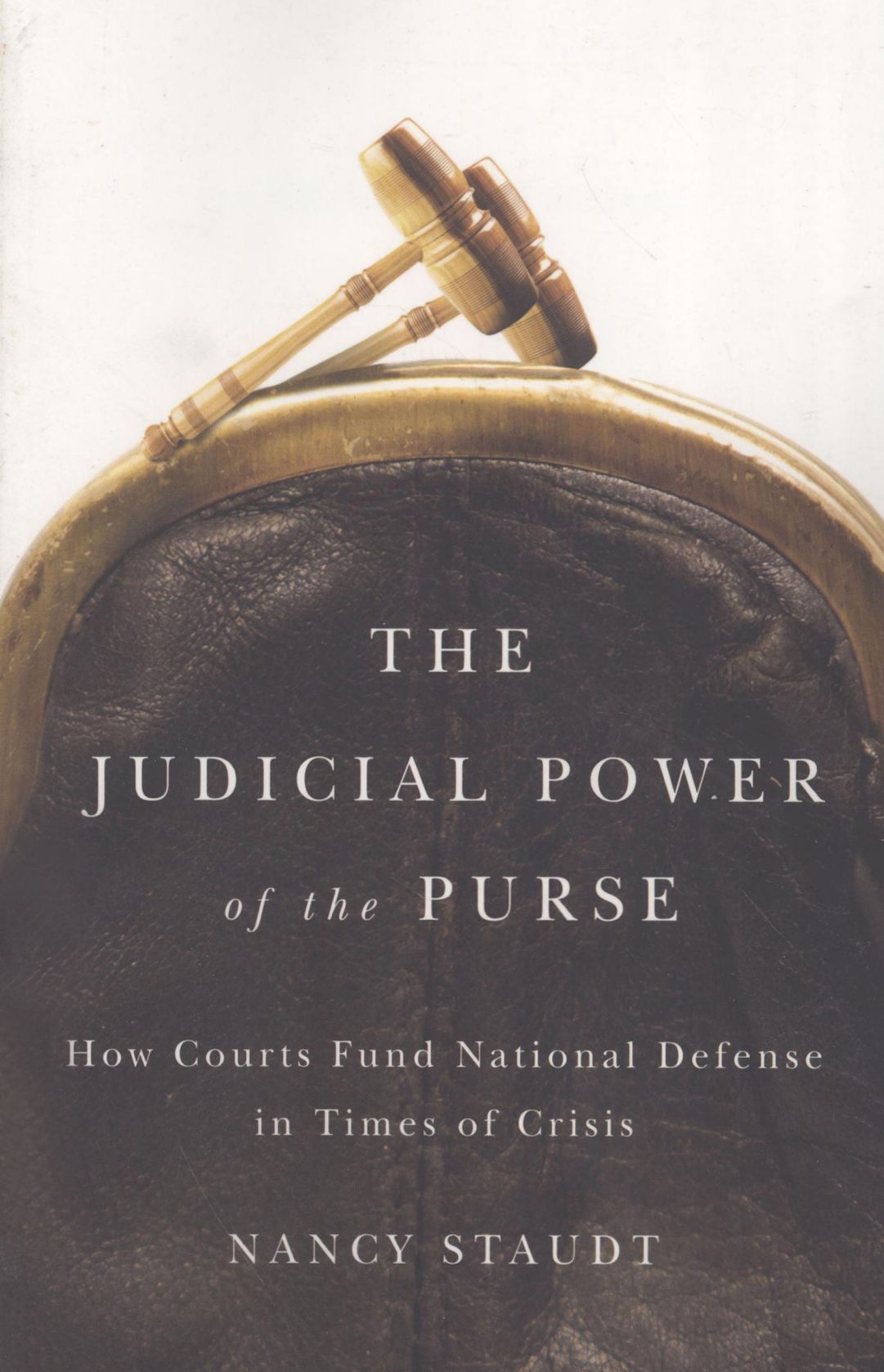
THE
JUDICIAL POWER
of the PURSE
How Courts Fund National Defense
in Times of Crisis
NANCY STAUDT

The Judicial Power of the Purse

How Courts Fund National Defense in Times of Crisis

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The Judicial Power of the Purse

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The Executive . . . holds the sword . . . the legislature . . . commands the purse.
The judiciary, on the contrary, has no influence over either the sword or the purse. . . .

