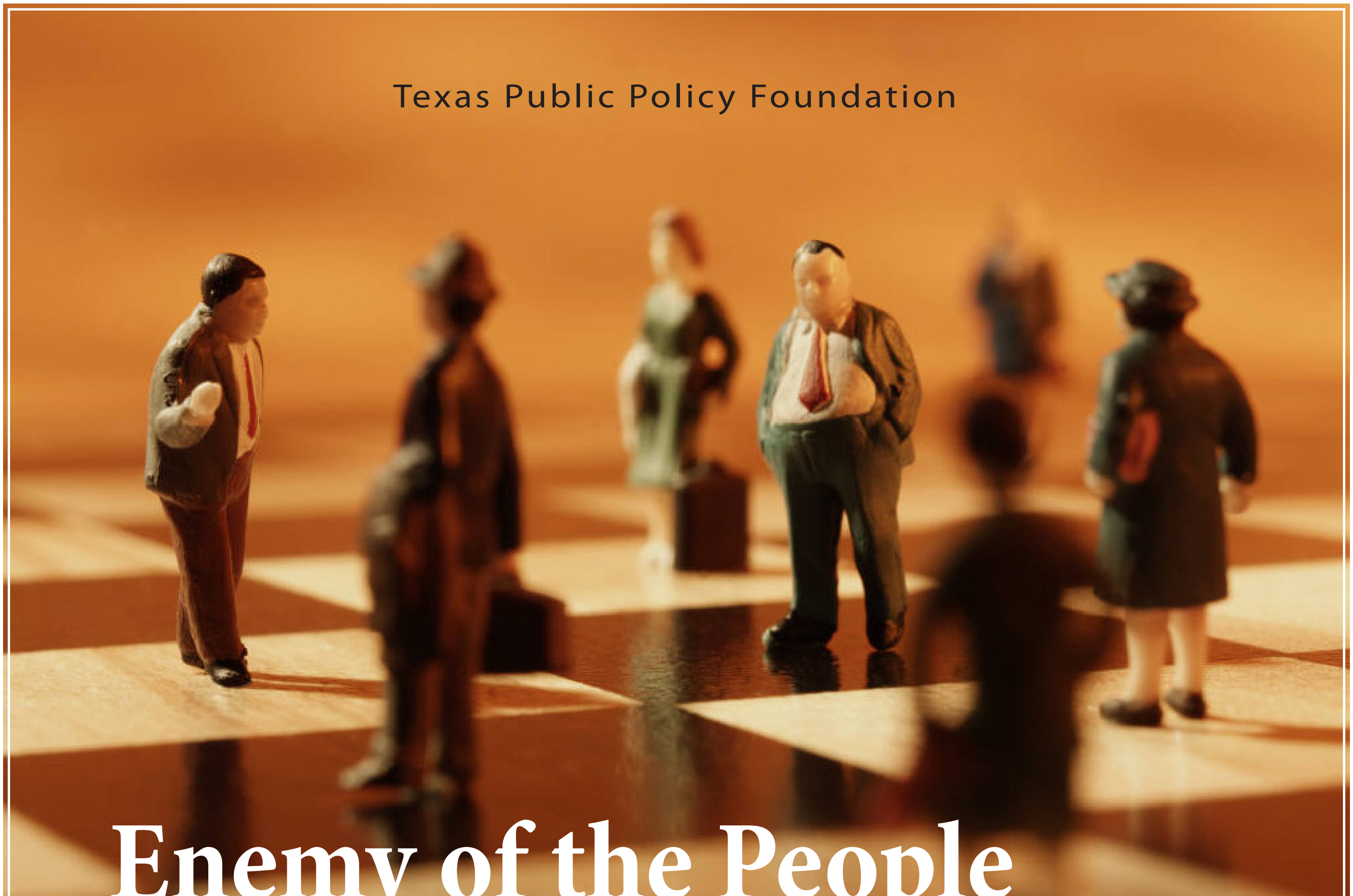
Texas Public Policy Foundation



Enemy of the People

How Government Barriers to Competition Hurt the Public and Subvert the Constitution

Mario Loyola

April 2014

Texas Public Policy Foundation

Celebrating 25 Years

April 2014

Texas Public Policy Foundation
by Mario Loyola

Table of Contents

Enemy of the People

How Government Barriers to Competition Hurt the Public and Subvert the Constitution

by Mario Loyola, Senior Fellow

Introduction

In the 2013 Texas Legislature, a bill was introduced that would have protected beer distributors from competition with each other, by allowing them to form a cartel that the state of Texas would enforce against both manufacturers and retailers. The hearings in the Senate Business and Commerce Committee were a spectacle: lobbyists for the beer distributors earnestly argued why the public badly needed the protections of the bill, while virtually every other industry and public interest group testified against it.

The bill ultimately did not become law. But the hearings were nonetheless a call to action. The fact is that state law—even in free-market Texas—is full of government-sponsored cartels of every size and description, from occupational licensing to agricultural marketing boards. Those cartels have one thing in common: all of them create staggering economic losses for the society as a whole, and virtually all of them should be considered violations of the public trust. Justifications of public health and safety are usually just a smokescreen to obscure forced transfers of economic wealth from the public to the special interests who advocate for the cartels and curry favor with politicians. And the losses to society are always greater than the benefits to the cartels.

The government-sponsored cartelization of the American economy over the past century has been a major driver of the expansion of federal power. States that created cartels for their politically powerful special interests became uncompetitive. The uncompetitive states soon formed coalitions in Congress to seek federal protection—in other words, federal sponsorship for national cartels that would subsume theirs and impose them on all the other states. Thus did the states freely give away the powers reserved to them by the 10th Amendment, in exchange for protection from competition.

Because of the appeal of even the most far-fetched public health and safety justifications, well-meaning legislators routinely find themselves creating "protections" for special interests that don't need them, protections that come at a frightful cost to the public. Legislators are almost always totally unaware of these costs, to say nothing of the general public. And they are equally unaware that the public health and safety concerns fade on closer inspection.

Hence the need for the present study. It will help both legislators and the general public better understand the economic consequences of government-sponsored cartels, and their corrosive effect on constitutional democracy. It will also help them to discern when the public health and safety justifications create valid grounds for exceptions to a general rule of free competition, free exchange, and freedom of association.

PART I will develop the following general theory: <u>Government policies that limit the freedom of association and freedom of contract are *always* injurious to the public, and can only be justified in rare cases where the demonstrable losses to the public are even greater.</u>

The cost-benefit analysis must begin with a rational assessment of the costs that will be engendered by any anti-competitive policy. In those rare cases where transactions between private parties produce injuries to the public that cannot be redressed by existing principles of law, such as torts, exceptions to the general rule of free competition can be justified only on the most narrow and strictly scrutinized application of the precautionary principle. The "enemy of the people" here is government policy that, in the service of a few, imposes hidden and ultimately unconscionable losses upon the public.

PART II applies the general theory to the sorts of laws that create cartels and injure the public without any valid public safety justification. This section will cover general overregulation, agricultural cartels, labor union laws, professional licensing, and laws such as those that pertain to alcohol sales and rental properties. This part will also make recommendations for reform with respect to each area discussed. This is the "legislator's guide."

PART III argues that federal overreach in the modern era is driven substantially, if not mostly, by the "capture" of state governments by special interests, who use government power to seek protection from competition. Those states that believe in freedom and competition and in the original Constitution must continue to resist federal overreach. But the battle can only be won by attacking the roots of federal overreach within state law itself, by extirpating state-created cartels. The key thing is to start eliminating the constituencies for federal overreach, by forcing those constituencies to live by the same principles of economic freedom and competition that most of America's working families face every day.

Virtually every special interest has its lobbyist, and many of the things they lobby for are valid improvements in the public interest. But when those lobbyists advocate for protection from competition, they are often asking the legislator to collude in an unconscionable injury to the public. Who represents the public interest then? Only our elected officials can do that. The purpose of this paper is to help them discharge that solemn duty.

