Enterprise and American Law 1836–1937

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To my wife, Beverly,
and my children, Arie and Erik

Preface

This is principally a book about legal ideas rather than legal institutions. It should be read as intellectual history and not as political, social, or economic history, although I have attempted to integrate historians' work in all these disciplines.

The dates in the title, 1836 and 1937, are symbolic and somewhat arbitrary. In 1836 Roger Brooke Taney was appointed Chief Justice of the United States Supreme Court. The rise of classicism as America's dominant constitutional philosophy can be said to begin with him. The year 1937 saw the great court-packing crisis of the Franklin D. Roosevelt administration—an event that, though not treated here, symbolizes the death of constitutional classicism.

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Journal 1593–1689 (1988); and "The Sherman Act and the Classical Theory of Competition," 74 *Iowa Law Review* 1019–1065 (1989). I am grateful to numerous earlier readers, but have profited in particular from comments by Ian Ayres, Frank H. Easterbrook, Lawrence M. Friedman, Robert W. Gordon, Lino A. Graglia, J. R. T. Hughes, Kenneth Kress, Thomas K. McCraw, Louis B. Schwartz, and Lester Telser.

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Introduction: Classicism, Democracy, and the Rule of Law

The Classical Tradition in American Politics

"Classicism" refers to a way of thinking about policy problems that dominated American law and economics during the first two-thirds of the nineteenth century. A unified theory of political economy, classicism had broad implications for both public and private law. Because they were classicists, nineteenth-century American jurisprudents could honestly believe that the law and all of the state's economic policy formed a single, seamless web.

American classicists adopted most of their economic and legal ideas from the British. Following Adam Smith, the principal English classical economists were Thomas R. Malthus, David Ricardo, James Mill, and his son John Stuart Mill. Classicism in the United States began later than in England and lasted longer, until Progressivism discovered British welfare economics and reformulated American legislative policy to match.

Historians sometimes equate classical political economy with the thought of Adam Smith, and his name is most widely associated with classicism. But in several ways Smith was not typical of the classical tradition. His basic impulses were more agrarian and less industrial than those of his followers. And mixed into *The Wealth of Nations* was an explicitly Protestant moral content that was suppressed in later English classicism. One might wish to divide the great classical political economists into a "natural law" group and a "utilitarian" group. Adam Smith and perhaps Malthus clearly belong in the former, and John Stuart Mill clearly in the latter. The others are transitional figures. For reasons elaborated in Chapter 7, most American classicists clung to Adam Smith's moralism and rejected most forms of utilitarianism.

Classical political economy in the United States is a Jacksonian phenomenon. Although one can speak of classical political economy during the Jeffersonian era, there are two good reasons for attributing classicism to the Age of Jackson rather than to that of Jefferson. First, classical political economy was struggling to take hold in Jefferson's day, and was still a controversial economic doctrine in the United States. Second, the Jeffersonian impulse, like Adam Smith's, was far more agrarian than industrial. In fact Jefferson was quite hostile toward industrial development and would have preferred a nation of farmers with only a minimum of indigenous industry to support them.

Andrew Jackson was an entrepreneurial president. His terms of office—or, in political economic terms, his regime—stood for economic growth, unobstructed by "artificial" constraints. The two greatest classical *legal* institutions in the United States—the modern business corporation and the constitutional doctrine of substantive due process—are both distinctively Jacksonian products. The modern business corporation had its origin in the general corporation acts, one of the most important legal accomplishments of a regime bent on democratizing and deregulating American business. The founders of substantive due process—Thomas Cooley, Christopher Tiedeman, and John Dillon—were Jacksonian to the core.

Beginning with the Jackson era, the work of the classical political economists became one of the most salable products in the American market for economic and political ideas. Classicism offered a complete view of human nature, an ethical defense of self-interest, a theory of political economy that seemed to work—and all of this in a package that complemented American moral and religious beliefs about independence and individual freedom. Lawyers and judges were inevitably among this market's most enthusiastic traders. As a result, classicism as economic doctrine gradually merged into classicism as legal and constitutional philosophy.

