

2-2015

# The Opening of American Law: Neoclassical Legal Thought, 1870-1970: Epilogue

Herbert J. Hovenkamp

*University of Pennsylvania Law School*

Follow this and additional works at: [http://scholarship.law.upenn.edu/faculty\\_scholarship](http://scholarship.law.upenn.edu/faculty_scholarship)

 Part of the [Constitutional Law Commons](#), [Courts Commons](#), [Criminal Law Commons](#), [Intellectual History Commons](#), [Jurisprudence Commons](#), [Law and Economics Commons](#), [Law and Society Commons](#), [Legal History Commons](#), and the [Political History Commons](#)

---

## Recommended Citation

Hovenkamp, Herbert J., "The Opening of American Law: Neoclassical Legal Thought, 1870-1970: Epilogue" (2015). *Faculty Scholarship*. 1809.

[http://scholarship.law.upenn.edu/faculty\\_scholarship/1809](http://scholarship.law.upenn.edu/faculty_scholarship/1809)

This Article is brought to you for free and open access by Penn Law: Legal Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Penn Law: Legal Scholarship Repository. For more information, please contact [PennlawIR@law.upenn.edu](mailto:PennlawIR@law.upenn.edu).

## THE OPENING OF AMERICAN LAW: NEOCLASSICAL LEGAL THOUGHT, 1870-1970: EPILOGUE

### Contents

#### Introduction

#### PART ONE: *Human Nature and the Sources of Law*

1. Scarcity, Biology, and the Rational Actor
2. Natural Selection, Deterrence, and Mental Defect
3. The Science and Law of Race

#### PART TWO: *Neoclassical Legal Thought*

4. Economics and Law in the Progressive Era
5. Social Value, Taxation, and Public Finance
6. From Institutionalism to Legal Realism
7. Recasting the Common Law: The Management of Risk and Relationship

#### PART THREE: *The Neoclassical Firm and the Formation of Modern Business Policy*

8. The Revolution in Corporate Finance
9. The Separation of Ownership and Control
10. The Twisted Path to Innovation Policy
11. Structuralism in Competition Policy
12. Distribution and Vertical Control

#### PART FOUR: *Neoclassical Public Law*

13. The Substantive Due Process Triumvirate: Health, Safety, and Morals
14. The Waning of Classical Labor Policy
15. The Regulatory State and Federalism

### Epilogue: The New Deal at Bay

Legal Realism left American legal theory holding an empty bag. It was a “destructive movement,” Grant Gilmore lamented in 1951. “We stand amid the wreck and ruin of a jurisprudence which cannot be rebuilt.”<sup>1</sup> To say that law was “positive” or “legislative” was consistent with the period’s waning modernism, but neither term provided useful content to legal policy. At the same time, Legal Realism’s cynicism should not be exaggerated. Although it appeared in popular books such as Jerome Frank’s *Law and the Modern Mind*,<sup>2</sup> many Realists ended

---

<sup>1</sup> Grant Gilmore, *Book Review*, 60 YALE L.J. 1251–52 (1951) (reviewing KARL N. LLEWELLYN, *THE BRAMBLE BUSH*. (New York: Oceana, 1951)).

<sup>2</sup> JEROME FRANK, *LAW AND THE MODERN MIND* (New York: Brentano’s, 1930).

up working in government. For all appearances they were enthusiastic supporters of a new age of legislation, redistribution, nonjudicial regulation, and expertise. They went from rebellion to establishment in a brief time.

The Great Depression, the War, and the massive changes brought about by government wrought considerable anxiety about law. If law was to be the product of policy science, then where was the science? A central question for legal theory became whether social science and economics were consistent with democratic policymaking, and promised legal institutions that could facilitate growth and defensible concepts of liberty, democratic participation, and fairness. The initial attempt at a positive answer, driven strongly by Legal Realist values, was a search for nonmarket mechanisms of impartial policymaking. When that quest failed, economists, legal scholars and later policymakers increasingly returned to more market-driven approaches.

While the period following World War II desperately sought consensus, the writing of American intellectuals only showed how elusive consensus could be. Influential works of American social history, including Oscar Handlin's *The Uprooted* and Will Herberg's *Protestant, Catholic, Jew*, both undermined the myth that the United States was a single great "melting pot," blending all cultural identities into one slightly off-white batter. Herberg settled for the idea of a "triple" melting pot, which included Protestants, Catholics, and Jews but slighted Muslims, Hindus, Buddhists, or the variety of other religions practiced by millions of Native, Chinese, and other immigrant Americans.<sup>3</sup> *Brown v. Board of Education* and later Bull Connor's televised fire hosing of nonviolent demonstrators dramatically exposed the nation to the reality of racial conflict.<sup>4</sup> Senator Joseph McCarthy's campaign to root out Communists became a symbol of 1950s' suppression of dissent.<sup>5</sup>

## Reconstructing and Delimiting the Common Law

The search for rational consensus in law was driven as much by practical considerations as ideological ones. One heroic effort was the Restatement projects of the American Law Institute (ALI), which were never intended to be either radically revisionist or particularly jurisprudential. They were substantially

---

<sup>3</sup> WILL HERBERG, *PROTESTANT, CATHOLIC, JEW: AN ESSAY IN AMERICAN RELIGIOUS SOCIOLOGY* (Garden City, NJ: Doubleday, 1955); OSCAR HANDLIN, *THE UPROOTED: THE EPIC STORY OF THE GREAT MIGRATIONS THAT MADE THE AMERICAN PEOPLE* (Boston: Little, Brown, 1951).