Part I. The Poison of Government-Created Cartels

Since the earliest days of the Industrial Revolution, free market capitalism has struggled against the perception that, left to its own devices, it is merely a cruel exercise in social Darwinism. This has fueled a narrative of "market failures" and "market dysfunctions" and "special conditions," all of which are used to justify government interventions. That the resulting human hardship is caused not by market forces, but by the very government interventions meant to protect against human hardship, continues to escape large numbers of people in every walk of life.

People who notice these unintended consequences of government intervention develop a bias towards limited government. Those who don't notice those consequences develop a bias towards expansive government. The arguments of the latter often go by the name of "race to the bottom." The idea is that without government intervention, businesses (or state governments) will chase profits, and fail to protect common folk, in a moral race to the bottom.

What this argument ignores is that, in our society, workers and citizens maintain rights of exit just like corporations–they can always go somewhere else. Hence, in order to compete for profits, businesses and states must also compete for *people*, creating a "race to the top" that is the flip side of the race to the bottom. Only by seeing the race to the top along with the race to the bottom do we get something like a complete economic picture.

If a person can't see the race to the top, he is bound to develop a gloomy and woefully incomplete notion of how markets work. Inevitably, such a person will come to propose policies that are not just ill-designed, but wrong in principle, and sooner or later counter-productive in effect. And then, when the undesirable results ensue, the person fails to perceive that they arose from his own policies. Instead, the person assumes that the disastrous results arose somehow from the free market—and from the failure of his policies to intervene strongly enough in it. He doubles down.

These observations help to explain the surprising persistence of the myth that the Great Depression was caused by market failure, and that government policies rescued the country from it. In fact, the Great Depression started as a serious but otherwise mundane recession. What turned it into a worldwide catastrophe was the cartelization created by the Smoot-Hawley tariffs of 1930. This, like so many other ill-considered policies of the New Deal era, started out in response to the farm sector's pleas for help after a decade of global overproduction and rock-bottom food prices. Once the agricultural tariffs started, other sectors of industry also cried out for protection, and a protectionist wall was raised around the United States. Retaliatory measures by other countries clobbered U.S. exports. Trade fell by some 66 percent from 1929 to 1932.[1]

The Smoot-Hawley tariffs were the wrong response for several reasons. First, when faced with crises such as a recession, and its elevated rates of bankruptcy, the correct public policy is to facilitate the reallocation of human and material resources to positions of maximum productive value as quickly as possible. When that reallocation reaches the highest "exchange velocity" that can be achieved, all potential productivity gains are realized with the minimum pain and suffering.

Tariffs block this reallocation from happening across borders, which means that many transactions will be sub-optimal and will produce less than the possible gain. Tariffs also distort the relative value of goods and services (i.e., labor) domestically, leading to further misallocations and social losses.

The Smoot-Hawley tariffs inflicted untold suffering across America. But the cause-and-effect relation between protectionism and the social calamity it caused escaped most Americans until well after World War II. It was only during and after World War II that the American political class achieved consensus on the idea that free trade is good and protectionism is bad. In the meantime, America's working families had suffered privations such as they had never known, without ever suspecting that their own government's policies were to blame.

The crucial lesson of the disastrous Smoot-Hawley tariffs is a principle that had actually been around since Adam Smith's *The Wealth of Nations*, but which did not gain currency among economists and policymakers until decades after the Great Depression. The principle is that protectionist measures hurt the country that enacts them, in addition to its trading partners. The principle of comparative advantage in a system of free trade suggests that each country should specialize in producing the things that it produces best, rather than trying to produce everything, and that they should then trade their superior products for what other countries produce best.

Because tariffs raise barriers to importation of the best goods available at the cheapest price, consumers must find substitute products of inferior quality at higher prices. That's a general social loss. But beyond that loss is the misallocation of productive resources from the areas of comparative advantage to areas of comparative disadvantage, which represents losses among the very class to be protected. These lessons had all become part of the free-trade establishment consensus among U.S. policymakers and economists by the 1950s, although U.S. law still incongruently provides for retaliatory tariffs, and unfounded charges of "currency manipulation" against the Chinese remain a mainstay of our foreign relations.

> The Smoot-Haley tariff inflicted untold suffering across America. … It was only during and after World War II that the American political class achieved consensus on the idea that free trade is good and protectionism is bad.

The crucial lesson for purposes of this paper arises from the fact that the tariff is just a cartel-creation device at national scale. All of the reasons that protectionism hurts those it seeks to protect, in addition to everyone else, apply with equal force to government-created cartels at smaller scales. Cartel members may enjoy substantial artificial profits from cartel pricing, but by definition they are not allocating resources as competitively as they could, and because potential real profit is thereby left on the table, wealth creation is diminished, and everyone loses.

These basic economic principles were not, alas, widely understood in the early decades of the 20th century. In fact, the political consensus of the time clung fervently to articles of faith that were very nearly the opposite of these free market principles. Thus, unlike the farmers in John Steinbeck's *Grapes of Wrath*, economic policy tended to take one step forward and two steps back.

That is what happened with the antitrust laws. Responding to the dangers, sometimes real but mostly imagined, of large monopolies and cartels, the federal government had adopted the Sherman Act of 1890, which sought to combat monopolies and cartels and other "agreements in restraint of trade." But Congress and the Supreme Court created broad exceptions to the antitrust laws for the very worst monopolies and cartels, namely those created by government regulation.

It's not just that the government-imposed cartelization of the labor and agriculture markets made the Great Depression much worse. The embrace of government-sponsored cartels required a profound change in the nature of the Constitution itself.

Today, we are only starting to understand the poisonous consequences of these exceptions. It's not just that the government-imposed cartelization of the labor and agriculture markets made the Great Depression much worse. The embrace of government-sponsored cartels required a profound change in the nature of the Constitution itself.

It is crucial to note that under the Constitution as originally ratified and handed down all the way to the New Deal, the distribution of the power to regulate commerce among the federal and state governments achieved a carefully procompetitive balance. The federal and state spheres of authority were mostly exclusive—the federal government could regulate only things in interstate commerce ("among the several states"), while the states could regulate all their internal commerce, which lay beyond federal reach. The state's exclusive "police power" was understood to include most economic activity, particularly agriculture and manufacturing, which were thought to precede commerce. The federal government had just enough power to prevent individual states from discriminating against interstate commerce.

The genius of the system lay in its structure of "competitive federalism." Individual state governments were free to form whatever cartels they liked. But without being able to control the movement of goods and people across state boundaries, any state that adopted wide-ranging cartels would be clobbered in the "marketplace" of regulatory competition, where states compete for each other's people and businesses by adopting attractive regulations. Here the "race to the bottom" combined with the "race to the top" to produce those regulations that were deemed minimally necessary, with a competitive bias against excessive regulation.

The New Deal served the special interests of its political coalition: agriculture and labor. Every single one of the Supreme Court's New Deal decisions that expanded the scope of the federal commerce power was taken in a case related either to agriculture or labor, in which the federal government was responding to pleas for protection on the part of some would-be cartel that had found state governments useless to its purposes, for the reasons just explained.

National Labor Relations Board v. Jones & Laughlin Steel (1937) sanctioned a federally imposed system of collective bargaining in factories and shops across the nation.[2] *U.S. v. Darby* (1941) upheld national labor standards for the first time.[3] *U.S. v. Wrightwood Dairy* (1942) allowed the federal government to regulate intrastate sales of milk that were in competition with the interstate agricultural price-support cartels of the New Deal.[4] And the final blow—the Supreme Court's last Commerce Clause decision for the next 53 years—was *Wickard v. Filburn* (1942), which upheld the agricultural price-support cartel against a farmer who was producing grain for his own livestock's consumption.[5]

It is crucial to understand what these laws actually entail. The basic mechanism of action of this kind of law is to establish some prohibition on the freedom of contract among private individuals.

Recall that in a private market, the attempt to achieve and sustain cartel pricing is usually doomed because cartel members can always break ranks and charge a price somewhere between marginal cost and the artificially elevated cartel price, and thereby both undercut the cartel and still reap economic profit; and even if discipline is maintained among cartel members, a new competitor can always enter the field and gobble up market share by offering a more competitive price.

