
THE ROLE OF GOVERNMENT IN THE FREE MARKET

TIMOTHY SANDEFUR VS. HENRY BROWN*

MR. SANDEFUR: I'd like to briefly explain the law of economic liberty, and why this is an important area that really deserves much more judicial certainty and judicial protection than it has today. When you talk about economic liberty and the law, the big case is *Lochner v. New York*. *Lochner* was rightly decided, and it ought to be revived today. The reasons why are a little bit complicated for such a brief presentation, but I'll do my best.

What happened in that case was the State of New York made it illegal for bakery workers to work more than sixty hours a week. Some bakers who didn't have enough money liked to work more than this so they could earn more money. Mr. Lochner owned a bakery and allowed one of his workers to work overtime to earn more money—and was arrested. The New York State courts upheld the conviction, and the U.S. Supreme Court, in a 5-4 decision, overturned the conviction saying that the law violated Due Process Clause of the 14th Amendment.

The whole issue in *Lochner* centers on what is meant by “substantive” due process? To understand that, you need to look into political philosophy. What is the purpose of the state? That's a very complicated question, one that many people don't think is relevant today. Many people think that the state has no purpose. It simply is. Government simply is an outgrowth of human existence. People like Robert Nisbet, Richard Weaver, or Russell Kirk would make this argument.

America's Founding Fathers disagreed. They believed government does have a purpose and to understand what it is, they examined the writings of several political philosophers from centuries hence. One of these was Thomas Hobbes. In *Leviathan*, Hobbes starts by imagining what the world would be like if there were no such thing as government, what he called the “state of nature.” In this state of nature, people go around beating people up and taking away their things. Life in a state of nature would be “nasty, brutish, and short.” People would hate this so much that they would create a government in order to protect them.

What's interesting about Hobbes's state of nature is that he says there's *nothing wrong* with the big, strong people beating up the weak people and taking their things. There's nothing wrong with that because justice is whatever the government says it is. There's no such thing as justice without an authority figure to declare something just or unjust. If the government doesn't exist, there's no reason for the strong not to beat up the weak and take their things.

He says that in the state of nature, “There would be every man's that he can get, and only for so long as he can keep it.” There are no natural limits on what people can do to each other in a state of nature, no natural justice about

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*Timothy Sandefur is a fellow with the Pacific Legal Foundation. Henry Brown is a Professor at the University of San Francisco Law School, where this debate was held in October 2005.

people's treatment of each other; therefore, there's nothing to limit what kind of government people create. If you have the right to beat up weaker people in a state of nature, you can create a government that does just this.

John Locke, the seventeenth-century political philosopher, disagreed. He said that you can imagine what the world would be like without government, in a state of nature, and yes, people would beat each other up and take away their things. It would be *wrong*, however, because justice *does* exist before the state. Justice is something natural about human beings. Since it's wrong to beat up people and take their things, even if the government doesn't say so, then when the people get together to create a government, they face limits on what kinds of government they can create. Since they don't have the right to beat people up, they don't have the right to ask the government to beat people up for them. There are natural limits on what government can do.

Government exists to protect us from bullies; therefore, government cannot fall into the hands of bullies. It would be easy for it to do so. Bullies could take over the government and use it as a tool for their own benefit. Instead of beating people up on the sidewalk, they could create a bureaucracy to do it for them.

I'm reminded of an episode of *The Simpsons*, where Homer goes back to college, befriends the nerds, and gets them kicked out for a prank that he pulls. As the nerds are sadly leaving the college, Snake the Bully comes up and says, “Wallet Inspector.” They hand over their wallets and say, “You'll find this all in order.” He says, “I can't believe that worked,” and runs off with their wallets. Now, according to Hobbes, there's no reason that the government couldn't create a Wallet Inspector Department to just take people's wallets. Locke says that would be unjust. It would be a bully exploiting the power of the state for his own benefit, which would violate the basic purposes of government. If you had a security guard at a bank who decided to rob the bank, he would have exceeded his authority and committed wrong; he loses his legitimacy. The issue would be the same.

The difference between a legitimate use of force and an illegitimate use of force is, therefore the difference between law and mere command, and that's really important. Lockean political philosophy, unlike Hobbesian political philosophy, can distinguish between law and a mere command. *Law* is the use of the state's force to actually protect all of the people in society from wrongdoing. A *command* could be that, or it could be a bully using the power of the state for his own benefit, by taking away property belonging to people he doesn't like, like the King of England did.