Classicism and the Rule of Law

Classicism was not merely an economic philosophy. It was also a model for statecraft, and for private as well as public law. We seldom appreciate how closely early American jurists tied their law to economic principles. For example, one of America's first constitutional law treatises, Daniel Raymond's *Elements of Constitutional Law and of Political Economy,*[1] was also a treatise on economics. Many Jeffersonian and early Jacksonian legal scholars, such as Raymond, John Taylor, Alexander Hamilton, George Tucker, Theodore Sedgwick, and Thomas Cooper, were also political economists.[2]

Classical political economy purported to develop rules for evaluating a legal regime's justness or fairness without regard to how its wealth happened to be distributed. As a political and legal doctrine, classicism identified the best regime as the one that maximized total wealth. Distribution had secondary importance or no importance at all. But classicism did contain a theory of justice. Classicists were convinced that for too long the federal government and the states had been playing political favorites. The body politic as a whole was weaker when the state favored one politically powerful group at the expense of others—perhaps by giving it a special corporate charter with monopoly privileges or relief from taxation. The duty of the state was to enlarge the wealth of all its constituents, not merely of some. This duty was inherent in the notion of *political,* as opposed to private, economy.

Theodore Sedgwick, one of America's greatest antebellum legal scholars, expressed this view as well as any elite lawyer could. In the 1830's Sedgwick observed that the content of political economy and of law were precisely the same, except that the first was normative while the second was positive:

> What then is the difference between good laws and good public economy?—None—because all good laws tend to the production and just distribution of wealth; all good laws are good economy. But there is a difference between the science of law, and the science of public economy. The former teaches what the law is, which is the business of the lawyer to learn; the latter teaches what law should be, which is the business of the public economist, or legislator to learn. . . . The public economy of a country is clearly indicated by its laws; if the laws are good, the public economy is likely to be. . . .[3]

Above all, Sedgwick argued, political economy dealt with the welfare of the "public"—not with that of particular individual members. Only by maximizing the wealth of the group as a whole could the wealth of individual members be maximized. Political economy, he continued, teaches that

> all the wealth of a nation, public and private, may be supposed to be gathered into one great store-house, which is divided into public and private apartments; that the common stock is stored in the public rooms; that every industrious man has a private apartment, under the same roof, which is under his own lock and key. That as the public apartments are filled from the private, the better supplied the latter, the richer will be the stores of the nation. That if a man set fire to, or in any way destroy those parts of this building, where the public property is stored, he is a loser of course, because he is a partner in it, though the flames do not reach his own apartment; and if, through heedlessness, spite, or malice, he kindles a blaze in one of the private apartments, he then destroys one of those heaps, out of which the great public store-house is furnished.

For the elite nineteenth-century American lawyer, classical political economy was the best possible determinant of the rule of law. The best legal rule enlarged total social wealth, and the science of political economy provided the necessary instructions for making society wealthier. Explicit state involvement in the transfer of wealth was inherently suspect—because it made one person or interest group richer only by making another poorer.

Liberal critics today are inclined to view the classicists through the lens created by the Progressives and the policy makers of the New Deal. The classicists were bad, or at least deficient in theory, because they objected to state intervention in the market on behalf of the disadvantaged. As a naked proposition this is certainly true. But the political argument that turned Americans to the classicists was much different. To be a classicist was to be opposed to state intervention on behalf of the rich and the politically powerful. Classicism achieved its popularity in the United States in a political movement, Jacksonianism, that was heavily supported by society's disfavored classes. The issues were not welfare and subsidized education. Rather, they were special corporate charters or licenses that gave unique privileges to engage in business to certain favored people, while denying access to others. When Federalists intervened in the market, the immediate beneficiaries were generally people of property. In such a regime, arguments for a noninterventionist state leaned to the left, not to the right. To be a classicist in the 1830's was to be a liberal.

Classicism was a system for policy making dedicated to the principles that (1) the market, left to itself, works pretty well; and (2) the state should not play favorites. If classicism is to be faulted, it is not for preferring the interests of the wealthy or even of the entrepreneurial class over those of the poor. It is to be faulted for the naiveté of its faith in the market, or for its belief that the quality of a society can somehow be measured without regard to the way its wealth is distributed. But even here, classicism erected a monument that is difficult to tear down. The fundamental premise of classicism—that the government should not play favorites—is a lesson seldom learned by any alternative regime, whether fascist or Marxist, socialist or libertarian. Classicism at its best never came close to creating such a regime, but it probably did as well as any alternative.