The great promise of enlisting the government, from a cartel conspirator's point of view, is that government coercion provides a perfect solution to the problems of both cartel discipline and new entrants. By using the power of government coercion to enforce cartel discipline on members, and to prohibit the entry of new competitors, government had the power to transform cartels from suicide pacts into permanent wealth-transfer schemes at the expense of everybody. All it had to do was to prohibit private competitive transactions that would undercut the cartel's preferred arrangements.

Up to this point, the entire constitutional arrangement had put government in the role of protecting the public from cartels. But in the second quarter of the 20th century, the federal government and virtually all of the state governments simply switched sides, and jumped into the business of protecting cartels from the public.* In order for this to happen, the Supreme Court needed to turn the Constitution on its head, and declare the crucial limitation on the federal commerce power—and the correlative freedoms of association and of contract—all but a dead letter. It is disheartening in hindsight to see the ease with which the Court's New Deal decisions jettisoned the whole framework of limited and enumerated powers enshrined in the Tenth Amendment, the basic understanding on which ratification of the whole constitutional scheme had primordially depended.

Once they switched from protecting the public against cartels to protecting cartels against the public, federal institutions moved fast to embrace and expand the role. The transformation was complete with the Supreme Court's decision in *Parker v. Brown* (1943), which confirmed that all state-created cartels would henceforth enjoy immunity from antitrust enforcement.

If *Parker* extended immunity from antitrust enforcement to all state-created cartels, the newly expanded commerce power invited the creation of federal cartels.

The constitutional effects of this whole combination of developments at the federal and state level were profound. The expansion of the federal commerce power did not roll back the state police power. There would now be overlapping federal and state jurisdiction. Now a federal regulatory umbrella would be unfurled to protect the state's cartel-creation in all sectors.

Thus was "competitive federalism" transformed into "cooperative federalism." The states' incentive to regulate only as little as necessary, under the original Constitution, was thus transformed into a structural incentive to regulate as much as possible, under the constitution of the New Deal, as Michael Greve brilliantly explains in *The Upside Down Constitution.*

For purposes of the present study, it is crucial to gain a sense of the losses the public would now unwittingly sustain at the hands of a government captured by cartels. There appears to have been a sense among policymakers of the first half of the 20th century that arrangements in restraint of trade were bad unless they occurred under government auspices for public policy reasons.

Though that belief has persisted to the present day, there is one major problem with it. Government power does not make cartels better—it makes them infinitely worse. It does so in the manner suggested earlier—by protecting the cartel arrangement from the vulnerability it faces in a truly free market: the inevitability of (a) new competitors and (b) a breakdown in cartel discipline.

Absent the application of government power, any sustainable monopoly or oligopoly (at least outside networked industries) is most likely the result of efficiencies that lower the cost of goods and services for the public, and is therefore not a proper subject of antitrust enforcement.[6] But the intervention of government power on the side of a monopoly or cartel ensures that this will not be the case, and that inefficiencies, misallocations, and net social losses will be enshrined in law.

Therefore, the exception to antitrust enforcement for government-sponsored cartels paradoxically excludes from the enforcement of our antitrust laws the very category of conspiracies and combinations in restraint of trade that should be the first priority for antitrust enforcement.

* The government protects cartels "from the public" in the sense that, were the public allowed to compete fairly against most cartels, those cartels would be unsustainable in most cases.

The staggering social losses that result from government-sponsored cartels start with the fact that the government's intervention always takes the form of a prohibition on one or more categories of private transactions that would show a positive return if they were allowed to compete freely against the cartel arrangement. The prohibition slows or altogether halts the "velocity of exchange" that would clear the market of unrealized potential gains and would result in the most efficient allocation of human and material resources. In simple terms, the "protective" prohibition directly diminishes the society's capacity for real wealth creation.

The prohibition on public competition also effectuates a forced transfer by allowing providers of necessary goods and services to charge much higher prices for a lower supply of inferior quality than the market would otherwise deliver. And because the subject of cartels tend to be necessaries rather than luxury goods, the effects are grossly regressive, and hit working families hardest.

Finally, the forced transfers implicit in government-created cartels are even more wasteful than government subsidies, for the transfer is never "efficient" in the sense of somebody somewhere winding up with *all* the money that the public has been forced to disgorge. Because of the "dead-weight" loss that economists have extensively studied in monopoly and cartel pricing, the beneficiaries of government-sanctioned monopolies, cartels, and other arrangements in restraint of trade, always gain much less than the public is losing to support them. In fact, because the forced transfers are entirely "off budget," there is usually no transparent correlation between what beneficiaries gain and what society is losing.

There was enormous demand for this kind of government intervention between the world wars, and it became overwhelming once the Great Depression began slowing economic growth. The political picture was not helped by the fact that, as Milton Friedman used to say, protecting against cartels is in the general interest, but not in anybody's special interest. "Each of us is fundamentally more concerned with our role as a producer of one product," he once said, "than with our role as a consumer of 1,001 products."

With the citizenry at large unable to understand what was coming—that government was in essence conspiring with cartels in restraint of trade in order to effectuate a crippling forced transfer of wealth from working families to a variety of special interests—resistance collapsed. A constitution of private competition had been transformed into a constitution of government-created cartels.

One last issue remains to be discussed before we can proceed to articulate a general theory about government-created cartels—namely the issue of how to assess the public safety or public interest argument that is invariably used to justify them.

In order to see this question in its true light, it is necessary to recall that the core purpose of government is to protect private freedoms—and hence private rights—from abuse by others in the form of force and fraud. This requires giving government a certain amount of power—but not so much that it gives government officials themselves the power to abuse private rights arbitrarily.

So from the earliest days, society developed clearly limited rules of law that presupposed the freedom to enjoy and dispose of one's property as one sees fit, and protected that freedom in specific ways. This evolution proceeded from Roman law to English common law and down to our times. As Richard Epstein writes in *Design for Liberty,* "The private-law developments are marked by a deep sophistication in stating general rules that are then ingeniously applied to particular problems in the law of property, contract, torts, restitution and wills. The results are so solid that they have descended in broad outline to the present generation."[7]

In an economy based on private exchange, the role of government is thus crucial. To defend the rights of parties to a contract, the government enforces contracts, and supplies certain precautionary rules meant to minimize the possibility of fraud. For example, the old statute of frauds required that, to be enforceable, certain categories of contracts had to be in writing. To protect against injury to third parties that may arise from a contract, the government provides damages and restitution for negligent and intentional wrongs to persons and property—and sometimes imposes the obligation to take precautionary measures to prevent such wrongs.

The precautionary principle in torts is captured roughly in the formula used by Learned Hand in the seminal negligence case of *U.S. v. Carroll Towing Co.* (1947). Hand wrote that, with respect to negligent torts, the duty to take reasonable care is "a function of three variables: (1) The probability [of an accident]; (2) the gravity of the resulting injury; (3) the burden of adequate precautions. Possibly it serves to bring this notion into relief to state it in algebraic terms: if the probability be called P; the injury, L [for loss]; and the burden, B; liability depends upon whether B is less than L multiplied by P: i.e., whether B is less than PL."[8] Simply put, when one is engaging in an activity that may injure an unrelated party, one must take precautionary measures where the costs of such measures are outweighed by the probability of loss multiplied by the gravity of the potential loss.

Therefore, we start with two concentric circles of protection. The enforcement of contracts protects the parties to a contract. The law of torts substantially protects non-parties to a contract—in other words, the public.

In the modern age, government has gone far beyond the old legal principles that apply to contracts and torts, and has tended to apply a damagingly absolute form of the precautionary principle. Regulations meant to protect the public impose massive costs on parties to a contract, and on society in general, in order to sustain precautionary measures of very marginal benefit.

But in most cases, the right balance of safety and freedom is already in the law—in the old common law of contracts and torts. Precautionary measures that the common law would impose on parties to a contract are soon applied to that whole category of contracts. They then become a matter of industry practice, enforced by the courts. Hence, the private economy—armed with the common law rules—has an inherent capacity to develop its own precautionary measures for protecting the public.

