1998

The Cartelization of Commerce

Richard A. Epstein

Follow this and additional works at: http://chicagounbound.uchicago.edu/journal_articles

Part of the Law Commons

Recommended Citation

This Article is brought to you for free and open access by the Faculty Scholarship at Chicago Unbound. It has been accepted for inclusion in Journal Articles by an authorized administrator of Chicago Unbound. For more information, please contact unbound@law.uchicago.edu.
I. INTRODUCTION

The topic of this short essay is whether we should be willing to undo the New Deal. In order to attack this modest mission, I shall first ask just what our nation hoped to achieve when it put the New Deal into place. Once that question is understood, I shall then ask whether it is worth undoing the New Deal. To end the suspense, the answer is this: the quicker the New Deal can be undone, the better.¹

To explain why this recommendation is sound, we must return to the fundamental question of what is meant by "structural" Constitution and why it matters. The strong temptation is to greet this inquiry with impatience. We think about structure "merely" as a matter of form, or worse, as a matter of formalism. Oftentimes, we think of it as wholly unrelated to substance or even in sharp opposition to it. I hope to show that this bifurcation between constitutional structure and substantive law leads to most unsatisfactory conclusions.

I believe that the proper form of inquiry examines governance structures by asking whether they advance a worthy set of substantive ends. We must first defend these

¹ As I have noted elsewhere, “[t]he New Deal is inconsistent with the principles of limited government and with the constitutional provisions designed to secure that end.” RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN 281 (1985). For a more detailed exposition of my views on the New Deal and the Commerce Clause, see Richard A. Epstein, The Proper Scope of the Commerce Power, 73 VA. L. REV. 1387 (1987). For an opposing view of the New Deal, see 2 BRUCE ACKERMAN, WE THE PEOPLE: TRANSFORMATIONS (1998). Ackerman's theory, for all its academic ingenuity, is a theory that requires judges to surrender to political pressures, rather than adhering to their constitutional duty of interpreting constitutional text as they think proper and then letting the political process lead to amendment, if appropriate.
ends, and then show how the proposed structures will help achieve them. The strongest case against the New Deal thus strikes at its unprincipled agnosticism toward the appropriate form of social and economic life in the United States or, indeed, anywhere else. Ultimately, what is at stake here is nothing less than the key substantive choice about how to organize a complex national economy.

As a matter of principle, a person could believe in a system of open markets, to the extent that these are feasible and possible, in which free entry, free exit, and the free movement of prices, goods, and services are seen as promoting overall social welfare. When firms fail, the appropriate response is not to prop them up with subsidies, which will require taxing other individuals and activities. Rather it is simply to let failing firms go out of business, so that problems of excess supply can be addressed through exit rather than through manipulation and fine-tuning of an ever more stubborn market.

In trying to figure out why one form of economic organization is superior to another, we need to look at the consequences that each generates. Here it behooves us to recall the powerful economic theory that holds that open competition will move us fairly close to the social optimum while state sponsored monopolies move us in the opposite direction. There is nothing perfect about this process, to be sure, and any economy will experience some bumps and turns in the road. Yet, with all those qualifications, open competition will outperform state-administered cartels in what would otherwise be competitive industries.

II. THE THREATS OF MONOPOLY

The judicial interpretation of the United States Constitution before 1937 was by no means perfect, but at least it had the virtue of responding to one dominant theme. The dangers of monopoly lurk just about everywhere, and the Supreme Court, through its own monopoly on judicial review, tried to broker some accommodation between the multiple threats of monopolization.

One of these threats is that of private monopolization. Antitrust laws, either at the state or federal level, could in
principle offer an appropriate response to this difficulty. A second threat is that posed by state monopolies. To the extent that states impose barriers to the movement of goods and services in national markets, some national response seems appropriate. Throughout its history, Congress has done little to curb state restrictions on national markets that arise from outright prohibition or discriminatory regulation and taxation, all of which are designed to make it more difficult for out-of-state firms to compete with their in-state rivals. To combat that threat the Court has developed the negative or dormant Commerce Clause. Even if that doctrine is not explicitly authorized by constitutional text, it certainly resonates very powerfully with the general normative theory of competition first.

A third potential monopolist, and the focus of our discussion here, is the federal government. So long as it has extensive national powers, it is able to exert cartel-like control over production and distribution in national markets. Respecting the original limitations on the scope of the federal commerce power, however, impedes the ability of the United States to organize cartels. If it lies beyond the power of the federal government to regulate the activities of local manufacturers and farmers, then how can it cartelize the marketing of their goods?

III. THE NEW DEAL CASES

What is so striking about the Supreme Court's New Deal jurisprudence is that, as best I can tell, it reads as though interpretation of the structural Constitution should be keyed to promote national cartels. One characteristic of industrial planning during the 1930s, both in the United States and in Europe, was the belief that state-administered cartels could stabilize production and thus achieve desirable long-term outcomes.

