduce the frequency and severity of strikes. The weak rational basis test offers no reason to control the power of such state discretion, on which the entire unconstitutional conditions doctrine rests.

The same conclusion follows when the matter is considered from the point of view of its funding. Here there is no way to match the taxes paid by striking workers with the level of food stamp benefits that they are entitled to receive. It is quite possible that, even if they cannot recover benefits while on strike, they receive a net benefit from the system, because they are still covered for the same contingencies as all other recipients. If so, then some other parties must be net losers, but they are not allowed to complain either, even if they are shareholders whose tax dollars are being used to support the workers striking against their businesses. Who wins and loses is all quite impossible to determine anyway. There is no tracing mechanism to allow us to decide which set of benefits were funded by which person. More fundamentally, there is no normative criterion to render any forms of redistribution impermissible. Without fundamental right or suspect classification, we remain mired in a constitutional wasteland.

The case is thus a far cry from Sherbert. Outside the context of the establishment clause, there exists no general requirement that persons not be taxed for benefits they do not receive. Nor does Lyng involve a state-imposed choice between the receipt of a government benefit and the waiver of constitutionally protected rights. Without the food stamp program, the workers know that they will have to

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281 It would be a closer question if the statute purported to deny striking workers all food stamp benefits in perpetuity. That statute could no longer be justified on the ground that the government should not provide payments to workers locked in economic conflicts with their employers, but it might be justified (in a rational basis world) as an effort to reduce the number of strikes under the labor statute. This special exclusion of striking workers is far more difficult to sustain in a world without collective bargaining, where the question of strikes would be controlled by the common law of property, contract, and tort. But even in this case it would be important to distinguish between a world in which common law rules prevailed by legislative grace and one in which they prevailed by constitutional mandate. In the former, rational basis world, the statute would probably prove acceptable. But with any stricter scrutiny, the perpetual restriction would fall (assuming that the food stamp program itself would not fall).

282 The existence of such a mechanism can influence the outcome of cases. Ohio Bureau of Employment Services v. Hodery, 431 U.S. 471 (1977), involved a statute providing that workers for an employer whose business was shut down as part of a labor dispute other than a lockout were not entitled to receive unemployment compensation, even if they were nonunion workers who had not participated in the dispute itself. See id. at 471–77. The Supreme Court unanimously upheld the statute under rational basis review. It noted that each employer's contribution to the unemployment compensation fund was otherwise triggered by the number of its employees who received benefits. That basic structure, if unaltered, would have allowed the union to inflict heavy costs upon the employer if its strike forced the employer to close down its nonunion divisions. Such a union strategy would clearly influence the settlement of the strike. The funding imbalance was avoided by denying compensation to the innocent workers laid off. The same competitive balance could have been achieved if the nonunion workers received ordinary compensation from general revenues, not from the employer. But the rational basis test only required a good reason to avoid the payments by the employer; it did not require the adoption of an ideal compensation program that also protected innocent employees.
fend for themselves. After the passage of the food stamp program with this exception, they still have to fend for themselves. Basically they face the same costs and benefits from striking with the statute as they did striking before the food stamp programs were first introduced. At most the statute works a tiny change in the incentives faced by union workers who might delay striking, in order to induce the employer to lock them out first. The dominant feature of this case is that the unions have lost in a struggle over political power, and the broad gulf between power and entitlement cannot be crossed when judicial deference is the order of the day.

IX. CONCLUSION

The analysis of Lyng has brought us full circle in the analysis of unconstitutional conditions. It may now be useful to summarize where that journey has led. Initially it is useful to distinguish between the use of the doctrine as a matter of general legal theory and its use in connection with particular constitutional provisions. As a matter of theory, competitive markets and government power are often polar opposites. Within competitive markets, new entry is an effective check against private excesses. Accordingly, private contracts generally both advance the interests of the parties and make a positive contribution to the total welfare of the social system at large. Within this competitive setting, the emphasis of the law is rightly on transactional justice: whether particular contracts have been tainted by coercion, duress, fraud, or incompetence.

These transactional elements retain their importance whenever the government enters the market as an ordinary contracting party. But the traditional norms prohibiting coercion and duress are insufficient to police the legal monopoly that government exercises over certain critical domains. As a matter of general theory, the emphasis must shift from transactional to institutional justice, at which point three problems become paramount: monopoly, collective action dilemmas, and externalities. When the government uses only its monopoly of force to achieve its ends, classic constitutional questions arise under particular constitutional provisions. But when the government uses its power to contract or grant, then the issue of unconstitutional conditions proper is raised.