As a general rule, regulations that provide protections beyond that should be presumed to be unnecessary and wasteful. The Hand formula is a good guide to these cost-benefit analyses. It should be born in mind that the costs of precautionary regulations are first imposed on the parties to a contract, but are *always* spread throughout the society, so it is always society that pays for the measures government imposes to protect them. This argues for "strict scrutiny" in the application of the precautionary principle in regulations of the private economy.

The enforcement of contracts protects the parties to a contract. The law of torts substantially protects non-parties to a contract—in other words, the public. Only rarely are government protections needed beyond those.

The law of torts provides that injuries to persons and property should be compensated after the fact. If I negligently crash my car into yours, I am responsible for the damages. I have a duty to take precautionary measures only where the potential injury to you outweighs the costs of such measures to me. Only the most irrational, absolute form of the precautionary principle would dictate that I refrain from driving altogether, in order to avoid the marginally increased risk to your automobile from my driving. And yet such absurdities are precisely what government regulations require in many cases—and that is especially true in the case of government-created cartels.

As a general rule, the public safety justification (i.e., the precautionary principle) advanced for any government-created cartel is just a smokescreen for some special interest's naked desire for protection from competition, whatever the costs to everyone else. As Milton Friedman observed in *Capitalism and Freedom*, it should always raise a legislator's suspicions when the person making the public safety case for some government-created cartel is a lobbyist for the cartel.

In rare cases, transactions between private parties produce injuries to the public too diffuse to be traceable and that cannot be redressed by existing principles of law, such as torts. In such cases, exceptions to the general rule of free competition can be justified only on the most narrow and strictly scrutinized application of the precautionary principle. The judgment is ultimately a prudential one for legislators to make.

Representing the public welfare is, again, the duty of every legislator. … Alas, the politics of cartel-formation often sweep legislators with the momentum of a tsunami, and nobody is left to protect the public.

The Learned Hand "formula" suggests that precautionary measures are justified when the burden of precaution is outweighed by the potential loss multiplied by the probability of loss. This formula is already comprehended within the common law of torts as applied to private citizens, who are the source of all injuries not caused by the government. So government policies meant to prevent private injuries through the creation of government cartels have to show that precautions are necessary beyond those which the common law of torts already imposes on private parties.

That is a tall hurdle indeed, and should lead to the presumption that government-imposed precautions above and beyond the law of torts are *per se* unnecessary, or, in other words, that the public safety justification advanced for state-created cartels should be presumed to be a smokescreen.

The analysis developed thus far allows us to articulate the following general theory:

> **Government policies that limit the freedom of association and freedom of contract are *always* injurious to the public, and can only be justified in rare cases where the demonstrable losses to the public are even greater.**

The next section applies that general theory to the domain of government-created cartels.

Part II. A Look at Various Categories of Government-Created Cartels

The antitrust laws are designed to protect the public from price-fixing cartels. But a deft lobbyist can flip that coercive power 180 degrees *against the public* if he can come up with a moving appeal to public safety. This section offers a "legislator's guide" to laws that are badly in need of reform or repeal as a matter of public welfare. State officials should assail these laws wherever they exist: in their home state, in other states, and at the federal level.

That there is a dire need for such an approach will be obvious to legislators who consider the army of lobbyists who call on them every session. Virtually every lobbyist is advocating for a special interest. Virtually none advocates for the public welfare. Representing the public welfare is, again, the duty of every legislator.

Alas, the politics of cartel formation often sweep legislators with the momentum of a tsunami, and nobody is left to protect the public. In a separate statement to the Antitrust Modernization Commission's 2007 final report, Commissioner Kempf expressed his personal exasperation at the inability to enforce antitrust laws against government-created cartels in agriculture and labor:

> The big exemptions and immunities—the ones that count—are ones for labor and agriculture. They impact much of what the average American eats and drinks and uses to do things. And they do it every day. All day. These exemptions cost American consumers billions of dollars a year. Every year. As things turned out, there wasn't interest in facing up to those exemptions and immunities. Too much of a political football I suppose. The thinking—probably correct—ran something like this: No Democrat from an industrial state can support repeal of the labor antitrust exemptions and no Republican from an agricultural state can support repeal of food and dairy antitrust exemptions; so you get a bipartisan standoff: "I'll let you keep your exemptions if you let me keep mine."[9]

This part examines the major kinds of government-created cartels. It begins with a discussion of the *Parker* state-action doctrine, and what states can do to combat government cartels in other states. It then discusses problem of general overregulation. It then examines the major federal cartels ushered in by the New Deal in agriculture and labor—the ones that Commissioner Kempf railed against in his separate statement quoted above. The remainder of the section surveys cartels created by state law.

The Parker Doctrine: What States Can Do to Combat Government Cartels in Other States

The Constitution as understood before the New Deal left the states free to cartelize at will, because the federal commerce power didn't extend far enough to block their cartels unless there was discrimination against interstate commerce. On the other hand, if states were unable to discriminate against interstate commerce, their cartels would be vulnerable to market forces, and the state would get clobbered in the domain of regulatory competition. This arrangement has been called "competitive federalism."

But with the Supreme Court's New Deal decisions, the federal commerce power expanded dramatically, and so did the outer boundaries of the laws passed in exercise of that power, including the Sherman Act and other antitrust laws. The question that then arose was whether the federal antitrust laws now prevented the states from creating cartels.

That issue was decided by *Parker v. Brown* (1943), in which the Supreme Court took up a California law that created a stupendously complex production regime for raisins. Like much of the New Deal's agricultural legislation, it sought to protect the "right to farm" of Franklin D. Roosevelt's fancy from the effects of overproduction after World War I, and from the dramatically increasing farm productivity of the industrial era, which had combined to push food prices down to historic lows. Like much of the New Deal, the California raisin law was a government-created cartel designed to limit production and impose needlessly high prices on the public, with the twist that in this case California growers were producing most of the raisins in the United States.

Parker was a departure from "dormant" Commerce Clause doctrine, by which federal courts strike down any discrimination against interstate commerce, because the California law clearly did discriminate against interstate commerce. The law reserved a significant portion of production for sale within California, and only the excess could be shipped to other states, with the effect that California raisins cost much more outside the state than inside the state. At a time when 95 percent of the country's raisins were produced in California, the state law created a classic export cartel that allowed California growers to inflict cartel prices on the rest of the country but not inside their own state.

Parker recognized at least in principle that state laws cannot be allowed to injure residents of other states. But a study by Michael Greve shows that state officials have failed to exploit this opening against other states' cartels: "[S]tate enforcers have no compunction about enforcing antitrust rules against private out-of-state parties. In contrast, when anticompetitive conduct has been officially sanctioned by another state, state antitrust enforcers have consistently failed to act."[10] The reason for this failure, apparently, is that states like to keep their own cartels safe and sound, and would rather not stir up a hornet's nest by going after each other's cartels.

General Overregulation

The political dynamics that drive overregulation in areas such as healthcare, energy and the environment, education, and general business licensing, are not precisely the same as those that drive the typical rent-seeking cartel, such as professional licensing. Instead, overregulation tends to result from legislators' general lack of faith in the ability of the market to solve its own problems, and an overdeveloped faith in their own problem-solving abilities.

There is one crucial respect in which overregulation produces cartelized markets just as effectively as the more overt government-created cartels discussed in the rest of this section: overregulation raises prices above competitive levels.[11] High regulatory costs raise a barrier to entry for new competitors. They also give large firms a competitive advantage over smaller ones less able to absorb the costs.

These observations point to a surprising paradox: Though the political target of many regulatory schemes is "big business," it is big business that often benefits most from overregulation, for the simple reason that regulatory costs are more easily absorbed at larger scales. Thus, overregulation tilts the competitive playing field against smaller new entrants.