Consider, for example, Justice Cardozo's dissenting opinion

2. The most prominent example of such an antitrust law is the Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (1994).
in *Carter v. Carter Coal Co.* Justice Cardozo asserts that, when prices start to go down because of intense competition, the federal government under the Commerce Clause has the power to prop them up. Supporters of cartelization believed that the great vice of capitalism is that it allows orderly exit from the market to occur. It was under such a misconception that the National Industrial Recovery Act, which the Court struck down in *A. L. A. Schechter Corp. v. United States*, was implemented.

The same efforts to support cartel structures were also found in *United States v. Butler*, where the United States sought to use its spending power to rig national agricultural production to prevent "overproduction" without having to allow some farmers to go out of business. The government imposed a set of taxes upon the various local farmers, put the revenues from those taxes into the national treasury, and then remitted those particular taxes only to those farmers who reduced their acreage under cultivation. The deal looked powerfully coercive when viewed from the perspective of an individual farmer: the tax was precisely calculated so that if a farmer decided to stay out of the acreage reduction program he would go out of business. So farmers stayed in. The net effect of the program, therefore, was to transfer money from the farmer to the federal government and then back to the individual farmer. The back and forth movement of cash was a wash. But the real change was that the total amount of agricultural production was reduced which kept prices at an artificially high level. The program was a textbook illustration of the use of government power to advance monopoly behavior.

The Court invalidated the tax by finding that coercion was directed to individual farmers, but that short-sighted view oversimplified the situation. To be sure, some farmers were opposed to all forms of crop support and acreage limitations on

4. 298 U.S. 238, 324 (1936) (Cardozo, J., dissenting). Today this dissent no doubt represents the law.
5. 295 U.S. 495, 523-24 (1935) (noting that the Live Poultry Code, under which defendants were convicted, regulated the sale, purchase for resale, transportation, and handling of live poultry "from the time such poultry comes into the New York metropolitan area to the time it is first sold in slaughtered form").
7. See id. at 53-56 (describing relevant provisions of the Agricultural Adjustment Act).
8. See id. at 53-59.
9. See id. at 70-71.
principle. But for many farmers the program operated as a political solution to a "prisoner's dilemma" game in which all farmers would otherwise defect (by planting excessive acreage); to the extent that individual farmers were coerced, it was for their own benefit. The tax and rebate system therefore was an ingenious effort to use the Spending Clause to get around then-applicable limitations on the Commerce Clause which would not permit Congress to issue a flat prohibition on planting more than the specified number of acres. The true losers in this elaborate scheme of tax and rebate were the same individuals who would have lost from a direct restriction on acreage. It was consumers who suffered because they were forced to deal with stable cartels instead of competitive markets.

Schechter, Carter, and Butler were all decided before the constitutional revolution of 1937. In them one can sense that a fragile majority of the Supreme Court had a dim appreciation of the dangers of this sort of industrial policy with its rigging of the markets. The majority's willingness to strike down these efforts at cartelization showed how sound constitutional structure could work in aid of sound national policy. Unfortunately, the judicial will did not endure; when the pressure mounted, the Court, as is so often the case, retreated.

By the time we reach the National Labor Relations Act cases in 1937, the mood shifts. Now it appears as though the large impacts that labor unions have on national markets is a reason to regulate them at the federal level and thus to promote the organization of labor cartels through mandatory collective bargaining. Once this happens, of course, the Court must backtrack and rethink what it has done with agricultural goods and natural resources. The upshot is the decision in Wickard v. Filburn, where Justice Jackson sustains the use of the Commerce Clause to prevent a farmer from growing grain for his own livestock. In its odd way, Justice Jackson's decision is surely correct, for if the object is to maintain a nationwide cartel, then


Congress must find ways to curtail local sales and local consumption. We find out that what the Court cares about is not the ultimate structure of the national market but rather the power of the political branches to decide the particular form that any national market will take. Competition and cartelization are just two alternative forms of economic organization. No value judgment can be made, at least judicially, about their comparative worth.

This approach, I think, marks the endorsement of a very important mistake. We need to consider very carefully which matters a Court should constitutionalize and which matters it ought to leave to the political process. To the extent that we are able to make uniform and permanent judgments about the desirability of one form of arrangement relative to another, then we have a candidate for systematic constitutional protection. To the extent that we are dealing with questions such as which wars to fight or treaties to sign, we cannot hope to have any degree of confidence in a general rule. Accordingly, we ought to commit such matters to the legislative and the executive branches. By this test, the pre-1937 understanding of the Commerce Clause was superior because it made it much more difficult to organize national cartels. For this reason, the pre-1937 view should be defended on structural grounds.

By way of important caveat, it would be a mistake to say that these are the only grounds that matter. But here the textual arguments that set commerce in opposition to manufacture and production are strong enough to carry the day in their own right. What an appreciation of structure does is to knock out any dubious claim that some structural argument cuts against textual ones so that the 1937 Court was right to treat the former as more important than the latter. Quite simply, both strands of constitutional interpretation moved neatly in tandem.