<sup>4</sup> *Brown v. Board of Education*, 347 U.S. 483 (1954). See TAYLOR BRANCH, *PARTING THE WATERS: AMERICA IN THE KING YEARS, 1954–1963*, at 112–25, 283–84, 585–94, 767 (New York: Simon and Schuster, 1989).

<sup>5</sup> For different views of McCarthyism, see RICHARD M. FRIED, *NIGHTMARE IN RED: THE MCCARTHY ERA IN PERSPECTIVE* (New York: Oxford Univ. Press, 1990); M. STANTON EVANS, *BLACKLISTED BY HISTORY: THE UNTOLD STORY OF SENATOR JOE MCCARTHY AND HIS FIGHT AGAINST AMERICA'S ENEMIES* (New York: Crown Forum, 2007).

motivated by professional developments. From its founding in 1878, the American Bar Association had made rationalization and uniformity of the law one of its objectives.<sup>6</sup> A year later West Publishing Company inaugurated the Regional Reporter System, which large numbers of lawyers began using in the 1880s and 1890s.<sup>7</sup> The books were relatively inexpensive and collected the important case law of all of the states, organized by region. The relative insignificance of the West was clear in how the states were grouped. Kansas, in the center of the country, was in the *Pacific Reporter*. Lawyers now had an inexpensive way of comparing their own law with that of nearby states and were shocked to discover the degree of diversity.<sup>8</sup>

The ALI was a relative latecomer to unification. It was founded in 1923 and directed by William Draper Lewis, a Republican Progressive, friend of Theodore Roosevelt, and former Dean of the University of Pennsylvania Law School. The ALI's stated purpose was "to promote the clarification and simplification of the law and its better adaptation to social needs."<sup>9</sup> The first Restatements included Contracts (1932), Agency (1933), Conflict of Laws (1934), Property (1936), Restitution (1937), and Torts (1938–1939). Controversy continues about whether the Restatement project was "reformist."<sup>10</sup> Some of its reporters, such as Harvard's Joseph Beale who was in charge of Conflict of Laws, were ardent anti-reformers.<sup>11</sup> In addition, the first Restatement grew out of a pre-*Erie v. Tompkins* mentality that was inclined to look for a single best legal rule.<sup>12</sup>

Legal Realists were almost uniformly critical. Leon Green thought that the torts Restatement was an exercise in pure formalism.<sup>13</sup> Yale Law School Dean Charles Clark, also an advisor on the Property Restatement, first heaped praise on

---

<sup>6</sup> See Walker Lewis, *The Birth of the American Bar Association*, 64 A.B.A. J. 996 (1978); LAWRENCE M. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 305, 541 (New York: Simon & Schuster, 3d ed. 2005).

<sup>7</sup> See WILLIAM W. MARVIN, *WEST PUBLISHING COMPANY: ORIGIN, GROWTH, LEADERSHIP* 24 (St. Paul, MN: West, 1969). See also Robert M. Jarvis, *John B. West: Founder of the West Publishing Company*, 50 AM. J. LEGAL HIST. 1 (2010).

<sup>8</sup> On the relationship between the organization of the regional reporter system and interstate judicial citation, see Peter Harris, *Ecology and Culture in the Communication of Precedent among State Supreme Courts, 1870–1970*, 19 L. & SOC'Y REV. 449 (1985).

<sup>9</sup> *Report of the Committee on the Establishment of a Permanent Organization for the Improvement of the Law Proposing the Establishment of an American Law Institute*, 1 A.L.I. PROC. 1 (1923).

<sup>10</sup> See N.E.H. Hull, *Restatement and Reform: A New Perspective on the Origins of the American Law Institute*, 8 LAW & HIST. REV. 55, 70–74 (1990); and the symposium in 32 S. ILL. UNIV. L.J. 1 (2007).

<sup>11</sup> On Beale, see Chapter 7; and Symeon C. Symeonides, *The First Conflicts Restatement through the Eyes of Old: As Bad as Its Reputation?*, 32 S. ILL. UNIV. L.J. 39 (2007).

<sup>12</sup> On this impulse in the first Restatement, see G. EDWARD WHITE, *THE CONSTITUTION AND THE NEW DEAL 170–74* (Cambridge, MA: Harvard Univ. Press, 2000).

<sup>13</sup> Leon Green, *The Torts Restatement*, 29 ILL. L. REV. 582 (1935).

the Restatement of Contracts for its assembly of the great legal minds of the day. Then he dismantled the entire document, criticizing its excessive formalism and its substitution of citation for rigorous analysis. The Institute's "formula" served "to press the fruitful activities of its scholars into the dry pulp of the pontifical and vague black letter generalities."<sup>14</sup> In an unpublished paper the University of Iowa's Percy Bordwell criticized the Property Restatement's treatment of future interests as "a combination of ancient or rather early medieval history, analytic jurisprudence and reportorial legislation but not a statement of the positive law." In a subsequent review of the entire Restatement of Property he predicted its failure. "Legislation is legislation and scholarship is scholarship, but the Institute is not a legislature and its ways are not those of scholarship."<sup>15</sup> Myres McDougal said much the same.<sup>16</sup>