That's largely what the Magna Carta was written to address. King John was using the state to take away property from people he didn't like and keep it for himself. The Magna Carta has a provision that says no freeman shall be “disseised of his freehold, except by the law of the land.” You can't use the power of the state to take people's stuff

just because you don't like them, or just because they're unpopular or rich. You can only take people's stuff in punishment for a legitimate public offense, or in the furtherance of some kind of law that actually protects the general public.

So we see here two competing visions of government. Are there natural limits on what government may legitimately do to us, or is government radically free to do to us anything that it wants? Can government fall into the hands of bullies? In *Federalist* 51, Madison says, When you create a government, first you must create a government strong enough to control the people, but then you must also create a government strong enough to protect itself from falling into the hands of bullies who will use the government power to take people's things or to pass mere commands rather than law. The Founding Fathers intended to ensure that when government takes our things, it does so only for legitimate public reasons and not just to benefit particular classes. That's what the discussion of factions in *Federalist* 10 and *Federalist* 51 are about.

Modern economists call this the public choice problem, or rent-seeking, which tells us basically that when government can take things from some people and give them to others, that power will become a prize in a political contest. People will compete against one another to get the government to do it on their behalf. Let's say there are fifty people in this room, and I could take a dollar from each of you and give the fifty dollars to one of my three best friends. How much are they going to spend in an effort to convince me to give them that fifty dollars? It's simple gambling odds: \$50 times the 1/3 chance of them succeeding: a little over \$16. If they spend more than that, they tend to lose out. Now, how much are all of you going to spend to convince me not to take the one dollar from you? Only ninety-nine cents, right? If you spend two dollars trying to talk me into not taking your one dollar, you still lose. There's all this effort to get me to give you the money, but not much effort to get me to *not* take away *your* money. Everybody wants the government to do something for them, but they don't really care about the government taking their stuff.

There is a distinction between law and mere command. Mere command is when the state uses its power outside the boundaries of legitimate government, and it can do that because of the public choice problem to benefit organized groups against those who are disorganized or who are less politically able, persuasive, and adept. Who are those people? The poor.

The greatest case on this subject is *Loan Association v. Topeka*, a case from the 1870s in which the Supreme Court considered the constitutionality of a law that took taxpayer money and bought bonds in a private railroad. It took money from people who couldn't say No—because it was tax money—and gave it to a private railroad for its own private profit and private development. It took money from people who earned them and gave it to people who did not, because the railroad company had better lobbyists. The Supreme Court said that was unconstitutional under the Due Process Clause because it's mere command and not a law. Robbery, the Supreme Court said, is “nonetheless robbery if it is done

under legal forms.” That was the concept of economic substantive due process, and that's similar to what appeared in the *Lochner* case.

In *Lochner*, when New York made it illegal for people to work more than 60 hours, it was not actually benefiting the public; it was benefiting a particular class—those people who favored the law, the bakers who benefited from the law, and the labor activists who liked the law—at the expense of another class of people, those bakers who did want to work more time. It was not for a legitimate public reason, because there was no connection between the law and protecting the public health. The Supreme Court said there's no evidence that tired bakers cause illness, or that exposure to flour causes illness, or that the public at large is at risk from bakers who work overtime. It does not advance the public welfare and therefore does not satisfy the Due Process Clause, because it's not a law. It doesn't do something for legitimate public reasons. It's mere command.

Lochner is an unremarkable case in itself, but Justice Oliver Wendell Holmes' dissent is really interesting. Justice Holmes was a Hobbesian, very explicitly so. Holmes did not believe in natural rights or individual rights at all. For Holmes, to talk about the idea of morality having some connection to human nature was absurd; it was, he said, “like churning the cosmos in hopes of making cheese,” because there is no such thing as natural morality. Morality is whatever the people say it is. As a result, the government can do anything it wants to people, including forcibly sterilize them against their consent. There's no natural limit to what the government can do.