IV. Dismantling Federal Power: Prospects for the Future

Those who disagree with my arguments might claim that courts should not be making these types of policy decisions because they lack the competence to make informed judgments about complex economic arrangements. It is, we are told,

13. See, e.g., U.S. CONST. art. II, § 2, cl. 2.
always a mistake to take economic issues from the political branches which are far better able to handle them. In my view, this argument is mistaken.

In order to see the error, let us look briefly at the current situation under the dormant Commerce Clause. What we observe is a completely different constellation of constitutional values. There the Court takes charge and makes profound decisions on state regulation. Perhaps the Court is emboldened because it knows that Congress can overturn its decisions if it thinks them incorrect (although they rarely are). But what is so striking is the rhetoric that the Court uses to support its decisions. It displays the firm conviction that the main judicial goal is to preserve competition in the national market from state regulation. Once the justices start from the right view of their goal, they do a good job in protecting competition and free markets.

When the Supreme Court has scrutinized state agricultural adjustment programs under the negative Commerce Clause, the Court has had the good sense to strike them down. For

---

14. As I have explained elsewhere, the negative or dormant Commerce Clause power "prohibits states from intruding on the federal authority over interstate commerce even absent any congressional legislation on the subject of the state action." Epstein, Proper Scope, supra note 1, at 1408.

The negative Commerce Clause is essentially an interpretation of congressional silence—the Court assumes that the Founders and the Congress intended for interstate commerce to be the exclusive province of the federal government. See Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 209 (1824) ("It has been contended by the counsel for the appellant, that, as the word 'to regulate' implies in its nature, full power over the thing to be regulated, it excludes, necessarily, the action of all others that would perform the same operation on the same thing . . . . There is great force in this argument, and the Court is not satisfied that it has been refuted."). But see Willson v. Black Bird Creek Marsh Co., 27 U.S. (2 Pet.) 245, 252 (1829) (upholding state statute against negative Commerce Clause challenge, stating, "[i]f congress had passed any act which bore upon the case; any act in execution of the power to regulate commerce, the object of which was to control state legislation . . . . we should feel not much difficulty in saying that a state law coming in conflict with such act would be void. But congress has passed no such act.").

15. The regulation of insurance offers an excellent example of Congress overturning a decision by the Court in order to preserve state authority to regulate interstate commerce. In United States v. South-Eastern Underwriters Ass'n., 322 U.S. 533 (1944), the Court interpreted an act of Congress broadly to cover insurance despite prior rulings stating that insurance did not constitute interstate commerce. The Court assumed that "Congress wanted to go the utmost extent of its Constitutional power in restraining trust and monopoly agreements" and held that insurance was covered by antitrust laws. Id. at 558. In response, the Congress enacted the McCarran Act, 15 U.S.C. §§ 1011-1015 (1945), which overturned South-Eastern Underwriters and thereby preserved state authority to regulate insurance. The Court, in turn, upheld the McCarran Act as a constitutional delegation of congressional power to the states in Prudential Insurance Co. v. Benjamin, 328 U.S. 408 (1946).
instance, the Court recently decided *West Lynn Creamery, Inc. v. Healy,* a case involving the administration and regulation of dairy prices in Massachusetts. Massachusetts imposed a uniform tax on all dairy producers, whether inside or outside the state, and then took the tax proceeds and gave subsidies only to in-state producers. The state argued that there was no cause for complaint about this particular form of tax because it was uniform with respect to everybody. The Court indicated it was not faced with a very difficult problem at all. To the extent that Massachusetts placed a tax on all producers while providing a rebate only to some, the result was a differential cross-subsidy. Massachusetts was effectively imposing a tax on out-of-state producers for the benefit of in-state producers, even though such a policy would surely hurt, to some extent, Massachusetts consumers. The Court dutifully invalidated the tax.

The courts, I submit, should be equally assertive in protecting the substantial ends of the Constitution against federal programs as well. The courts should reverse the limitless reading of the Commerce Clause and reject the implicit economic logic that underlies the vast expansion of federal power: agnosticism between state-rigged cartels on the one hand and purely competitive processes on the other. Markets are not perfect; they do not always clear and all sorts of perturbations can happen. The weaknesses of markets, however, are aggravated tenfold by the presence of organized state cartels. The only question, to my mind, then, is how we can dismantle the federal power.

It will take more than a single constitutional decision. It will actually take some loyalty by the state appellate court judges and by the federal circuit court judges to push *United States v. Lopez* beyond its currently embattled position. Our task is not to work the political revolution in a moment. Our task is simply to understand that there is a strong intellectual case for

17. See id. at 188-92.
18. See id. at 198 (noting the respondent's argument that the tax was valid because of its "nondiscriminatory" nature).
19. See id. at 188, 207.
recognizing that the pre-1937 synthesis on these issues was, in fact, more intellectually coherent than the post-1937 approach. Precisely because we do have competitive national markets, we do not want national powers to regulate the wages and prices in those markets.