ALEXANDER HAMILTON, *The Federalist No. 78*

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book. Their thoughts and ideas are weaved throughout the chapters—immeasurably improving the substance.

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CONTENTS

INTRODUCTION

Two months before Germany surrendered, six months before the United States dropped atomic bombs on Hiroshima and Nagasaki, and well before Congress repealed the World War II revenue laws, the U.S. Supreme Court heard oral arguments in the case *Commissioner v. Court Holding Co.*[1] This 1945 controversy involved a three-way property transaction in which the Court Holding Company distributed real estate to its shareholders as a dividend; the shareholders then immediately sold the property to a predetermined third party. The evidence unambiguously indicated that the shareholders were involved in the deal for one reason: to enable Court Holding to avoid the status of seller, thereby steering clear of the high federal taxes imposed on the sale of corporate assets. Justice Black, writing for a unanimous Court, held in favor of the government, noting that "[t]o permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress."[2]

Four years later, in 1949, and six months before North Korea's surprise attack on the Republic of South Korea, the Court heard oral arguments in *United States v. Cumberland Public Service Co.*,[3] a case that involved remarkably similar facts to those in *Court Holding*. A corporation, its shareholders, and a third party engaged in a three-way property transaction undertaken to enable the Cumberland Public Service Company to sell its property while avoiding the negative tax consequences associated with the sales of corporate-owned assets. Justice Black, again writing for a unanimous Court,[4] noted the transaction looked "shadowy and artificial,"[5] but this time rendered a decision in favor of the taxpayer, thereby allowing Cumberland to avoid paying taxes. The Court acknowledged the "oddities in [the] tax

consequences,"[6] but justified the decision on the grounds that Congress had not enacted legislation specifically barring the use of shareholders as conduits to evade corporate taxes, and, moreover, the lower court tribunals themselves had reached a pro-government result in *Court Holding* and one that favored the taxpayer in *Cumberland.*

Scholars, courts, and commentators have attempted to reconcile the two cases, but conventional wisdom holds that the Supreme Court did nothing more than foster confusion and incoherence in an important area of the law. After all, the two cases involved identical legal provisions and virtually identical facts and circumstances, yet the justices unanimously agreed to issue divergent outcomes. Moreover, changes on the bench in the interim period were minimal: The Court had eight Democratic appointees in 1945 and nine Democratic appointees in 1949. In short, while the justices decided *Cumberland* to "clear up doubts arising out of the *Court Holding* case,"[7] they seemed to do just the opposite.

This book argues that while *Court Holding* and *Cumberland* appear confusing and irreconcilable on their face, the cases are in fact wholly predicable if important factors are taken into account, namely the existence of wartime conditions. The justices considered *Court Holding* at a time when the United States was fighting major wars against enemy states on several fronts, but *Cumberland* emerged after World War II had dissolved into peacetime. Why would wartime emergencies cause Supreme Court justices to transform their decision-making calculus in a manner that favors the government in the taxation cases that appeared on the Court's docket? Because in the words of President Roosevelt, and quoted by the Court itself: "War costs money."[8] In light of the massive and unavoidable financial costs that emerge in times of foreign policy crises, the justices have suggested in various ways and in various cases that "[i]n total war it is necessary that a civilian make sacrifices of his property and profits with at least the same fortitude as that with which a drafted soldier makes his traditional sacrifices of comfort, security and life itself."[9] Indeed, the Court has gone so far as to suggest that it has a role to play in raising the revenue necessary to meet the nation's wartime needs. In a dispute involving World War II taxes, the justices noted, the country was "faced with revenue needs and a tax program of a magnitude unthought of in modern times, and *we all realize it is necessary to raise every dollar of additional revenue that can be raised without seriously disturbing or shattering our national economy.*"[10]

The justices, of course, are not in a position to adopt revenue-raising laws or directly seize property for the nation's war effort, but they are able to render decisions in a manner that systematically favors the government in

cases and controversies that implicate the fiscal pie in times of war, thereby indirectly providing economic assistance to the nation in times of need. This book aims to convince readers that the justices use cases such as *Court Holding* and *Cumberland* to advance not only their own but also the nation's goals—providing access to economic resources, when necessary, to increase the probability of success on the battlefield. In short, the thesis of the book is that Supreme Court justices (as well as lower federal court judges) hold an implicit power of the purse, a power that can be used to realize extralegal and budget-related objectives.