In his *Lochner* dissent, Holmes says that “a constitution is written for people with fundamentally differing views.” That is an astonishing statement! Never before in the history of Western political philosophy had anybody suggested that you can have a constitution for people of fundamentally differing views. You have a constitution for people of fundamentally *shared* views. They may differ on the specifics, but they have to share common core beliefs about justice and injustice and right and wrong to have a constitution. For Holmes, however, the Constitution is simply a mechanism by which groups battle for power, because that's all there is for Holmes. There's no such thing as individual rights.

In his great dissent about free speech in *Abrams v. the United States*, he opens by saying “persecution seems perfectly logical to me.” For him, free speech was only a matter of social usage. It was good for society, and that's the only reason people have free speech. It's not a right; it's a privilege. That attitude toward rights took over after *Lochner* was decided and is today the prevailing view in the legal world. It became thus in 1937, with New Deal cases such as *United States v. Carolene Products* that invented the rational basis test.

When the government deprives you of your right to earn a living, a right protected in common and case law since at least the 16th century, a right which Justice William O. Douglas himself called “the most precious liberty that man possesses”, that is basically okay. The law only has be “rationally related to a legitimate government interest.” As

long as some non-drunk person could have voted for the law, it passes the rational basis test, and that's the current level of protection for economic freedom in this country.

Who is harmed by the rational basis test? That depends on your view of the free market. A lot of people hold this mythological view that capitalism is bad for the poor. Nothing could be more absurd. Capitalism is the only hope of the poor. Capitalism is the only way to lift people from a low economic status to a high economic status. To talk of economic liberty as benefiting the wealthy is patently absurd.

I'll give you an example. When I was clerking at the Institute for Justice, we considered doing a case in Florida about taxi cab drivers in Miami-Dade County. To drive a taxi in Miami-Dade County, you need a license, and the licenses cost \$15,000 each, which means that you have to lease them. You can't afford to buy them. All of the licenses are owned by three main businesses that lease them to drivers at \$500 a week, which means that the drivers drive from Sunday until Thursday to pay for their licenses. What they make the rest of the week is theirs to provide for their families and themselves. Now, it's not rich white guys driving taxis. It's the poor. It's the members of the underprivileged class, the immigrants, the people who live in the inner-city, who need the opportunity to earn a living. Unfortunately, the regulatory welfare state that we have imposed on people, largely by ignoring the 14th Amendment's Due Process Clause, deprives them of economic opportunities, makes it more expensive to hire them, makes them comply with absurd licensing requirements that are almost impossible to satisfy to get a legal job, raises the minimum wage to make it more expensive to hire people and provide them the kind of training they need in order to advance socially, and drives them into underground black markets providing services without a license, or even into the drug trade.

That's the briefest possible explanation of *Lochner* and why *Lochner* was right. *Lochner* stands for the principle that government exists to protect us in our rights. It does not exist to take things from the weak and give to the strong. It does not exist in order to give special favors to the politically favored at the expense of those who cannot persuade the government to do their bidding. The people who win in a competition of interest groups in the lobbying contests are the rich, the powerful, and the politically connected. The more power that you give to the government to redistribute wealth, the more power you're giving to lobbyists. The more power you give to lobbyists, the less power you give to the people who live in the inner-city, the working-class people who have to work for a living rather than trying to persuade the City Council to do things for them. Liberty helps us all, and it helps the poorest most of all because they don't have political power. They have to rely on the Constitution.

PROFESSOR BROWN: There is a distinction between a philosophical discussion as to what we think we ought to do and what we can't do. What is the role of government in a free market? Whatever it wants. I don't say that because that's what I'd prefer. I say that because I think the

Constitution gives the government a fair degree of leeway. How does it do that? Before I answer that, there are two other questions. One is what is a permissible role of government? What can the government do under our Constitution? The second one is what's the advisable role? Tim has spoken very eloquently about the advisable role. I think we also have to speak to the issue of the permissible role, which is dictated in Article I. "Congress shall have the power to regulate commerce with foreign nations, and among the several states," and to make all laws which are necessary and proper for carrying that out. If they make the connection between commerce and what they seek to legislate, Congress has room to act. That's number one. Then the question is, Should they act?