Tulane Legal Realist Mitchell Franklin believed that the Restatements were "transitional" documents paving the way for codification.<sup>17</sup> "At the very least, the historic function of the American Law Institute is its role of affording a transition from the classic American law of the nineteenth and early twentieth centuries to a new American law." Samuel Williston, Reporter for the Restatement on Contracts, observed that "in every other civilized country," judge-made law eventually "became unwieldy" and "a code has followed. . . . [M]y own belief is that we shall repeat the history of other countries. . . . This Restatement . . . will serve as a better foundation for a code."<sup>18</sup>

In important ways the Restatement's drafters looked backward, attempting to rationalize a diverse and inconsistent body of legal rules. Grant Gilmore's argument that the ALI's Restatement agenda was to hold off Legal Realism was certainly overstated.<sup>19</sup> When the Restatements were conceived in the late 1920s, the impact of Legal Realism was not yet ominous. The biggest impulse toward change came from Holmes's less radical but nevertheless transformative ideas about the purpose and effects of the common law. The Restatement project was reformist in this more limited sense.

---

<sup>14</sup> Charles E. Clark, *The Restatement of the Law of Contracts*, 42 YALE L.J. 643, 647 (1933). For the reactions of other Legal Realists at Yale, see LAURA KALMAN, *LEGAL REALISM AT YALE, 1927–1960*, at 26–28 (Chapel Hill: Univ. of North Carolina Press, 1986).

<sup>15</sup> Percy Bordwell, unpublished review, quoted in Clark, *supra* note 14, at 646–47 n.6; Percy Bordwell, *Restatement of the Law of Property*, 51 HARV. L. REV. 565, 569 (1938).

<sup>16</sup> Myres S. McDougal, *Book Review*, 32 ILL. L. REV. 509 (1937) (reviewing first Restatement of Property).

<sup>17</sup> Mitchell Franklin, *The Historical Function of the American Law Institute: Restatement as Transitional to Codification*, 47 HARV. L. REV. 1367 (1934).

<sup>18</sup> Samuel Williston, *Written and Unwritten Law*, 17 A.B.A. J. 39, 41 (1931). On the Legal Realists' treatment of Williston, see Mark L. Movsesian, *Williston as Conservative-Pragmatist*, 32 S. ILL. U. L.J. 135, 137, 138 (2007).

<sup>19</sup> See GRANT GILMORE, *THE DEATH OF CONTRACT* 55–68 (Columbus: Ohio State Univ. Press, 1974); and Grant Gilmore, *Legal Realism: Its Cause and Cure*, 70 YALE L.J. 1037 (1961).

For example, the Williston-directed Restatement of Contracts was strongly influenced by Holme's highly commercial orientation, with its emphasis on shared expression rather than internal state of mind, its concern about creating proper incentives, its emphasis on remedies, and its generally amoral attitude about performance. The provision on nuisance law in the Restatement of Torts, drafted just as legislative land use regulation was becoming prominent, was an exercise in pure marginalism. "Nontrespassory" harms to the land of others, including noise, smoke, excessive water, immoral conduct, and other activities, were unlawful, "unless the utility of the actor's conduct outweighs the gravity of the harm."<sup>20</sup> This "harm/utility" formulation had never appeared in the case law, but it applied a kind of marginalist cost-benefit analysis to private land use disputes. The Restatement test was borrowed from the work of another Holmesian, Judge Learned Hand's opinion in *Smith v Staso Milling Co.*, which had held that nuisance injunctions should be subjected to a utility balancing test.<sup>21</sup> In 1942 a Connecticut court became the first to apply this section, concluding that the operation of a castor oil plant would not be enjoined simply because a small number of workers at neighboring businesses were allergic to castor bean dust. This approach required "balancing" of competing interests, and in this case the castor oil facility had taken every step to limit its emissions. The only alternative was to close the plant, but it was under contract to the army and "its product is indispensable to the prosecution of the war." Under the Restatement approach, "Regard must be had not only for the interests of the person harmed but also for the interests of the actor, for the interests of the community, and, under the present circumstances, for the nation."<sup>22</sup>

Unlike the reforms later promoted by the Legal Realists, the Restatements continued to operate within a framework that acknowledged the centrality of the common law and (implicitly) the market, as well as the essential role of the courts. Whether or not law was legislative in character, within the Restatement conception it was still largely made by judges. In addition, the Restatements perpetuated the view that the same body of common law rules could be applied across the full range of human activity, without specialized rules for different situations.

By contrast, the Legal Realists were increasingly obsessed with market diversity, leading them away from both the Restatement vision and the common law itself. They were more supportive of the uniform law approach that was already underway when the first Restatements were drafted. The National Conference of Commissioners on Uniform State Laws, which had been organized in the early 1890s, strove to unify state law by promoting uniform legislation. Its

---

<sup>20</sup> RESTATEMENT OF TORTS § 826 (1939).

<sup>21</sup> *Smith v. Staso Milling Co.*, 18 F.2d 736 (2d Cir. 1927).