Not surprisingly, quite a few scholars have documented the manner in which Congress and the president have dealt with fiscal issues in wartime emergencies,[11] but the extant literature is virtually silent on the financial role of the federal courts in times of crises. Students of the judiciary, to be sure, have investigated legal challenges to emergency funding measures, such as property seizures, banking regulations, and excess profits taxes, and have noted that courtroom disputes enable judges both to support and derail economic policy.[12] But the literature has failed to explore the possibility that *judges are in a position to engage in revenue raising and spending polices in their own right.* More to the point, scholars have not identified federal judges as fiscal actors positioned to influence the size and use of the federal budget.

A handful of scholars in both law and political science have explored federal judges' ability to affect state and local funding decisions, and more than thirty years ago, the legal scholar Gerald Frug aptly characterized a series of federal judicial mandates as an exercise of the "judicial power of the purse" given that courts were able to force state and local governments to spend public funds on certain activities, irrespective of their own preferences or those of their constituents.[13] The title of this book, of course, derives from Frug's early and important insight vis-à-vis judicial powers. The substance of this study, however, moves far beyond Frug's descriptive point and demonstrates that judges are able to both raise and spend federal monies irrespective of the preferences of the other two branches of government. Federal judges, in short may not have the formal power of the purse (it lies with Congress), but, as evidenced in the chapters that follow, they nevertheless can—and do—systematically exercise control over a surprising portion of the federal budget.

Uncovering and describing federal judges' roles in the national budgetary process charts new territory, but it also raises two important questions: Do judges have any penchant to employ their fiscal authority in times of crisis, thereby increasing the nation's ability to adequately respond to perceived threats? If so, do judges in fact use their budgetary powers differently

in times of crisis than in periods of relative calm? This study seeks to answer these inquiries through the lens of emergencies brought about by military threats or attacks from abroad. Stated most directly, the book sets aside the interesting questions that emerge in the context of domestic emergencies and focuses on the exercise of *judicial purse powers in times of foreign policy crises.* Foreign policy crises, as defined here, are emergencies that raise national defense issues associated with military safety and security, but not issues that implicate nonmilitary foreign aid, diplomatic and trade relationships, and so forth.[14]

The Plan of the Book and Its Place in the Extant Literature

To investigate if, how, and when judges use their fiscal powers, this book sets forth an *information theory of crisis jurisprudence,* a theory that posits rational judges, like individuals and policymakers generally, prefer periods of safety and security to those plagued by danger and chaos. Given this preference, judges are likely to render decisions in the cases and controversies that show up on their dockets in a manner calculated to keep the nation safe. Preparing and readying the nation for possible engagement in military hostilities is an extremely costly endeavor, and thus the information theory argues that instrumentally rational judges will seek to enable the nation to fend off foreign threats by strategically using the judicial power of the purse.

Judges, of course, are experts in legal and constitutional matters, and not foreign policy matters. Accordingly, they will have difficulty identifying foreign policy crises, yet they will want to deploy their decision-making powers to help fund national defense in dangerous times. Consequently, the information theory posits that judges will take judicial notice, perhaps *sub silencio,* of credible cues emerging from the elected branches of government that signal potential foreign policy crises. These cues can take a range of different forms, such as a congressional declaration of war, a major troop deployment by the executive branch, or the conscription of men into the army in preparation for military engagement. The important theoretical point made below is not the specific cue relied on, but the idea that judges will look to experts to determine the existence of a foreign policy crisis, not to their own perceived expertise or to that of the parties litigating before them.

