



THE STATE AND THE RULE OF LAW IN A MIXED ECONOMY

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PREFACE

THE present book is a revised version of the Tagore Law Lectures, delivered by the author at Calcutta University in January 1970.

There is not a single contemporary country in which the state is not today actively involved in the conduct of economic affairs. State intervention ranges from the total control and planning of economic activities in the "centrally planned" economic systems to countries which, like the United States, still adhere to the ideology of free enterprise, but have in fact a great variety of regulatory and even entrepreneurial state activities. It is the object of this book to analyse some of the major types of state involvement in the "mixed economy," *i.e.* the economic systems—representing the great majority of the world's contemporary states—in which public and private enterprise operate either side by side or in competition with each other. Since state activity has in most cases grown haphazardly, a systematic analysis of this problem has lagged behind the actual growth of state intervention. It is hoped that the following pages will make some contribution to the discussion of this crucially important area.

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WOLFGANG FRIEDMANN
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CHAPTER 1

SOME OBSERVATIONS ON PUBLIC AND PRIVATE ECONOMIC POWER IN CONTEMPORARY DEMOCRACY

I CAN think of no more challenging task than to discuss in this book some basic aspects of the rule of law in a changing world. It is primarily as a lawyer that I propose to outline some of the major structural changes and problems posed by the growing role of the state, and the increasingly intricate interlocking of public and private power in contemporary democratic society. Yet it would be inexcusable for a lawyer, dealing with a theme such as this one, to ignore contemporary trends in economic, political and sociological thinking. Any legal order is a reflection of certain political and social values. It is political and economic factors that determine the role of the state in the economy. There are two tasks that the lawyer can and must fulfil in analysing the role of the state. One is the imparting of order and some kind of system into the variety of political, economic and social phenomena, a quality which is—or at least should be—the result of legal training. The other is the lawyer's specific concern with the problem of justice. Justice, or what is, in contemporary debates, often called the "rule of law" is not an absolute. Unless we accept the more inflexible kinds of natural law philosophy—all of which, in this writer's opinion, express a particular kind of political and moral philosophy under the guise of eternal verities¹—we shall have to admit that ideals of justice reflect widely differing concepts of society. There are ideas of justice which enshrine the inequality of men, races, nations or

¹ For an elaboration of this view see *Legal Theory* (5th ed., 1967), Chap. 28, especially p. 350 *et seq.*

castes, opposed by those that stress man's basic equality, irrespective of nation, race, religion or social status. There are philosophies of justice which are based on the sanctity of private property—justified by earlier philosophers such as Locke or Hegel as the natural fruit of man mixing his sweat and labour with the soil. On the other hand, Socialist philosophy regards the public ownership of the major means of production and a minimum claim of each to a share of the resources of the nation as elementary aspects of justice. The list of antinomic ideas of justice could be indefinitely extended. In these lectures, my concern will be a limited aspect of the rule of law—its function in non-totalitarian societies which have a "mixed economy." In the words of a distinguished authority,² "This phrase is commonly interpreted to indicate a situation in which the role of government as owner and regulator has become sufficiently large to cast doubt on the validity of 'capitalist' and 'free enterprise' as appropriate adjectives but not sufficiently large to justify the appellation 'socialist.'" This excludes the countries that have a more or less totally socialized economy,³ *i.e.* the Soviet Union and the countries joined with it in the Comecon, as well as Communist China. In these countries, the major means of production are socialized and subject to centrally directed planning. Private property exists to a limited extent and enjoys some legal protection but it has no significant impact on the economic planning and structure of the country. By contrast, the "mixed economies" are all characterized—though with a great variety of "mixes"—by the coexistence of public and private economic power. To a considerable extent, this means a mixture of public and private enterprise, either by the nationalization of certain sectors of industry, or by the competition of public and private enterprise in certain sectors of the economy. But a mixed economy means much more than that. It encompasses a variety of ways in which the power of the state is used to control or direct the economic system of the

² E. Mason, in Mason (ed.) *The Corporation in Modern Society* (1960), at p. 15.