<sup>22</sup> *Heppenstall Co. v. Berkshire Chem. Co.*, 11 Conn. Supp. 82 (Conn. Super. 1942), citing RESTATEMENT OF TORTS § 826 and Comment, *Injunction—Nuisance—Balance of Convenience*, 37 YALE L.J. 96 (1927).

principal projects were a series of “model acts” that state legislators could adopt.<sup>23</sup> Its early achievements were uniform acts in commercial law, including negotiable instruments (1896), warehouse receipts (1906), the highly influential Uniform Sales Act (1906), and bills of lading (1908). These statutes attempted to harmonize the law made in state courts with the “general” commercial law *Swift v. Tyson* (1842) imposed on federal judges in diversity cases. As Justice Story had stated in *Swift*, “The law respecting negotiable instruments may be truly declared . . . to be in a great measure, not the law of a single country only, but of the commercial world.”<sup>24</sup> Story did not foresee the extent to which *Swift* produced divisions between the federal and numerous state courts. By 1908 the Uniform Negotiable Instruments Act had been enacted in thirty-five states, and the Uniform Sales Act was to have even greater success.<sup>25</sup> Most of the uniform acts were later merged into the Uniform Commercial Code, with its nine distinct articles for different areas of commercial activity.<sup>26</sup>

Drafting on the Uniform Commercial Code began in 1940 and turned into a joint effort in 1942. Chastened by its harsh treatment from the Legal Realists, the ALI joined in. Karl Llewellyn was the principal drafter, but as the code developed it contained little of the radical critique that the Legal Realists had envisioned. The UCC was first and foremost a consensus document, deducing the law from observed behavior in commercial markets. Llewellyn famously queried bankers “If I were a cheque and I arrived in your bank where would I go?”<sup>27</sup> The UCC’s revisionism was largely limited to deviations from common law rules that business persons regarded as unrealistic or as reflecting judicial ignorance of how the business world works. For the most part, the market remained alive and well.

The Restatement Second project was initiated in 1952, after Legal Realism had been woven into the legal fabric and state diversity imposed by *Erie v. Tompkins* was well established. The Reporters of the second Restatements were largely centrists. They included E. Allan Farnsworth on Contracts, with Arthur Linton Corbin as advisor; A. James Casner on Property, and William Prosser and John W. Wade on Torts. The greatest changes in mindset lay in the second Restatements’ decreasing trust of markets and greater regard for consumers and other vulnerable or unsophisticated participants. This resulted in a softening of the merchant-oriented rules of contract law, as expressed in the Restatement (Second) of Contracts (1979). In addition was the formal embrace of strict liability for defective products in the Restatement (Second) of Torts § 402A (1977). Grant Gilmore saw in these developments a subtle “coming together” between contract

---

<sup>23</sup> See WALTER P. ARMSTRONG, JR., *A CENTURY OF SERVICE: A CENTENNIAL HISTORY OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS* (St. Paul, MN: West, 1991).

<sup>24</sup> *Swift v. Tyson*, 41 U.S. (16 Pet.) 1, 18 (1842).

<sup>25</sup> See William Schofield, *Uniformity of Law in the Several States as an American Ideal*, 21 HARV. L. REV. 510 (1908).

<sup>26</sup> Robert Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 799 (1958).

<sup>27</sup> WILLIAM TWINING, *KARL LLEWELLYN AND THE REALIST MOVEMENT* 270–73, 313, 316 (London: Weidenfeld and Nicolson, 1973) (quotation on 316).

law and tort law. Both threatened an “explosion of liability.” The gradual death of nineteenth century tort doctrine that tied liability to fault “matches the decline and fall of nineteenth century consideration and contract theory.”<sup>28</sup>

## The Promises and Limitations of Public Governance

Elite legal thought through the 1960s was dominated by two conflicting trends. *First* was an attempt to justify and define the more legislative approaches that Legal Realism and the New Deal promoted. *Second* was the increasing view that legislation is inherently unstable, inefficient, and prone to capture by special interests. In the 1960s and after the second of these largely disemboweled the first.

## The Transformation of Substantive Due Process: Liberty Rights and Special Interest Capture

The Supreme Court recognized the end of the *Lochner* era in its 1938 *Carolene Products* decision.<sup>29</sup> Nevertheless *Lochner* produced two quite different lingering effects. *First*, although the Court largely stopped second-guessing economic legislation, substantive due process analysis of *nonmarket* liberties continued unabated and even expanded. *Second*, the Supreme Court lost its most important tool for combating special interest capture. In this sense, *Carolene Product’s* strong presumption of constitutionality represents the high point of a confidence in the legislative process whose defense had yet to be articulated. A generation later that view would become the target of public choice and rent-seeking theory, which once again picked up the anti-legislation/anti-regulation mantle.

On the first effect, *Lochner* became shorthand for a set of essentially contract rights against the State. But as *Carolene Products* itself acknowledged in its famous fourth footnote, the theory of preferences that drove Anglo-American economic and political theory included other human choices that were not strictly economic at all. A significant number of Supreme Court decisions during and after the *Lochner* era recognized liberties outside the realm of ordinary economic bargaining. Already in 1890 Brandeis and coauthor Samuel D. Warren argued in the *Harvard Law Review* for a legally protected right to privacy, even though Brandeis later became one of *Lochner’s* strongest critics.<sup>30</sup> The Supreme Court’s *Buchanan v. Warley* decision (1917) discussed in Chapter 3 hinted at protection for noneconomic liberty in its condemnation of residential racial segregation by zoning.<sup>31</sup> *Meyer v. Nebraska* (1923) found that people had a liberty right to learn a foreign language. The Court struck down a World War I-era statute that made it unlawful for any school to teach a foreign language to children who had not yet reached the eighth grade. The opinion, written by Horseman Justice James

---

<sup>28</sup> GILMORE, THE DEATH OF CONTRACT, *supra* note 19, at 94–95.