First, government monopoly power creates a broad range of bargaining outcomes that will allow the state and any individual to be better off than they were before the bargain. The costs of achieving some bargaining outcome, however, can dissipate a large portion of the achievable social gains. Limits on the types of gains that the state

283 Similarly, employers have a small incentive to delay a lockout in order to induce a strike.
can hope to extract by bargaining with its citizens can limit the social losses associated with strategic behavior. In general, if the government can cover the costs of running the instrumentalities that it controls, it should not be allowed to hold out for any portion of the general surplus. The imposition of a condition on a grant is often an attempt to shift some portion of that surplus from some persons or interest groups to others. The factional politics it encourages and the social losses that it imposes are good reasons to incorporate protections against such abuse at a constitutional level.

Second, government regulation and taxation are means to effect implicit transfers of wealth between individuals. The bargain that is made with one citizen may have the effect of freezing other citizens out of the market or setting them at a competitive disadvantage. That is the lesson learned from both the corporate charter and the highway franchise cases. A firm cannot escape these external costs simply by reducing the prices it charges for goods and services. A legal rule that requires the government to make available to everyone on equal terms the privileges afforded to a few — for example, incorporation, or access to roads — largely controls this problem. The power to select confers greater powers on government officials than a rule that requires consistent treatment between rivals for government favors. At a normative level, the doctrine of unconstitutional conditions represents the sound limitation on public discretion.

Another part of the inquiry is not normative, but positive. How well do the cases conform to this model of unconstitutional conditions? In one sense they do not, because the language of externalities and strategic behavior is not drawn from Supreme Court cases. The Justices have worked more by hunch and intuition than by systematic theory. But the question is less one of words, and more one of judicial behavior. In this regard, the answer depends heavily on the extent to which the Supreme Court proceeds from the distrust of government power. In the pre-1937 period of the doctrine, there were clear hints that the preservation of a competitive system was an appropriate judicial function. The foreign incorporation cases and the regulation of highway cases both reflected that concern. Nonetheless, these pre-1937 cases showed at best an inconsistent and halting devotion to general principles of economic liberties. Accordingly, unconstitutional conditions arguments were pressed forward with only modest vigor. In the foreign corporation cases, they achieved long-term beneficial outcomes, but in the highway cases they were easily circumvented.

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284 See, e.g., Adkins v. Children's Hosp., 261 U.S. 525, 546–48 (1923) (listing four exceptions to the general principle of freedom of contract, most of which have little to do with the standard accounts of market failure).
In the post-1937 era, concern with economic liberties and competitive markets has been stripped of its normative constitutional authority. It is not surprising, therefore, that the doctrine of unconstitutional conditions has but weak application in these areas. Nonetheless, the far greater weight that has been attached to speech and religion has been matched by an increasing resort to unconstitutional conditions doctrine. The Court seems alert to the dangers that arise when governments externalize costs through regulation and taxation, and attempt to bargain strategically with individual citizens. Within specified subject matter areas, the emergent doctrine thus takes on the same contours that would have been imposed if the Court had continued to protect economic liberties and private property. Various forms of implicit transfers across religious or political groups are looked upon with deep suspicion, and controlled with a fair measure of sophistication and success. The efforts by the government to "lever" its monopoly advantage into protected areas are stoutly resisted.

But the court will not generalize to all areas of government activity. In order to account for its caution, we are thus brought back to the fundamental distinction that has dominated so much of constitutional law since the 1937 revolution. Why is the protection of economic liberties and property interests less a function of the judiciary than the protection of speech, religion, and other selected fundamental rights? To that question I think there is no satisfactory reply, because the same forms of government failure can pervade both areas. The object of government is to maximize the cooperative surplus of human activities in all domains, and the object of the Court is to help ensure effective government. The Court therefore should not sanction abuses of the political process, whether they offend speech, liberty, or property. Instead, a presumption of distrust should attach to all government action. That presumption should allow the Court to organize its thinking on unconstitutional conditions in particular and constitutional law in general around one proposition: where the Court routinely allows strategic behavior and implicit wealth transfers by government, there constitutionalism ends.