For that question, you should take a look at the intent behind the Commerce Clause. In 1783, Great Britain was closing its ports to U.S. shippers. Today, U.S. shippers would go to the government and say, If Britain is closing their ports to us, we ought to close our ports to them. That's fair; we need that to protect free markets in our own country. At that time, however, we couldn't do that, because the Articles of Confederation did not give the federal government power to act in those situations. When the Founders were debating the Constitution, one of the things that came up was we need to have a federal government with sufficient power to regulate interstate commerce and commerce with foreign nations to protect the free markets, U.S. industry, and U.S. businesses. The Constitution would be viewed as a document designed to protect the economic interests of the property class. It's protected through the power to regulate, not the power to let alone. They want that regulation to protect their interests. One of the primary reasons for the Commerce Clause, in the first place, was to protect the power and the interests of the business class in the free markets of the United States.

In *Lochner*, the Court says that the maximum hour law is invalidated for three reasons. One, it infringes upon the workers' freedom to contract. They felt that the worker had the right to work; they had a right to the job. A law that precludes them from working as they would infringes upon their freedom to do that, their freedom of contract, and their freedom to make a living. Second, government can interfere with that agreement or contract only to serve a valid police purpose, and it's for the Court to decide what a valid legal purpose is. Finally, it was the role of the Judiciary to scrutinize legislation to protect the people from a broken contract. In other words, the Court in *Lochner* saw its role as protecting the freedom of contract in a free market, not interpreting the role of government in the Constitution.

The Court views the Government's actions in the *Lochner* case as a form of wealth redistribution, as a way of distributing wealth in a negative fashion. After the Depression, after the Roosevelt threat of court-packing, the Court returned to this issue. Chief Justice Hughes later asks what this freedom of contract is, for the Constitution does not speak of it. I would say, Maybe it's in the same place as this right to privacy. Conservatives would argue that there's no right to privacy, yet they will strongly hold onto freedom of contract. Hughes is saying, where in the document do

you get this freedom of contract? Going back to my first issue, what can the government do to regulate the free market? Anything it wants. Why? Because there's nothing in the Constitution to preclude that. To the contrary, the Constitution gives the federal government broad powers to regulate markets. But should the government regulate markets?

It's easy to answer the first question. Do they have the power? Yes. The second question is harder: Ought they to do that? Are there reasons why the government should stay out of it? From a practical perspective, the government's not very good at that. There are certain inefficiencies with respect to the government's activities, with respect to the market, but there are other issues to consider. Number one, what do we mean by free market? Whenever we talk about the free market and the rights of business to be free from government intrusion, it's not entirely clear to me what we define as free markets. We have great laws which greatly favor U.S. business, both domestically and internationally. By businesses, I don't mean businesses in general. We have laws that favor some businesses over others. We have tax policies that favor businesses in general. The Bush Administration has passed tax cuts that favor one to ten percent of the population, generally people who own or invest in businesses. If you have a tax policy that disproportionately redistributes wealth to the wealthy, that policy will also help business. We have a policy that strikes me as not necessarily free in the conventional sense because it is a policy that encourages certain types of behavior that are most favorable to business. Finally, we have Federal Reserve policies which encourage businesses to reinvest in infrastructure and in stocks. When the Federal Reserve manipulates the interest rate, those choices are made in part to encourage you to make certain decisions, decisions which favor business. The government is very involved in the free market and in manipulating the process, and it's often in a way that favors business over the individual. I'm not entirely certain what we mean by free market. Free market in the classic sense is that the government is not involved. From the perspective of policy, in regard to taxation as well as manipulating the process, our government is directly involved in this process.

It's really not a free market. Congress sent President Bush a letter complaining about Halliburton's activities. They pointed out a couple of key things that Halliburton is doing they felt were improper for the government to promote by giving them provisional contracts. They pointed out bribery, big-rigging on foreign projects, dealing with nations suspected of terrorism, considering employees indicted for fraud. There was an audit that determined there was \$2.8 million charged for hotel costs, while the audit found there were cheaper alternative hotels. There was a charge that the company was overcharging fuel supplies that came out to \$212 million. There was a charge that the company billed the government over 36% more for meals than were allegedly served to troops in Iraq. How is it a free market when we have an administration that gives preferential treatment to particular companies? More importantly, not only did we give preferential treatment but we allowed them to be fairly

lax in how they take advantage of that freedom, of those choices, of that preference. How are we defining a fair market if other companies are kept out of the process of bidding for Iraq work, or one company gets a disproportionate share?