<sup>29</sup> *United States v. Carolene Prods.*, 304 U.S. 144, 152 & n.4 (1938).

<sup>30</sup> Samuel D. Warren & Louis D. Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890).

<sup>31</sup> *Buchanan v. Warley*, 245 U.S. 60 (1917).

McReynolds, provided an interesting list of constitutionally protected liberty rights:

... not merely freedom from bodily restraint but also the right of the individual to contract, to engage in any of the common occupations of life, to acquire useful knowledge, to marry, establish a home and bring up children, to worship God according to the dictates of his own conscience, and generally to enjoy those privileges long recognized at common law as essential to the orderly pursuit of happiness by free men.<sup>32</sup>

The Court relied on *Lochner*, *Adkins*, and several other substantive due process decisions. Two years later, *Pierce v. Society of Sisters* overturned a state statute that closed parochial schools, including Catholic schools. Justice McReynolds wrote the opinion.<sup>33</sup> In *Skinner v. Oklahoma* (1942) the Court recognized a right of procreation, striking down a statute that provided for more-or-less automatic sterilization of certain convicted criminals.<sup>34</sup> This liberty right took wing in the 1960s, providing greatly expanded constitutional protection for an assortment of “fundamental” rights that the text of the Constitution did not explicitly embrace. What most of the cases had in common is that significant interest groups opposed the conduct, often on moral or religious grounds, but the conduct itself was typically consensual and caused little or no injury to third parties. *Loving v. Virginia* recognized a constitutional right to marry, striking down statutory bans on interracial marriage (“miscegenation”).<sup>35</sup> *Griswold v. Connecticut* struck down a statute forbidding the distribution and use of contraceptives, in the process recognizing a fundamental right to privacy.<sup>36</sup> *Roe v. Wade* (1973) recognized and defined a woman’s right to have an abortion.<sup>37</sup> Finally, *Lawrence v. Texas* held that the State may not prohibit consensual sexual activity between adults of the same sex.<sup>38</sup>

The second effect of *Carolene Products* was that its deference toward economic regulation largely undermined the Supreme Court’s ability to limit “capture” by special interest groups. In retrospect, neither *Lochner*-style economic due process nor *Carolene Products*’ extreme deference was a good vehicle for ferreting out the harmful effects of special interest control of legislation. The *Lochner* approach either condemned legislation without regard to capture or assumed capture without proof. *Carolene Products* went to the opposite extreme, largely removing the Court’s ability to limit special interest economic legislation unless it ran afoul of an explicit constitutional provision. The

---

<sup>32</sup> *Meyer v. Nebraska*, 262 U.S. 390, 399 (1923).

<sup>33</sup> *Pierce v. Soc’y of Sisters*, 268 U.S. 510 (1925).

<sup>34</sup> *Skinner v. Oklahoma*, 316 U.S. 535 (1942).

<sup>35</sup> 388 U.S. 1 (1967).

<sup>36</sup> 381 U.S. 479 (1965).

<sup>37</sup> *Roe v. Wade*, 410 U.S. 113 (1973).

<sup>38</sup> *Lawrence v. Texas*, 539 U.S. 558 (2003), overruling *Bowers v. Hardwick*, 478 U.S. 186 (1986).

development of public choice theory, discussed below, was an attempt to recover this lost element of substantive due process.

*Carolene Products* itself illustrates the problem. The statute in question grew out of the same dairy industry campaign that led to the suppression of oleomargarine, discussed in Chapter 5.<sup>39</sup> The “filled milk” provision that the Court upheld prohibited sellers from inserting non-milk oils into their milk products. Carolene’s product, then called “Milnut,” contained evaporated milk with a small amount of coconut oil. The mixture whipped very easily, thus making it a substitute for pure cream. The product is sold to this day under the name “Milnot,” owned by J.M. Smucker’s, Inc. It contains considerably less fat than whipping cream and no saturated fat. From the beginning, the principal purpose of the legislation was not to protect consumers from a harmful product, but rather to protect the dairy industry from competition.

### Legal Interpretation and Judicial Review

One important legacy of Legal Realism was the belief that all of law, including common law, is essentially public in character. As a result the traditional distinction between private and public law is either porous or untenable. In *Shelley v. Kraemer* (1948) the Supreme Court held that mere judicial enforcement of a private racially restrictive covenant implicates “state action” under the Fourteenth Amendment, suggesting that even common law contracts could be “public.”<sup>40</sup> The courts declined to jump the precipice, however, and held *Shelley* closely to its facts. In 1956 the Supreme Court refused to apply it in *Black v. Cutter Laboratories*, which upheld judicial enforcement of a private arbitration board’s dismissal of a worker for membership in the Communist Party.<sup>41</sup> The Court rejected Mabel Black’s protest that judicial enforcement of the decision violated her First Amendment rights, finding no state action but only a private labor agreement. In 1959 the Legal Realist Leon Green wrote that even tort law was “Public Law in Disguise.”<sup>42</sup> A year later, however, Ronald Coase would declare in “The Problem of Social Cost” how utterly private the law could be.<sup>43</sup> Green’s article has largely been forgotten, while Coase’s is the most cited of all time.

A second legacy of Legal Realism was the belief that law is fundamentally democratic and legislative, but also complex and best interpreted by experts. One influential attempt to reconstruct a practical and lawyerly defense of legal interpretation was Henry Hart and Albert M. Sack’s book of teaching materials entitled *The Legal Process*.<sup>44</sup> The book came out in 1958 in a mimeographed

---

<sup>39</sup> See Geoffrey P. Miller, *The True Story of Carolene Products*, 1987 SUP. CT. REV. 397.