³ In UN language, they are called "centrally planned economies."

country, even insofar as it remains operated by private enterprise. In this book I shall attempt to sort out the principal ways in which state control is applied to the economic system. I shall distinguish between four major aspects of state power in the national economy.

FOUR FUNCTIONS OF THE STATE IN THE MIXED ECONOMY

The first function to be discussed is that of the *state as provider*. This is a function commonly associated with the concept of the social welfare state. In this capacity, the state makes itself responsible for the provision of social services so as to ensure a minimum standard of living for all, in mitigation of the free play of economic forces.

Second, the *state functions as regulator*. In this role, the state uses various leverages of control, notably the power to regulate investment in industrial development, the volume and kind of imports and exports through such means as exchange controls, and import and industrial licensing controls. This device, though used by any country that suffers from a more than temporary balance of payments deficit and a consequent foreign exchange shortage, is particularly important for the developing countries, such as India.

Third, and most important, *the state functions increasingly as entrepreneur*. It operates certain sectors of the economy, either through semi-autonomous government departments, or through state owned corporations. It is the co-existence of the public and private sectors of industry which poses certain fundamental problems of equality of treatment and equity as between the public and private sectors. The difficulties are due to the fact that the state also exercises a fourth function, which we may term: *the state as umpire*. The state as the repository of legislative, administrative and judicial power must evolve some standards of justice, as between the different sectors of the economy—some of which are state enterprises. It must therefore differentiate between the entrepreneurial and the arbitral function.

I need not emphasize how important an understanding and appraisal of these various state activities is in India—a country that has, since independence, been governed by a philosophy of “mixed economy” and social welfare.⁴ The constitution itself outlines a “public sector,” *i.e.* the categories of industries and public utilities that are to be operated by the state itself. Important though this public sector is—and the sphere of state enterprise has recently been increased by the nationalization of banks—it underlines the fact that India is a country in which most of business and industry remains in private hands. But perhaps even more important is the regulatory function of the Indian Government, through the controls exercised over national and particularly foreign investment, in the form of industrial licence and import permits, and the allocation of foreign exchange. Countries that seek to develop and diversify their economic system under a general plan must exercise control over foreign investment and use control mechanisms to ensure priorities in economic development, foreign investment and the allocation of scarce resources within the framework of a general economic development plan.

But the “mixed economy,” and the balance of public and private power which this implies, is a world-wide phenomenon. The function of the state as a provider of social welfare is now universally recognized. The United States joined the ranks of the social welfare states after the Great Depression in 1933 under the first Roosevelt administration, and has today as ubiquitous and intricate a system of social welfare as any of the countries less addicted to the fading philosophy of *laissez-faire*. In the rest of the Western world from Sweden to New Zealand and including all the major countries of Western Europe, the social welfare responsibility of the state, despite wide differences in extent and organization, is no longer a matter of controversy. A few mavericks apart, in any country of the Western world, no party platform any longer opposes social welfare in prin-

⁴ See *e.g.* Ganguly, *Public Corporations in a National Economy* (1963), pp. 65 *et seq.*, 375 *et seq.*

ciple. Controversies centre around its scope and the financial, legal and administrative modalities.

Public enterprise is no less universal a phenomenon, although it is far more ubiquitous in some countries than in others. Public enterprise forms a major sector of the national economy in countries like Italy, where the state-controlled companies penetrate virtually all major sectors of the economy. In Britain and France the basic industries were nationalized after the war. But even in countries like the United States or West Germany—pictured as citadels of private enterprise—public enterprise plays a much greater part than generally assumed. In the United States, apart from the sphere of federal power, where public corporations such as the Tennessee Valley Authority play a major role, the various states operate hundreds of public enterprises, many of them of great economic significance. In post-war West Germany, where the market economy philosophy has dominated since the end of the war, transport, power and public utilities—which in Britain, France and many other countries are the sphere of state-wide public enterprise—are generally operated by regional or local authorities. As we shall see subsequently, the range and forms of public enterprise differ considerably from country to country. But the problem of how to adjust “the changing balance of public and private power”⁵ poses itself everywhere. In a dictatorial system, the question of how to strike this balance is not a basic problem of justice. It is rather a problem of efficiency. In the Soviet economy there has been in recent years a measure of legal and administrative decentralization of state enterprises, so as to promote competitive efficiency by a kind of price and market mechanism, commercial accountability and greater managerial autonomy. Neither in the systems of the Soviet type nor in the Fascist-corporative type of system exemplified formerly by Nazi Germany and Fascist Italy, and presently by Franco’s Spain, is the balance between public and private enterprise anything but a question of utility. But in the non-totali-