What is the appropriate role, considering all these issues, of a government in a free-market? There are three key areas. One is to regulate Congress to ensure nondiscriminatory policies, and by that I mean policies which favor business. What is the traditional use of the Commerce Clause? It is to protect businesses from discriminatory processes and allow unfettered transit of commerce throughout the states to help business.

Second, to protect citizens from the aggressive tendencies of the marketplace. That's both for prospective workers and purchasers. When companies aggressively act in the marketplace to the detriment of workers and purchasers, it is to the disadvantage of all citizens. The local Channel 7 here has this "Eye On" segment where they investigate business practices, and they expose whatever the business practice is and make them change their practices for the betterment of the citizens. That's at five and eleven o'clock. When a business does something to the detriment of the consumer, they look to the government for aid and regulation. When we look at the cost of prescription drugs, we look to the government for aid in stemming the high tide of that cost or for relief from the burden of the cost in the United States. We look to the government for some help with these issues, to encourage behavior which benefits the whole. At the extreme, we have *U.S. v. Heart of Atlanta*, the case in which the Civil Rights Act of 1964 was used to prohibit the motel from excluding African-American guests. Does the Constitution support regulation of private actors? No. However, Congress would be able to take the Commerce Clause and pass legislation on issues that affect interstate commerce. The argument is that if you run a motel, that motel is in the business of interstate commerce. The discriminatory practice of that interstate commerce discourages people from travel in certain parts of the country. That behavior is one that is good behavior for Congress to discourage, and they do so through the Commerce Clause. They do so as a form of regulation of business.

Are they taking the commerce clause to its logical extreme? Absolutely, but it's one that benefits a societal goal. On many levels, that is a permissible use of government action with respect to regulation of the marketplace. All you're doing is stopping undesirable tendencies. If anything, you're actually increasing their business by increasing the people who are able to use the hotel. Some people might say I'm no longer going to go there because they encourage these people to come, but most likely they will be off-set by the people who will start going to the hotels.

Government can clearly use preferential policies to encourage business to act. Does that improve the free market? Absolutely. Does that interfere with the freedom to choose? No doubt about it. If the society is acting in a way that's not beneficial to the whole, then government is free to use the tools at its disposal to encourage different behavior. Often those tools have a direct effect on the free market.

Kenneth Lux's book, *Adam Smith's Mistake*, has an interesting parable in it. Sometime during the waning days of the Middle Ages, two merchants and a monk were traveling together. The monk was just returning from a pilgrimage to Rome. The merchants entertained both themselves and the monk with stories of what they had bought and sold during various exploits. The monk, feeling somewhat badly that he didn't have much to offer in the way of stories, thought to show the merchants the silver chalice he had purchased in Rome and was bringing back to his cathedral. He was pleased when they were duly impressed, as he had been, with its simple elegance and beauty. Being merchants, accustomed to being bold in such matters, they asked the price. When the monk told them, they were amazed. He had paid far less for it than it was worth. Laughingly, they congratulated his unworldly soul for driving such a hard bargain. They were surprised, however, when the monk did not take pleasure or satisfaction in their congratulations. Instead, he became rather morose and turned silent, and his face began to dim. The monk said, This is terrible. I must now proceed back to Rome and try to find this fellow and give him a fair price. The merchants, at the very least, must have rolled their eyes.

This story is told because we make assumptions about the free market, how the free market benefits society, how, if we always act in our self-interest, if we always make choices that will maximize our own economic worth, we will benefit the whole. An example of that, Bush's tax cuts benefit the whole. If the definition of benefit is that the size of the pie is going to increase, that the amount of wealth has been maximized, there's no disputing that tax cuts benefit the whole. But at what cost? Katrina happens. Millions of dollars a month are spent on Katrina and instead of having a surplus, we now have a deficit. When Bush speaks of sacrifice, the sacrifice is not the tax cuts, which benefits business in the free market. The sacrifice is the individual. Katrina will be paid for with that sacrifice. You can't always make decisions based solely on the assumptions of the free market. In effect, the free market will write a contract. The right to make the choices will ultimately benefit the whole. Sometimes there's just a policy choice. Sometimes the whole is better benefited by encouraging behavior which is more beneficial to it.