<sup>40</sup> *Shelley v. Kraemer*, 334 U.S. 1 (1948).

<sup>41</sup> *Black v. Cutter Labs.*, 351 U.S. 292 (1956). Chief Justice Warren and Justices Douglas and Black dissented.

<sup>42</sup> Leon Green, *Tort Law Public Law in Disguise*, 38 TEX. L. REV. 1 (1959).

<sup>43</sup> 3 J.L. & ECON. 1 (1960) (actually published in 1961). See the discussion *infra*.

<sup>44</sup> HENRY M. HART, JR. & ALBERT M. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* (tent. ed., 1958).

“tentative edition,” which Harvard Law School distributed free upon request to interested law teachers. Thus it remained, widely used but with minimal revision, for nearly forty years until Foundation Press published it even though it had become conceptually obsolete.<sup>45</sup> *The Legal Process* had been intended for a course in legislation, but evolved to include administrative decision-making and even some common law approaches. Its central message was that law could be improved through increased institutional competence, greater transparency, and “reasoned elaboration” designed to discover the law’s underlying purpose. Legal policy for Hart and Sacks is inherently democratic and legislative, but statutes are never sufficiently complex to describe the entire reality to which they apply. They are the products of political compromise, ambiguous and open-ended. The job of the expert decision-maker is to use interpretative tools in order to locate a statute’s “meaning” and then apply it to the case at hand.

Meanwhile, Henry Hart’s other coauthor Herbert Wechsler wrote “Neutral Principles of Constitutional Law,” intended both to defend and limit the Supreme Court’s counter-democratic decision in *Brown v. Board of Education*.<sup>46</sup> Wechsler believed that *Brown* adequately elaborated its conclusion that separate public schools were “inherently unequal,” but he faulted the Court’s subsequent and unelaborated decisions desegregating municipally owned bathhouses and publicly sponsored operas.<sup>47</sup> Unlike schools, these facilities were voluntary rather than mandatory and thus did not fit within *Brown*’s rationale without further explanation. Looking back to the era of substantive due process, Wechsler saw that the Court’s willingness to permit state restrictions on labor unions but unwillingness to permit labor-protective legislation as another instance of superficially non-neutral decision-making. For Wechsler as for Hart and Sacks, the key to principled lawmaking was for the courts to identify some neutral rationale that justified differential treatment and then provide a reasoned explanation. Unstated but lurking in the background, of course, was that “neutral” principles existed, could be discovered, and even yield determinate results, if only enough process and elaboration were applied. One harsh critique was that Wechsler’s “neutral” principles did not even reach to mandatory desegregation of public facilities, a burden that Wechsler carried to his grave.<sup>48</sup>

---

<sup>45</sup> HENRY M. HART, JR., ALBERT M. SACKS, WILLIAM N. ESKRIDGE, JR. & PHILIP P. FRICKEY, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* (Westbury, NY: Foundation Press, 1994). See William N. Eskridge, Jr. & Philip P. Frickey, *The Making of the Legal Process*, 107 HARV. L. REV. 2031 (1994).

<sup>46</sup> Herbert Wechsler, *Toward Neutral Principles of Constitutional Law*, 73 HARV. L. REV. 1 (1959). Hart and Wechsler’s classic law school casebook is HENRY M. HART, JR. & HERBERT WECHSLER, *THE FEDERAL COURTS AND THE FEDERAL SYSTEM* (Brooklyn, NY: Foundation Press, 1st ed., 1953).

<sup>47</sup> *Mayor & City Council v. Dawson*, 350 U.S. 877 (1955) (per curiam) (beaches and bath houses); *Muir v. Louisville Park Theatrical Ass’n*, 347 U.S. 971 (1954) (per curiam) (city-sponsored operas).

<sup>48</sup> Two forceful critiques, a generation apart, are Arthur S. Miller & Ronald F. Howell, *The Myth of Neutrality in Constitutional Adjudication*, 27 U. CHI. L. REV. 661

Yale professor Alexander Bickel concluded from his own exhaustive study of the Fourteenth Amendment that the *Brown* desegregation decision was neither explicitly contemplated nor foreclosed by the Amendment's drafters and proponents. As a result the decision was permissible and attained further legitimacy because it was unanimous.<sup>49</sup> Given that the Court had discretion to go either way and that its result was socially just, Bickel wholeheartedly supported it. In *The Least Dangerous Branch*, a constitutional law classic that cemented Bickel's position as one of his field's greatest scholars, Bickel wove a powerful, prolegislative argument that judicial review is disruptive to democratic process and must be used sparingly.<sup>50</sup> He brought the terms "countermajoritarian difficulty" and "passive virtues" into constitutional discourse, emphasizing that judicial review can readily be overused and in the process can threaten democratic institutions and undermine public confidence in government. The Court must search relentlessly for non-constitutional alternatives and always write decisions striking down statutes as narrowly as possible.