This gives big corporations a vested interest in overregulation, with results that are readily observable in many industries, from the for-profit education sector to the oil producers. Legislators should bear that in mind when they find their bigger constituents acquiescing to massive regulatory schemes that their smaller competitors vehemently rail against. The interests of the latter should always be preferred in such a situation, not because government should ever pick winners and losers, but because the smaller competitors represent the new entrants necessary to keep production and prices competitive. Letting big business enjoy the comparative protection of overregulation leads to the same cartel pricing and attendant social losses as any other government-backed cartel.

Indeed, because of the problems of maintaining a classical cartel even with government backing—namely, among the other things, the difficulty of achieving and maintaining sector-wide consensus on price and production targets, and political costs to the legislators who support them—government-backed cartels face certain pressures that overregulation does not, and the tendency has been for the latter to supplant the former. As the administrative state has continued to develop apace, overregulation has become a secure blanket for all sorts of hidden cartels. These cartels are often unintentional, the unintended but inevitable consequence of the regulations that are dizzyingly complex and heavy-handed, but special interests are nonetheless quick to take advantage of them and become vested in them.

To cite just one example, consider the Department of Education's regulations on the conditions for eligibility of higher education institutions to receive federal student aid. In order for a student to qualify for federal student aid, he must attend a degree-granting college or university that is accredited by an accrediting agency that is "recognized" by the Secretary of Education. The regulations come in the form of conditions that accrediting agencies must meet in order to secure the Secretary's "recognition." Layered on top of the standards that the formerly-independent accrediting agencies themselves impose for their precious accreditations, is now a heavy set of federal rules governing everything from the definition of "credit hour" to how schools must track graduating students' income and job performance in the years after they graduate.

The key here is the federal student aid, which rests on unassailable political foundations (what elected official will declaim against helping students?), despite the fact that it effectively cartelizes the higher education sector at virtually every level. The infusion of federal money creates an essentially national cartel for the federally "recognized" accrediting agencies; it is no longer their prestige as independent accreditors that makes or breaks their market position, but rather federal approval. Those who do not secure recognition are out of business.

At the next level down from the accrediting agencies, where it really matters, federal regulations create a cartel for degree-granting colleges and universities, which, once admitted as members of the cartel, are allowed to tap into huge federal subsidies, and hence are able to charge tuition well above a competitive price. Meanwhile, institutions of higher education that do not grant degrees, or fail to meet one or another of the federal regulations, are cut off from both federal funds—and from the students that depend on them.

It is proper to characterize the cartels created by the Department of Education rules as "hidden" (despite the fact that they're quite obvious) because the explicit purpose of the law is not to protect cartel members from competition, but rather to control education policy. Yet the effect is to protect traditional higher education institutions from the competition of new business models such as adaptive and online learning, and institutions that grant workforce-skills certifications rather than the degrees that are increasingly too general and too outdated to meet the needs of a 21st century workforce. Thus, in higher education as in many other areas, federal overregulation has the same effect as explicit cartels created by law.

Agriculture

By far the most extensively cartelized sector of the American economy is agriculture, which was in many ways the driving force behind the New Deal. The great crisis that struck American farmers between the world wars was partly due to a temporary circumstance—after the dislocation of World War I, world agricultural production boomed. But there was another factor at play, namely that industrialization and its modern technologies had started to reach the countryside and were producing explosive gains in farm productivity. The country didn't need a large fraction of its labor force on farms anymore. A massive excess of farm labor was bound to produce bankruptcy on a large scale, even without world overproduction, and even without the Great Depression.

The sad truth was that a way of life was ending for millions of American families that had never known another. This fueled a major political reaction, with President Roosevelt insisting that the government would do everything necessary to protect the "right to farm." Of course, he could only protect people's right to do something that was unnecessary in the new economy by forcing the rest of society to subsidize the activity in one way or another, and that is just what the New Deal did.

Agriculture is difficult to cartelize at the state level because much agricultural production consists of commodities produced throughout the country, which creates conditions of nearly perfect competition. Any state that seeks to cartelize such a sector of agriculture would, except in rare cases (such as California raisins), suffer major losses because of the inability to prevent exit or entry of competing produce and labor across its borders.

Hence, calls for federal intervention in the agricultural market grew more insistent during the 1920s and reached a fever pitch early in the Roosevelt administration. Amidst warnings by the farm union leader, Ed O'Neil, that revolution in the countryside would come within a year unless something was done to help America's farmers, Congress enacted the Agricultural Adjustment Act of 1933. The AAA paid farmers to destroy crops and livestock, and leave land idle, thus restricting output and raising farm prices as in a classic cartel. Subsidies were paid out of a tax on food processing. The AAA's nationwide reach and impact on most categories of farm production made it a particularly "successful" government-created cartel, and farm production declined markedly, with a significant rise in food prices.

The AAA was struck down by the Supreme Court in *U.S. v. Butler* (1935),[12] one of the last times the Court would defend the Constitution against an impermissible federal intrusion into purely intrastate commerce. But a new version of the AAA was quickly enacted, which this time subsidized nonproductive uses of land, and was upheld. The New Deal included a host of other agricultural measures, all designed to subsidize excess farming capacity, lower production, and raise (or "stabilize") prices at supracompetitive levels.

By far the most extensively cartelized sector of the American economy is agriculture, which was in many ways the driving force behind the New Deal.

The massive cartelization of the farm sector has survived through many modifications to the present day.[13] Farmers of wheat, corn, cotton, rice, and other commodities ("program crops") receive subsidies under programs with roots in the New Deal. These subsidies averaged $15.5 billion per year in FY2001 through FY2009. Unlike "program crops," federal support for fruits and vegetables is generally limited to crop insurance and disaster assistance.

The dairy industry is perhaps the most heavily cartelized, with a dizzying myriad of price supports, direct subsidies, and federal milk marketing orders. These programs keep milk prices much higher than they should be. In addition, state programs have flourished under the federal umbrella. Milk producers in Texas enjoy a number of additional "protections" under this federal umbrella, including restrictions on the sale of "raw milk" to the public, which, under current law, is prohibited outside the farms on which it is produced.

In fact, it was an early New Deal Supreme Court case upholding a naked price-fixing cartel under state law, *Nebbia v. New York* (1934),[14] that set the tone for this cartelization of the agricultural market. New York state had imposed a maximum price of nine cents per quart of milk, and one hapless seller and buyer combined to break the law.

As Richard Epstein recounts in *How Progressives Rewrote the Constitution* (2006), the general norm of the late 19th and early 20th centuries was that government interference with prices and production was warranted in industries "affected with the public interest."[15] Before the New Deal, this dispensation to government regulation was generally applied only to industries that tended to produce "natural

When legislators and regulators override market signals of consumer demand with their own invariably baseless convictions of "fair price," they distort the incentives to production created by consumer demand.

monopolies." But after the New Deal, it was applied broadly to all sorts of industries in which perfectly competitive conditions obtained, such as the sale of milk.

The majority opinion contained precisely the sort of economic nonsense that would mark many of the Court's pronouncements, and many a legislator's sentiments, after 1937:

> If the lawmaking body concludes that an industry's practices make unrestricted competition an inadequate safeguard of the consumer's interests, produce waste harmful to the public, threaten ultimately to cut off the supply of a commodity needed by the public, or portend the destruction of the industry itself, then any appropriate statutes passed in an honest effort to correct those threats may not be set aside because the new regulations fix prices reasonably deemed by the legislature to be fair to those engaged in the industry and to the consuming public.[16]

It is hard to improve on the dissent of Justice McReynolds: "To him with less than 9 cents, [the New York law] says: You cannot procure a quart of milk from the grocer although he is anxious to accept what you can pay and the demands of your household are urgent!"[17] A law intended to safeguard "the consumer's interest" and prevent "waste harmful to the public" had the obvious effect of injuring the consumer's interest and creating waste harmful to the public. And yet such was the economic ignorance of legislators and judges that the law remained in effect for years.