The cues received by the courts will generally contain consistent messages (that is, both Congress and the president will take action indicating a crisis either exists or does not exist), and in these circumstances judges will have no difficulty discerning the presence or absence of a foreign policy

crisis. It is possible, however, that the elected branches will convey contradictory messages: Congress may refuse to support the president's decision to deploy troops by withholding funds or through some other formal and public mechanism, suggesting the two bodies of government have diverging views on whether a foreign policy crisis is at hand. In this context, judges must assess the credibility of the messages and, in effect, side with one branch or the other on the question. For a number of reasons outlined below, including the long-standing judicial deference to legislative actions in times of foreign policy crises—but not necessarily to those undertaken by the executive branch—the information theory of crisis jurisprudence posits that judges will often trust cues emanating from Congress more than those sent by the president when the two branches are at odds and when the nation's finances are implicated.

The president, as the nation's commander-in-chief, certainly has valuable information and expertise in the foreign policy context. The political scientist Aaron Wildavsky proposed the "two presidencies thesis" more than forty years ago, arguing that policymakers systematically support the executive branch in the foreign policy arena given the president's foreign policy information, knowledge, and experience, but not in the domestic context where the two branches are assumed to be on equal footing.[15] More recently, the legal scholars Eric Posner and Adrian Vermeule have focused specifically on federal courts and have made a strong case for federal judicial deference to the president's foreign policy choices on grounds similar to Wildavsky's two presidencies thesis.[16] The information theory presented and empirically investigated below, however, is not in conflict with the idea that judges and policymakers should or do privilege presidential cues on *specific wartime policies* because it is a theory that addresses judges' use of their budgetary powers in periods of crises more generally—not their decisions with respect to specific executive branch policy choices. Indeed, the cases and controversies that allow judges to operate as fiscal agents often do not involve military matters at all, but routine disputes in taxation and other financial areas of the law. The information theory posits that court-induced financial assistance is apt to emerge when Congress and the president send consistent cues indicating that the nation's safety and security are threatened. If the president is supportive of increased levels of defense but Congress is silent or even opposed to military action, courts are unlikely to offer a funding boost on the grounds that military success does not depend on it.

The information theory of crisis jurisprudence does not imply that when federal judges choose to act, they will always attempt to loosen budgetary

constraints in an effort to enable the nation to consume greater levels of defense. Rather this new understanding of the courts posits that judges will deploy the judicial power of the purse both negatively and positively. More specifically, judges will support the government in times of crisis by rendering decisions that expand the fisc when they believe extant safety and security are inadequate and thus greater levels of defense are necessary to protect the nation's interests. But if judges receive trustworthy cues indicating that current policy has gone astray—that military activities have become excessive—courts will seek to tighten the fisc by siding with private parties in litigation and against the government, thereby forcing the latter to make unwanted payouts and limiting the amount of public funds available for continued military endeavors. In these circumstances, judges will seek to shrink the size of the fiscal pie to promote their desire for the optimal level of defense spending. To see why judges are likely to adopt this strategy, consider a situation in which Congress formally repeals its prior support for a president's wartime activities and reduces funds available for defense generally. In this scenario, judges are likely to employ their powers in a manner also intended to squeeze the budget and, in the process, implement judicial incentives for the executive branch to reconsider its course of action and possibly reduce the level of military activity perceived to be excessive.

The information theory, in short, focuses on the trade-off that judges routinely face between "all other goods" (such as law, policy, institutional stability, personal legacy, and so forth) and "safety and security." Judges seek the ideal level of defense, but must rely on the cues and signals emanating from the elected branches of government to determine whether extant levels are too high or too low. When they receive credible information that defense levels are insufficient to keep the nation safe, they will trade off all other goods for more defense; if they receive cues indicating defense levels have become disproportionate to the amount needed for safety and security, they will decide cases in a manner that enables greater consumption of the other desired goods, such as law and ideology. Absent such cues, judges will issue opinions that reflect their belief that current defense levels are optimal and thus they need not increase nor shrink the size of the budget: The ideal bundle of goods is already being consumed.

This study builds on the extant literature in that it conceptualizes judges as instrumentally rational actors seeking to implement individual preferences over a range of goods, but it also presents a new understanding of the courts. Judicial scholars have long theorized and investigated the role of *micro*-level factors, such as the facts of a case, specific laws, and judicial