### The Critique of Political Markets

Hart, Sacks, Wechsler, and Bickel all understood that legislation is imperfect and incomplete. They were nonetheless committed to the view that both legislation and administrative law were worth preserving. Increasingly after the 1950s, however, critics from law, economics, and political science all began to see legislative and administrative processes as so deeply flawed that they rarely reveal the social will. Regulation in particular seemed very costly in relation to results, a point that James M. Landis brought home in his 1960 *Report on Regulatory Agencies* to president-elect Kennedy. Landis's report was influential because during the heyday of Legal Realism he had been the author of an important and far more optimistic book, *The Administrative Process*.<sup>51</sup>

Landis had been the first Chairman of the Securities Exchange Commission, as well as Dean of the Harvard Law School. His 1938 book on *The Administrative Process* was intended to defend the infant administrative state from some of its harshest critics, including the American Bar Association and older Progressives such as Roscoe Pound, who believed the agencies threatened absolutism and arbitrary decision-making.<sup>52</sup> Roosevelt's own Brownlow

---

(1960); Mark V. Tushnet, *Following the Rules Laid Down: A Critique of Interpretivism and Neutral Principles*, 96 HARV. L. REV. 781 (1983).

<sup>49</sup> See Alexander M. Bickel, *The Original Understanding and the Segregation Decision*, 69 HARV. L. REV. 1 (1955).

<sup>50</sup> ALEXANDER M. BICKEL, *THE LEAST DANGEROUS BRANCH: THE SUPREME COURT AT THE BAR OF POLITICS* (Indianapolis, IN: Bobbs-Merrill, 1962).

<sup>51</sup> JAMES M. LANDIS, *THE ADMINISTRATIVE PROCESS* (New Haven, CT: Yale Univ. Press, 1938); JAMES M. LANDIS, *REPORT ON REGULATORY AGENCIES TO THE PRESIDENT-ELECT* (U.S.G.P.O., 1960). See THOMAS MCCRAW, *PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, ALFRED E. KAHN* (Cambridge, MA: Harvard Univ. Press, 1984).

<sup>52</sup> See Walter Gellhorn, *The Administrative Procedure Act: The Beginnings*, 72 VA. L. REV. 219 (1986); Reuel E. Schiller, *Reining in the Administrative State: World*

Committee *Report* (1937) had concluded that administrative agencies were a “headless” fourth branch of government that lacked democratic accountability, and required greater supervision from the executive branch.<sup>53</sup> Although Landis’s lectures were given just after the Court-packing controversy, most of Roosevelt’s new Court appointments had not yet been made and the current Supreme Court was hostile. The year before an opinion by Justice Sutherland had likened the truncated procedures of the Securities and Exchange Commission, Landis’s own agency, to the “intolerable abuses of the Star Chamber.”<sup>54</sup>

Landis’s defense of the administrative state must be read against this background. He was in essence writing a brief. He defended agencies as more flexible than courts, and more able to command expertise, and acknowledged that they needed to be accountable to the designated branches of government. He also argued that agency rule-making could make them more proactive, seeing problems in advance rather than waiting for litigation, as courts must do.

Landis’s *Report* to president-elect Kennedy twenty-two years later revealed how much the gleam had left the rose. Landis lamented that agencies were much costlier than anticipated, and that they lacked coordination among one another and often issued inconsistent orders. Effective rule-making was often undermined by industry interference: “the regulatees have become the regulators.”<sup>55</sup> What is strikingly absent from Landis’s *Report*, however, is any suggestion that a greater range of business firm activities be removed from agency control. There may have been problems, but he did not see deregulation as a solution.

Landis was hardly the first to note the problem of special interest capture of government process. As noted previously, *Lochner*-era decisions often assumed it. In fact, American political thinkers had been aware of it since James Madison expressed concern that interest groups (“factions”) would hijack the government for their own ends. Madison wrote in *The Federalist* No. 10 that guarding against factions required both cohesiveness among citizens and checks and balances incorporated into the structure of government.<sup>56</sup>

A hallmark of Progressivism was its faith in grass roots political markets and a belief that the solution to special interest problems was broader and more direct involvement by voters. The muckraking journalists of the early twentieth century largely saw corruption and lack of popular involvement as going hand in

---

*War II and the Decline of Expert Administration*, in *TOTAL WAR AND THE LAW: THE AMERICAN HOME FRONT IN WORLD WAR II* 185, 186 (Daniel R. Ernst & Victor Jew eds., Westport, CT: Praeger, 2002).

<sup>53</sup> See *Report of The President’s Committee on Administrative Management in the Government of the United States* (U.S.G.P.O., 1937); and Donald R. Brand, *The President as Chief Administrator: James Landis and the Brownlow Report*, 123 *POL. SCI. Q.* 69 (2008); Elena Kagan, *Presidential Administration*, 114 *HARV. L. REV.* 2245 (2001).

<sup>54</sup> *Jones v. Sec. & Exchange Comm’n*, 298 U.S. 1, 28 (1936).

<sup>55</sup> LANDIS, *REPORT ON REGULATORY AGENCIES*, *supra* note 51, at 19, 50.

<sup>56</sup> *The Federalist*, No. 10 (Nov. 22, 1787) (Madison).

hand. That was the principle theme of Progressive muckraker Lincoln Steffans's 1906 book *The Struggle for Self-Government*. His better-known book, *The Shame of The Cities*, emphasized ballot corruption as the cause of municipal government failure.<sup>57</sup>

Progressive Era social scientists firmly believed that government reform was an essential goal of their disciplines. In his departing address as President of the American Political Science Association, Woodrow Wilson defined political science as "the accurate and detailed observation of these processes by which the lessons of experience are brought into the field of consciousness, transmuted into active purposes, put under the scrutiny of discussion, sifted, and at least given determinate form in law."<sup>58</sup> Soon after he left Princeton to become governor of New Jersey and then U.S. president.