⁵ This is the sub-title of Andrew Shonfield’s important book, *Modern Capitalism* (1965).

tarian society, as it is represented by India and by the countries of Western Europe and North America, the differentiation of various functions of state is not only a matter of economic efficiency and political balance. It is also a problem of justice. It goes to the very foundations of the legal order.

THE MEANING OF "STATE"—SOME BASIC REFLECTIONS

The ubiquitous use of the word "state," in such phrases as "state control," "state Socialism," "loyalty to the state," etc., can easily disguise the fact that there are basically divergent philosophies of state, and that the adoption of the one or the other of these philosophies has far-reaching consequences for the appraisal of the relations of public and private power.

The extremes at either end are represented by the philosophies of Hegel and Marx—a renegade disciple of Hegel. For Hegel, the state is of necessity the embodiment of individual freedom. In a continuous progression of dialectic triads, from the elementary logical opposites of being and nothing, to the position of the state in world history,⁶ Hegel arrives at the glorification of the absolutist Prussian monarchy of his time as the embodiment of the world spirit. Internally, this means the denial of any right to resistance against the authority of the state by the individual, or of any autonomy of groups, be they churches, professional associations and, of course, labour organizations (which were not yet developed in Hegel's lifetime.) Externally, it means that the synthesis between the state's internal aspects could not be—as it had been for Kant—a world federation of a league of nations, but only the "passing of the state into history." For Hegel was an ardent nationalist and a worshipper of war, as the fulfilment of national destiny.

It is evident that in this conception, the state is not just

⁶ As the distinguished Italian philosopher, Benedetto Croce, *What is Living and What is Dead in Hegel's Philosophy* (1912) has shown, Hegel confuses logical opposites and historical distincts.

an organization or a focus of power, but the supreme embodiment of man's individual and social aspirations. Nor is there any distinction, in the Hegelian philosophy, between different types or constitutions of states. It is "the state" that is the embodiment of freedom. For Hegel this meant the denial of any kind of democracy and the embodiment of the personality of the state in the hereditary monarchy. The disastrous consequences of this kind of dialectic became obvious in the neo-Hegelian movements, which led straight to the philosophy of German National Socialism and Italian Fascism. The Führer, the Duce, the "Caudillo" became the impersonations of the state, expressing the will of the people in a semi-mystical integration of all the elements within the community.

While Karl Marx was schooled in Hegelian dialectics, his philosophy of state became the very antithesis of that of Hegel. The state is for Marx merely the administrative, executive and legal machinery by which the ruling class ensures its control over the means of production and the exploitation of the working class. The state is an instrument of oppression, and it will therefore wither away once the means of production have, as a result of the revolution of the working classes of the world, been transferred into the hands of the community.

Between these extremes there is a vast variety of philosophies of state, which tend to veer either towards the Hegelian or the Marxist point of view. They characterize the state either as the organic integration and emotional focus of the many groups and individuals within it, or, on the contrary, as a mere formula for the crossing and balancing of various competing and conflicting interest groups. It may suffice to mention a very few of these many theories.