The cartelized agriculture sector provides an elegant laboratory demonstration of why government-created cartels are terrible. When legislators and regulators override market signals of consumer demand with their own invariably baseless convictions of "fair price," they distort the incentives to production created by consumer demand. The effects are either overproduction, with prices below cost, or a restriction in output, with prices well above cost. The "exchange velocity" that would quickly reallocate comparatively unproductive resources to positions of greater inherent value is slowed, injuring both the public and those which the regulation seeks immediately to protect. The ultimate effect is to amplify the very cycles of boom and bust that such regulations are often meant to stabilize.

Texas law contains many examples of this flawed approach. The Texas Agriculture Code provides for "agricultural marketing associations."[18] These associations are empowered to set production and price targets among members. The law doesn't at first blush appear to exclude new entrants, but the cartel can be sustained because it allows the marketing association—one of the earliest and most classic kinds of production cartel—to bring all producers within a given area under its umbrella, and conduct its price-fixing and horizontal market division in the open, under protection of the law. The arrangements would otherwise be subject to criminal penalties under the antitrust laws; it is only with government sponsorship under the *Parker* doctrine that they are shielded from the antitrust laws.

The stated "policy" of this chapter of the Texas Agricultural Code is to promote the cooperative production and marketing of agriculture products, "eliminate speculation and waste," and "stabilize" the production and marketing of agriculture products.[19] The chapter thus announces at the outset that its purpose is to create combinations in restraint of trade, on the same flawed economic rationale as *Nebbia*.

A few sections further down, the chapter emphatically declares that nothing that occurs under its provisions is a violation of the antitrust laws.[20]

Labor

Perhaps the most basic example of a government-created cartel is the federal minimum wage. Contrary to popular perception, the minimum wage is not a "right" offered to workers but rather a "prohibition" imposed on them. It does not give anybody the right to a job that pays a minimum wage, because employers have no obligation to hire.

The minimum wage law only makes it illegal for people to work for less than the minimum wage, and *only* in situations where they would *need* to. It is not a guarantee of higher wages, but a prohibition on employing workers at the bottom rung of the socio-economic ladder—the ones who have nowhere to go but up. It prohibits the poorest and least-skilled among us from working at all in order to sustain artificially high wages for people on the next-higher rung of the ladder.

The minimum wage is, very simply, a barrier to entry in support of a naked price-fixing cartel. When the federal minimum wage is actually higher than the wages the market would offer, the effect of the law is a social calamity. By all accounts, the clearest possible case for a *criminal* antitrust enforcement action is a price-fixing cartel that can be sustained indefinitely because of strong barriers to entry and a structural guarantee of cartel discipline. That is the minimum wage.

Alas, the cartelization of America's labor market goes far beyond minimum wage laws. That cartelization was created mainly by two New Deal-era laws: the Fair Labor Standards Act of 1938 and the National Labor Relations Act of 1935. The minimum wage is part of the Fair Labor Standards Act, which also includes a prohibition on child labor (under the age of 16) and a 40-hour work week for hourly workers. The National Labor Relations Act of 1935 (NLRA) enshrined federal union laws, though some of its worst aspects were curtailed in 1947.

As originally enacted, the NLRA created a one-sided regime of cartel power for labor unions. It allowed a majority of workers in a firm or subunit to join a union that would be its exclusive bargaining agent. Through the "closed shop," the union could exclude competing non-union labor, or members of another union—effectively forcing workers to join the union if they wanted to work at the firm. The law then required them to pay dues to the union. In an elegant example of the twisted logic behind these laws, the NLRA explicitly aimed to redress the "inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract."[21] Of course, as we've seen elsewhere, the law's very purpose is to limit employees' freedom of association and liberty of contract.

The original NLRA gave the unions enough rope to hang themselves. After World War II, labor became increasingly radicalized in the United States. In just a few years, millions of Americans were involved in strikes, many of them weeks long. Many union leaders were Communists, and Communism was spreading among the rank-and-file. In 1946, with the Cold War in full swing, a major labor uprising rattled the business community and the political class. Millions of Americans went on strike. The following year, congress enacted the Taft-Hartley Act over President Harry Truman's veto.

The Taft-Hartley Act significantly amended the NLRA. Its most important provision was to repeal the NLRA's "closed shop," which greatly weakened the union's ability to exclude non-union members. That single change in the law was destined to marginalize the union in an increasingly diversified economy with an increasingly mobile labor force. The Taft-Hartley Act also established the states' Right to Work election: It allowed states to pass laws prohibiting obligatory union dues, and provided that such laws would supersede the NLRA's contrary provisions. Right to Work laws thus gravely weaken the ability of unions to coerce employers, nonmembers, and members alike. There are now 24 states with Right to Work laws.

In the states that have not passed Right to Work laws, however, the collective bargaining provisions of the NLRA still allow soft ways for unions to exclude competing rivals, and prevent the exit of employers, who can be prohibited from leaving the state for the haven of lax labor laws by the National Labor Relations Board.

Texas is relatively free of the labor restrictions that plague other states. Indeed, if the same competitive consensus that has kept the Texas labor force relatively free of government intervention were applied in other sectors of the economy, the majority of cartels protected by Texas law would vanish. Texas leaders nonetheless have a stake in fighting the federal labor laws and the labor laws of other states, because a competitive national labor market will benefit everybody.

Professional Licensing

In examining the anticompetitive effects of professional licensing, it is useful to begin the discussion with the dis-

Texas is relatively free of the labor restrictions that plague other states. Indeed, if the same competitive consensus that has kept the Texas labor force relatively free of government intervention were applied in other areas, the majority of cartels protected by Texas law would vanish.

tinction that Milton Friedman makes between registration, certification, and licensing. Registration is meant for publicity, and simply requires that people who engage in an activity, for example taxi driving, register their name on a public list and perhaps obtain a number, which a taxi driver could display on his cab. The next level is certification, under which a government agency certifies that a person or business meets certain standards, without preventing people who do not meet those standards from engaging in the activity. And finally there is licensing, which is certification married to a prohibition on anybody not certified engaging in the licensed activity, usually subject to criminal penalties.[22]

All schemes of occupational registration, certification, or licensure, should be subject to the following general principles. First, private issuers of the certification should be preferred over a government issuer; in other words, government should not at all be involved in certifying, registering, or licensing many of the occupations that are regulated today. Second, if the government does regulate an occupation, then the law should guard against the regulatory board (or other entity that decides the standards, administers examinations, and issues the certificate) being captured by members of the profession in question; it should be controlled by a majority representing the public (consumer) interest. Third, government registration should be preferred to government certification. And fourth, government certification should be strongly preferred to government licensure and should prevail in virtually every case.

Many states do not follow this hierarchy, and instead impose licensing requirements on a dizzying number of occupations. For example the Texas Occupation Code has an entire chapter on barbers, barber shops, and beauty parlors. The 83rd Legislature bravely confronted the weighty issue of how to license the person who administers shampoo to the head. HB 2095 made dramatic changes to the law; henceforth, someone holding merely a barber student permit will be allowed to shampoo and condition hair in a licensed barber shop or dual shop, but the state will no longer issue barber apprentice permits. The bill likewise allows a barber shop or dual shop owner to employ a barber student to shampoo and condition hair, but, with a proviso that demonstrates how carefully the Legislature weighed the issues involved: a student's barber school may not receive any compensation for the student shampooing or conditioning in the barber shop or dual shop. Current shampoo apprentice permit holders may continue to shampoo and condition hair in a licensed barber shop or dual shop until the permit expires. In the meantime, barber shops or dual shops may continue to employ shampoo apprentice permit holders to shampoo and condition hair.

This silly and mildly grotesque concoction of rules reflects the effectiveness of lobbyists for the barbershop schools, who obviously wanted to shore up their cartel by getting the state to suppress the awful practice of apprenticeship in barber shops, what with all the obvious public health and safety risks from apprenticeship.

Whatever the justifications advanced for this scheme, we may safely say that the government has no business forbidding you from paying the person of your choice to apply shampoo to your head.