This book explores the relationship between classical political economy and American law in six broadly defined areas relating to business enterprise in the nineteenth and early twentieth centuries. Part I examines the development of the classical concept of the American business corporation—a concept designed simultaneously to make the business corporation an efficient engine of economic development and to free the corporate form of business firm structure from its preclassical attachment to interest group politics. Part II considers how classical political economy provided the intellectual background for constitutional theory and helped define the limits of state and federal jurisdiction to regulate business behavior. Part III looks at one set of classicism's failures—the markets in which competition seemed not to work—and relates the development of "regulated industry," or separate branches of economics and law designed to ensure that even these markets would function in the "public" interest rather than for the benefit of special interest groups. Part IV argues that the Gilded Age and Progressive Era constitutional doctrine of substantive due process was driven by classical political economy, and that it became obsolete and an object of ridicule as classicism gave way to more modern, more interventionist neoclassicism. Part V describes one of the most embarrassing political failures of classical economics: its notion that combinations of capital and combinations of labor should be treated in exactly the same way. State policy should not prefer one to the other, because business combinations and labor unions organized for exactly the same reasons. Finally, Part VI reexamines the antitrust movement, the most explicit intersection of law and economics before the New Deal, and argues that we have greatly underestimated the role of economics in the common law of trade restraints.

The Importance of Theory in Legal History

Writing about the history of American economic law has been dominated by a mode of analysis that makes every issue into a political conflict. Marxists, conservatives, and even many liberals appear to believe that every economic question the law addresses is ultimately answered by a process of interest group politics—with each interest group dedicated to enriching its own members, whatever the consequences for society as a whole.

The propositions that people organize into interest groups, that interest groups place the welfare of their own members above the welfare of society, and that throughout history interest groups have spoken up enthusiastically on most of the major economic issues that legal policy makers have addressed are indisputable. But to look exclusively at political concerns in economic policy making results in a misleading and limited perspective on American legal development.

Theory has always been an essential part of state policy. Although theory is sometimes a thin disguise for politics, it can be much more. To take a simple example, special interest politics alone does not explain why toll bridges and gaslight utilities in the nineteenth century succeeded so often in acquiring legal monopoly status, while ordinary manufacturers and retailers did not. It was not merely that the bridge owners wielded enormous political power or had unusual control over the governmental process. All the political dispute and rhetoric was dwarfed by a simple consideration of accepted theory. Within the classical and neoclassical economic models toll bridges and gaslight utilities were natural monopolies, while manufacturers and retailers were competitively structured.

In such cases theory was the dog and politics but the tail. Every important political dispute of the nineteenth century—whether the railroads should be government owned or price-regulated private enterprise, whether utilities should have express monopoly rights, whether antimonopoly provisions in state constitutions should apply to utilities—rested firmly on premises from theoretical economics. Anyone who studies the great monopoly cases in American constitutional history and ignores the role of economic theory is seeing only a small and faded part of a magnificent picture. The *Charles River Bridge* case (1837) may have been a political dispute about entitlements to a lucrative market; but it was more fundamentally a dispute about state policy toward natural monopoly in an era when classical natural monopoly theory was in its infancy. The *Slaughter-House Cases* (1873) may tell a tale of legislative corruption; but, even if there is such a story to tell, its importance is dwarfed by the great public health problems that confronted New Orleans. One should more appropriately compare the slaughter-house monopoly with the Pure Food and Drug Act than with the Yazoo County land fraud.

To be sure, economic theory can never relieve the state of the burden of politics. There is no dichotomy between science and politics. On the contrary, science is a form of politics. One purpose of scientific model building is to explain observed phenomena and make predictions. But an equally important purpose is to produce consensus. A scientific model becomes successful when it convinces those who practice a particular discipline, and it may convince by a variety of mechanisms, including many that are political or even rhetorical.[4] The science of political economy in nineteenth-century England and America was no exception, and neither was the law.