For the German jurist, Otto von Gierke,⁷ a leading exponent of the organic theory of corporate personality and also a German nationalist, the state was the highest form of corporate organization, embodying and integrating all the lesser types of corporate bodies within it. For the French

⁷ *Die Genossenschaftstheorie* (1887).

jurist, Léon Duguit,⁸ the state is not a person distinct from the individuals who exercise the functions of government, which are to organize certain social services and to control their operation. All are subject to the supreme principle of social solidarity. Duguit therefore advocates strong checks on the abuse of state power—as, indeed, they have been developed in the French system of *Droit Administratif*.⁹ For the contemporary Austrian-American jurist Hans Kelsen,¹⁰ the state is nothing but a system of human behaviour and social compulsion. An act of state can be such only by virtue of a legal norm that qualifies it as such. This includes any order of compulsion, regardless of ideology. For the contemporary American political scientist, Earl Latham,¹¹ the state is essentially “a cash register, ringing up the additions and withdrawals of strength, a mindless balance pointing and marking the weight and distribution of power among the contending groups.”¹² These contending groups include the “public groups” which are endowed with “officiality.” They exercise power over all other groups and individuals; they themselves form a conglomerate of social forces struggling with each other as well as providing compromises between the conflicting pulls of private social groups. It is perhaps not surprising that such a theory should have been developed in the United States, where the conflicts of contending social and economic pressure groups are on a bigger scale and more open than in most other countries. But this is essentially a difference of scale rather than of principle. Another contemporary American scholar¹³ sees something more in the state, which he describes as “the ultimate organization of the national society, ... characterized by a common acceptance of a certain authority and by the fact that its members identify themselves with it.”

⁸ e.g. *Droit Social* (1922).

⁹ On this, see further below, p. 76 *et seq.*

¹⁰ e.g. *General Theory of Law of State* (1946).

¹¹ *The Group Basis of Politics* (1952).

¹² *Op. cit.* at p. 37.

¹³ Carlston, *Law and Structures of Social Action* (1956), at p. 65.

I have sought to articulate an intermediate position by using the concept of a "reserve function" of the state.¹⁴ To a large extent the state does indeed essentially function as a "mindless" organization, as the point at which the various contending social forces and groupings intersect. This means an absolute rejection of the Hegelian approach. The policy of a state, at any given time, represents a balance between the contending interests of capital and labour, of producers and consumers, of the organized lobbies of the manufacturers of automobiles or pharmaceuticals, of farmers, of veterans' organizations, of highway builders, railroads, shipping lines or airline carriers.¹⁵ To these private or semi-private interests we must add the "public groups," *i.e.* the groups endowed with certain aspects of public authority, such as the Civil Service, the various legislative organs or the judiciary.

But surely the "state" means something more than that. It is the focus of loyalties, of emotional allegiances and, especially in times of crisis, the embodiment of a sense of unity transcending the balancing of competing interests. The users of public transport may appeal to the public authority for protection against a crippling strike which results from a confrontation of employers and labour. The consumers may invoke state power against abuses of manufacturers, the small business may seek legal restraints on monopoly power, and so on. The residuary "public interest" which the state, through the various arms of government, is expected to grant is a complex and many-sided concept. Unfortunately, it is war, or lesser types of conflicts between nations, that bring out the residuum of loyalty to the state most strongly. It is then that people become emotionally engaged and are ready to fight and die for India or the United States, for Russia, China, or Germany. Perhaps one day these emotional identifications will

¹⁴ See *e.g.* *Law in a Changing Society* (1959), p. 301 *et seq.* and in support, Miller "The Constitutional Law of the Security State" in 10 *Stanford L.R.* at p. 645 *et seq.*

¹⁵ In his *American Capitalism* (1952), John Kenneth Galbraith has spoken of the "countervailing power" of the various organized interests that tend to check and keep each other in balance.

be transferred from the state to humanity, but the day is not yet.

In dealing with the "state" in these lectures, I will understand it both as a focus of centralized power, which results from the balance between various contending social and economic interests, and as the embodiment of certain ideas of justice and public interest encompassing the community as a whole. Millions of individuals are in fact at the same time organized in one or the other of the thousands of economic and social groupings that make up the fabric of contemporary society and unorganized individuals, who face the power of officialdom, or a large corporation, a labour union, or a professional association. As such, they look to the state for protection and implementation of some basic principles of justice. In a pluralistic society, of which the "mixed economy" is an important aspect, the help of the state may be invoked either against private power (*e.g.* price controls or anti-trust decrees or nationalization of enterprises) or against public power (*e.g.* through judicial restraint on administrative arbitrariness). In the latter case, one arm of state power is used to control another.