The general problem with these schemes was summed up neatly by Milton Friedman:

> The most obvious social cost is that any one of these measures, whether it be registration, certification, or licensure, almost inevitably becomes a tool in the hands of a special producer group to obtain a monopoly position at the expense of the rest of the public. There is no way to avoid this result. One can devise one or another set of procedural controls designed to avert this outcome, but none is likely to overcome the problem that arises out of the greater concentration of producer than of consumer interest. The people who are most

> concerned with any such arrangement, who will press most for its enforcement and be most concerned with its administration, will be the people in the particular occupation or trade involved. They will inevitably press for the extension of registration to certification and of certification to licensure. […] The result is invariably control over entry by members of the occupation itself and hence the establishment of a monopoly position.[23]

But the problems, as Friedman also points, is much worse in the case of licensing, than in the case of certification, because of the prohibition on a whole category of exchange. That prohibition is an inherent cartel-creation device, and will tend to restrict output and raise prices above competitive levels in every case. Meanwhile, the interest in protecting the public is wholly satisfied by non-exclusive credentialing that leaves the public free to choose whether to seek credentialed or non-credentialed purveyors according to its own judgment. As Friedman points out, where licensing is chosen instead of credentialing, it "amounts to saying that we in our capacity as voters must protect ourselves in our capacity as consumers against our ignorance, by seeing to it that people are not served by incompetent physicians or plumbers or barbers." The social losses engendered in such schemes vastly outweigh the dubious benefits.

The Texas Occupations Code should be sweepingly amended to effectuate a transition from licensing to credentialing as the dominant form of the state's guarantee that those engaged in business meet minimum standards.

Alcohol Laws

Many states heavily regulate the manufacture, distribution, and sale of alcohol. An entire volume of the Texas code is devoted to the subject. The heavily intrusive regulations are rife with opportunities for cartels, and those opportunities have not gone unexploited.

Take beer laws. Many states preserve what is reverently referred to as the "three-tier structure" of separating brewers, distributors, and retailers through licensing. With craft brewers wishing to sell to the public, and brewers developing sophisticated downstream distribution, the distributors are caught in the middle, and public pressure means an eroding position under state laws across the country.

Nothing can justify the many provisions in Texas law whose sole purpose is to protect some group of industry participants from competition.

In the 83rd Texas Legislature, the beer distributors tried to obtain a measure of protection in SB 639, a bill that was ultimately withdrawn in favor of a much weaker measure that passed along with a series of procompetitive reforms to the beer laws. SB 639 would have forced manufacturers to charge one price to distributors statewide, regardless of varying market circumstances, but allow the distributors to sell to retailers at any price they wished. Supporters testified that this would clarify existing law and prevent dishonest dealing by brewers.

But from the consumers' point of view, SB 639 was the worst of all possible worlds: restricted output and higher prices. The bill was very simply an attempt to create a government-sponsored price-fixing cartel for a small group of distributors whose role in the market is largely unnecessary.

Alcohol laws should be concerned exclusively with public health and safety. The interest in temperance may justify additional restrictions, as a community may see fit. But none of these considerations can justify regulations whose sole purpose is to protect some group of industry participants from competing against each other, and others. The states' alcohol laws should be sweepingly amended to reflect the public interest in a competitive market.

Part III: Reclaiming a Federalism of Competition and Freedom

In both text and structure, the Constitution that was originally ratified contained powerful restraints on government power at all levels, and gave society free rein to flourish within a framework of basic rules that favored freedom and competition. The results were so beneficial to so many generations of Americans that for 150 years, it proved impossible to form a coalition of special interests powerful enough and stable enough to transform the Constitution from one of competition into one of government cartels

There is a strong tendency of special interests to seek government protection from competition at the expense of everyone else. When the government provides such protection, it is invariably imposing a coercive *prohibition* on the freedom of association.

despite the relentless, eternal pressure on government officials to provide benefits for special interests.

The Progressive Movement established the foundations for that coalition, and the New Deal brought that coalition to the fore. It was that coalition—chiefly of agricultural and labor union interests—that gave Roosevelt his 1936 electoral landslide. Henceforth the new Constitution would operate to impose powerful restraints on the people, and give government free rein to expand its power within a framework of principles that favor special interests and governing elites in legislature in the land.

As it had been known and handed down for 150 years, the Constitution was a powerful bulwark against these subversions. One of its most powerful competitive design features was the combination of a limited federal commerce power within the framework of limited and enumerated federal powers that inhered in the structure of Article I, and was enshrined in the 10th Amendment, which made it clear that everything not within the limited federal sphere was reserved to the states or to the people. In order to accomplish their purpose, the Progressive/New Deal movement had to gather enough political strength to overwhelm and destroy this part of the Constitution, and it did.

The Constitution originally gave Congress the power to regulate commerce "among the several States." Commerce that was purely internal to one state was left clearly outside federal power, and within the exclusive jurisdiction of the states. But in *Wickard v. Filburn* (1942), the Supreme Court abandoned the clear constitutional division between federal and state powers. Intimidated by President Franklin D. Roosevelt, it succumbed to the argument that an increasingly complex national market required increasingly complex national controls. That is how the Constitution's framework of limited and enumerated powers was transformed into one of absolute and indefinite federal power over economic activity.

Our modern constitutional history is a story of how special interests "captured" both state and federal government, and turned them into a machinery of extracting wealth from the rest of society. One of the clearest and most egregious examples of this "extraction" is the practice of creating government-sponsored cartels under the guise of protecting the public. Because the expansion of federal overreach did not entail a reduction in the state's jurisdiction, overlapping federal and state power would now create a multitude of opportunities for collusion in cartel-making, and states would now be free to create the worst cartels under federal protection.

There is a strong tendency of special interests to seek government protection from competition at the expense of everyone else. When the government provides such protection, it is invariably imposing a coercive *prohibition* on the freedom of association. The effect is to reduce economic output and raise prices artificially. Protecting the public from that injury is the purpose of antitrust enforcement against monopolies and cartels. And yet as explained in Part I, monopolies and cartels that arise purely in the free market—without government intervention—are injurious to the public only in rare special cases, and only for finite periods of time. In all other cases, they are beneficial to the public, because they arise through efficiencies and economies of scale, which increase output and lower prices. The only monopolies and cartels that nearly always injure the public are those created by government.

When state governments satisfy a special interest's desire for a government-created cartel—for example through anticompetitive restrictions in commercial and professional licensing—the state invariably suffers significant economic losses. The reduced output makes the state's economy uncompetitive compared to that of other states. States that adopt such uncompetitive practices tend to aggregate in congressional and other national coalitions in order to "federalize" their cartels. This is how the New Deal cartels in labor and agriculture first came about. Indeed, this is the process that has been chiefly responsible for undermining the 10th Amendment and the whole framework of limited and enumerated powers.

Many of those cartels persist to this day, though they were presented as emergency measures—demonstrating another danger of government-created cartels: unlike those in the free market, which are always ephemeral, government-created cartels have the force—and staying power—of law.

Before 1937, the Constitution had been generally interpreted to guarantee certain basic freedoms which were beyond the power of government, and which, if anyone could regulate them at all, were subject to the preeminent domain of the states, not the federal government. But the New Deal proved stronger than that Constitution. It created a new Constitution in its image. And that Constitution has been busy creating monopolies and cartels and other forced transfer schemes ever since, turning democracy in America into an instrument of economic extraction for special interests, a process which has marked the decline and fall of other great societies.

The government-sponsored cartelization of the American economy, beginning at the state level, could not proceed against the bulwark of limited and enumerated powers. This is because government-sponsored cartels in one state would make that state uncompetitive when compared to other states that had not created such cartels. A federal umbrella was necessary, both in legislation, and in court doctrines—such as the *Parker* doctrine—that would make society "safe for cartels" as Richard Epstein has written.

Many constitutional conservatives see the struggle to restore the Constitution as a fight between "states' rights" and the federal government. But the real struggle is among the states themselves. It is a story of uncompetitive states seeking federal protection from interstate competition, by having the federal government impose an uncompetitive baseline on everybody.

America's history of government interventions in the economy has one stark lesson which is the reason for this paper: Government-created cartels must be defeated at the level of the states *before* they become federalized, for once federalized, they become all but impossible to remove. The task for those who aim to recapture the Constitution is nothing less than to reverse the tectonic shift that led from a federalism of competition to a federalism of cartels.

Government-created cartels must be defeated at the level of the states *before* they become federalized, for once federalized, they become all but impossible to remove.

So where should we start? One good place is here at home. The laws of the state of Texas have proven highly susceptible to capture by cartel interests. The first step is to develop a program for systematically extirpating and reducing the cartelization of the Texas economy in the laws and regulations of the state of Texas. The Texas Code should be scoured and scrutinized in the light of the principles developed in this paper. Overregulation should be sweepingly rolled back. State protection for cartels in the sale of agriculture, alcohol, and other goods should be removed. Most categories of occupational licensing should be converted to non-exclusive credentialing.

This will require careful scrutiny of the Texas Code. Any scheme in the Texas Code that regulates the production or sale of a good or service should be examined with a critical eye. Does the scheme tend to restrict output and increase prices by prohibiting some sort of otherwise lawful conduct? If so, is there a public health or safety justification? Is the public fully protected by the common law principles of contracts and torts? If not, is the public health or safety justification compelling as to the corresponding prohibition, or is it possible to accomplish the scheme's public health or safety justification without imposing any sort of prohibition? Applying this analysis systematically will reveal, for example, that virtually all categories of exclusive occupational licensing should be converted to non-exclusive state-issued certifications, or certifications issued by non-governmental organizations.

The task for those who aim to recapture the Constitution is nothing less than to reverse the tectonic shift that led from a federalism of competition to a federalism of cartels.

A substantial degree of success in decartelizing the Texas economy has the potential to make Texas the most explosively productive economy in the United States and indeed the world. If a leading state such as Texas were to take such a step, it would shine a powerful light for others to follow. Indeed, Texas is already a beacon for Californians and others seeking better opportunities in a more hospitable regulatory climate. The beacon of a Texas economy truly freed from the shackles of government-sponsored cartels would shine much brighter still. Texas could start to build a coalition of states to embrace competitive policies and turn away from the relentless cartel-formation that state governments have proven only too susceptible to.

While we fight government-created cartels in Texas, we must also look to strike back against the most egregious government-created cartels of other states, in particular by exploring the state AG's previously unexploited power to assail the government-created cartels of other states in lawsuits under the federal antitrust laws, particularly by finding chinks in the armor of the *Parker* doctrine.

Finally, it is critical to assail the umbrella that the federal government creates for state cartels of all sorts, not just in agriculture and labor, but even in such things as tax policy (e.g., deductions for state tax payments that create a huge incentive for states to tax the given thing or activity) and federal grants to the states (e.g., transferring federal revenue to the states inflates state and federal spending far beyond the spending levels each sovereign would sustain if it was spending only what it could politically afford to tax on its own). These cartels are more hidden, entrenched, and insidious. Identifying them requires some extensive study. One major area of federal cartelization in the context of coercive federal funds, where the Texas Public Policy Foundation has done a major study.[24]

Once states feel the pressures of true regulatory competition, free from the umbrella of federal protection, government at all levels of our federal system will tend to diminish its scope and give freer rein to a freer society.

Conclusion

Proponents of heavy-handed government regulation point to the financial crisis, growing income inequality, and the failure of free market capitalism in much of the developing world. These views have reinforced a narrative that has persisted doggedly since the Great Depression, despite all evidence to the contrary. The narrative holds that the free market is dangerously unstable, unworkable, and unjust, and that government must step in to "correct" its problems.

In fact, as the Great Depression showed, government "medicine" is invariably worse than the disease, leading to enormous instability, market failures, and social injustice. The perceived need to "correct" the day-to-day functioning of the free market has led the government to expand its power far beyond the role government was supposed to play under our Constitution. Government now regulates virtually every aspect of social activity. If Friedrich Hayek were alive today, he would doubtlessly see America's "road to serfdom" being paved in the 60,000 pages added every year to the Code of Federal Regulations.

The Reagan Revolution represented a triumph of limited government, economic freedom, and personal responsibility—the principles that made our country great. Two decades later, it is clear that those principles are not merely the path to improving our society—they are the principles on which the survival of free society depends. It is the duty of every public official to advance those principles in word and deed. A good start is to identify, attack, and defeat the government-created cartels and massive overregulation that have turned our Constitution upside down, and impose an unconscionable injury on the people every single day. ✯

Endnotes

[1] http://future.state.gov/when/timeline/1921_timeline/smoot_tariff.html.
[2] 301 U.S. 1.
[3] 312 U.S. 100.
[4] 315 U.S. 110.
[5] 317 U.S. 111.
[6] *See* Robert Bork, *The Antitrust Paradox* (1993).
[7] Richard A. Epstein, *Design for Freedom* (2011) 44.
[8] *United States v. Carroll Towing Co.* 159 F.2d 169 (2d. Cir. 1947).
[9] Antitrust Modernization Commission, "Report and Recommendations" (2007) 435.
[10] Michael S. Greve, *Cartel Federalism? Antitrust Enforcement by State Attorneys General*, 72 U. Chi. L. Rev. 99, 104 (2005).
[11] Richard Posner, "Theories of Economic Regulation," NBER Working Paper No. 41 (1974) 344-346.
[12] 297 U.S. 1.
[13] *See generally*, Congressional Research Service, The Farm Price-Cost Squeeze and U.S. Farm Policy (2005).
[14] 291 U.S. 502.
[15] Richard Epstein, *How Progressives Rewrote the Constitution* (2006) 77-81.
[16] 291 U.S. at 538 (citations omitted).
[17] 291 U.S. at 557.
[18] Texas Agriculture Code, Chapter 52.
[19] Ibid, Section 52.002.
[20] Ibid, Section 52.005.
[21] 29 U.S.C. § 151.
[22] *Capitalism and Freedom*, 144-45. The following discussion is drawn substantially from Chapter IX of the book, pp. 137 et seq.
[23] *Capitalism and Freedom*, 148.
[24] http://www.texaspolicy.com/sites/default/files/documents/2013-10-RR07-LooseningFederalStraightjacket-CTAA-MarioLoyola.pdf.

About the Author

Mario Loyola is a Senior Fellow at the Texas Public Policy Foundation. He joined the Foundation in July 2010 as founding director of the Center for Tenth Amendment Action, focusing on energy and environment, healthcare, and other federalism issues. Loyola began his career in corporate law. Since 2003, he has focused on public policy, dividing his time between government service and research and writing at prominent policy institutes. He served in the Pentagon as a special assistant to the Under Secretary of Defense for Policy, and on Capitol Hill as counsel for foreign and defense affairs to the U.S. Senate Republican Policy Committee.

Loyola is a regular contributor to *National Review* and National Public Radio, and has written extensively for national and international publications, including op-eds in *The Wall Street Journal*. He has appeared on Fox News, CNN, BBC Television, and more. Together with Prof. Richard A. Epstein, Loyola wrote three *amicus* briefs for the U.S. Supreme Court in the Obamacare case, *NFIB v. Sebelius*.

Loyola received a B.A. in European history from the University of Wisconsin-Madison and a J.D. from Washington University School of Law. He is admitted to practice law in New York State, the Commonwealth of Puerto Rico, the U.S Supreme Court, and the Fifth Circuit Court of Appeals.

About the Texas Public Policy Foundation

The Texas Public Policy Foundation is a 501(c)3 non-profit, non-partisan research institute. The Foundation's mission is to promote and defend liberty, personal responsibility, and free enterprise in Texas and the nation by educating and affecting policymakers and the Texas public policy debate with academically sound research and outreach.

Funded by thousands of individuals, foundations, and corporations, the Foundation does not accept government funds or contributions to influence the outcomes of its research.

The public is demanding a different direction for their government, and the Texas Public Policy Foundation is providing the ideas that enable policymakers to chart that new course.

Texas Public Policy
FOUNDATION
Celebrating 25 Years

900 Congress Ave., Suite 400 | Austin, Texas 78701 | (512) 472-2700 phone | (512) 472-2728 fax | www.TexasPolicy.com