THE STATE AND THE PRIVATE CORPORATION

Perhaps the most important and critical aspect of the changing relationship between public and private power is the role of the modern large-scale corporation in contemporary industrial society. The big corporation is a typical and dominant phenomenon of a highly developed industrial society. In the countries of the West, it has all but displaced the individual entrepreneur. In a few cases, such as Ford or Du Pont or Siemens, the name of the founder lingers on, and the family still exercises a controlling influence. But generally the large organization enterprise is a self-perpetuating bureaucratic organization, a complex hierarchy in which chairman and presidents come and go, and function very much like Cabinet Ministers or senior civil servants. They represent and work for an institution which, in name,

and substance, outlasts any particular personality. The modern corporation has its elaborate structure and hierarchy and many of them—called “multi-national” corporations—have international ramifications. They enter into complex international agreements, either with foreign governments or with enterprises of other countries. The assets and budgets of the largest corporations exceed by far those of most of the smaller states of today. For these and many other reasons, the big corporation of contemporary capitalist society has often been likened to an empire, a political organization exercising quasi-public power, and the question of its relation to the state has been discussed by many contemporary jurists, economists, political scientists and sociologists—especially in the United States.

PUBLIC AND PRIVATE POWER, THE PUBLIC INTEREST AND THE STATE

The status of the private corporation is a major aspect of the wider problem of the relation of public and private economic power. Does this private economic power, concentrated in the giant modern corporation, absorb the substance of the state? Is the “public interest” merely a cloak for the interplay of private pressure groups, using the machinery of government? Can the socialization of economic enterprises reverse this trend and assert the public interest against private economic power? Are government-owned corporations the instrument by which public power and the public interest should be asserted? Or do the giant state corporations become autonomous power structures of their own, resembling in structure, influence and the manner of operation the private corporations which they either replace, or with which they compete?

In order to answer these questions I propose first to survey briefly some of the most important theories that have been put forward about the relationship of public authority and private economic power.

At the beginning of the century, the Austrian jurist, Karl Renner—who ended his life as the first President of the

reconstituted Austrian Federal Republic after the Second World War—published a book called *The Institutions of Private Law and Their Social Function*,¹⁶ which basically accepts, but importantly modifies, the Marxist theory that the ownership of the means of production determines the legal structure of society. Renner takes as his point of departure the thesis put forward by Marx in *Das Kapital* that, by virtue of his ownership of capital, the capitalist becomes an “industrial commander.” For Renner, ownership of capital, in the more developed industrial society, becomes the centre of a number of complementary legal institutions—such as sale, loan, tenancy, and above all, contracts of service—by means of which the function of ownership is broken up into a number of specialized functions. Property becomes the source of a number of power relationships, such as control of factories, ownership of shares, the lending of capital or the letting of property. Sometimes the substance of property passes from the owner of the formal title (*e.g.* the mortgagor) to the effective controller of the property (*e.g.* the mortgagee). Property remains the source of power, and the owner of industrial capital exercises, by virtue of his position, a quasi-public authority over the people and economic relationships that ought to belong to public authority. In a second edition of his book, published in 1927, Renner modified his position. He thought that public corporations, by carrying out economic activities on behalf of the state, and collective labour arrangements—which in the intervening quarter of a century had developed from very tentative beginnings to a major aspect of modern capitalist societies—could counter the dominance of the capitalist owner. In a significant departure from original Marxist thought, Renner came to believe that law was not simply a “superstructure” but could actively express and influence the trend of social development.

It is interesting to compare this evolution of the thought of a Marxist jurist with that of John Maynard Keynes, who—also in the 1920’s—from a non-Marxist point of view, saw

¹⁶ The revised edition was published in England and prefaced with a brilliant introduction by Professor O. Kahn-Freund in 1949.