"Law" was the operative word in Wilson's statement, but law coming from where? Wilson believed that voters were too unsophisticated to make difficult policy decisions directly. Nevertheless, he was committed to broad voter participation in the election of wise and honest officials.<sup>59</sup> During his presidency the Constitution was augmented by the Seventeenth Amendment, which provided for direct election of U.S. Senators, and the Nineteenth Amendment, which extended the vote to women. Wilson himself was initially opposed to women's suffrage, but ostensibly changed his mind after observing the role of women in the war effort.<sup>60</sup> By contrast to the Progressives, the political philosophy of the New Deal was much more inclined toward governance by administrative agencies, with much of the decision-making delegated to experts, and with less direct forms of political accountability.

These visions of the relationship between democracy and good government all had their critics. The interest group theory that developed in the young discipline of political science was preoccupied with legal institutions at every level. Reacting to the overly abstract and optimistic visions of democracy that characterized the nineteenth-century study of government, the new generation called for more realism and harsher critiques. Arthur Bentley's highly influential *Process of Government* (1908) examined how interest groups affected government decision-making within Congress, the presidency, courts, state legislatures, and even political parties. He subtitled his book "A Study of Social

---

<sup>57</sup> LINCOLN STEFFENS, *THE STRUGGLE FOR SELF-GOVERNMENT: BEING AN ATTEMPT TO TRACE AMERICAN POLITICAL CORRUPTION TO ITS SOURCES IN SIX STATES OF THE UNITED STATES* (New York: McClure, Phillips, 1906); LINCOLN STEFFENS, *THE SHAME OF THE CITIES* (New York: McClure, Phillips, 1904).

<sup>58</sup> Woodrow Wilson, *The Law and the Facts*, 5 AM. POL. SCI. REV. 1, 2 (1911).

<sup>59</sup> See SHELTON STROMQUIST, *REINVENTING "THE PEOPLE": THE PROGRESSIVE MOVEMENT, THE CLASS PROBLEM, AND THE ORIGINS OF MODERN LIBERALISM* (Urbana: Univ. of Illinois Press, 2006).

<sup>60</sup> See Akhil Reed Amar, *The Bill of Rights as a Constitution*, 100 YALE L.J. 1131, 1164 n.152 (1991).

Pressures.”<sup>61</sup> The influential leftist historian Charles Beard argued in 1913 that the U.S. Constitution represented the triumph of commercial interests and those owning mainly personal property, as over against more agrarian interests whose wealth was largely in land. Beard attempted to show first that the membership of the Constitutional Convention was disproportionately composed of owners of securities, traders and shippers, and other forms of commercial wealth; and second that the Constitution protected these interests by devices such as restrictions on state debtor relief laws.<sup>62</sup>

Interest group theory also played an important role in the writing of the economic institutionalists and Legal Realists. Their work also reflected an urge to use economics and law as tools of reform. In mainstream economics resources flow without friction to the place where they will do the most good. In the real world, the institutionalists argued, organizations and special interests always get in the way. The most influential institutionalist attack on collective decision processes was Berle and Means’s *The Modern Corporation*, which was fundamentally about the power of management to wrest control from shareholders, who were much more diffuse and had smaller individual stakes.<sup>63</sup> Significantly, however, Berle and Means saw legislation as a cure, as if it could somehow be immune from special interest influence.

An important characteristic of institutionalism was its identification of the specific institutions that make public decisions, rather than the more abstract approaches that characterized neoclassical economics. Corporations are different from courts, which are different from agencies, which are different from legislatures. Institutional economist John R. Commons wrote a posthumously published book entitled *The Economics of Collective Action*, concerned with how organized group action could leverage power in nongovernmental institutional settings, such as bargaining between employers and employees.<sup>64</sup>

The heavily empirical approach championed by Berle, Means, and Commons explained the value of institutionalism and Legal Realism, but also suggests why they ultimately failed. Their strength lay in their study of specific institutions in the real world, but they too often became bogged down in detail. Critics complained about the lack of methodological rigor in work that variously

---

<sup>61</sup> ARTHUR F. BENTLEY, *THE PROCESS OF GOVERNMENT: A STUDY OF SOCIAL PRESSURES* (Chicago: Univ. of Chicago Press, 1908). See DANIEL T. RODGERS, *CONTESTED TRUTHS: KEYWORDS IN AMERICAN POLITICS SINCE INDEPENDENCE 176–211* (New York: Basic, 1987).

<sup>62</sup> CHARLES A. BEARD, *AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES* (New York: Macmillan, 1913).

<sup>63</sup> ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (New York: Macmillan, 1933); see Chapter 9.

<sup>64</sup> JOHN R. COMMONS, *THE ECONOMICS OF COLLECTIVE ACTION*, esp. at 25–35 (New York: Macmillan, 1950).

called upon exhaustive example, political theory, history, and even Darwin and Freud to explain group political behavior.<sup>65</sup>

The study of public decision-making became more formalized in post-institutionalist writing by political scientists and sociologists. Of particular importance were C. Wright Mills, *The Power Elite* (1956); Anthony Downs, *An Economic Theory of Democracy* (1957); and Robert A. Dahl's *Who Governs?* (1961).<sup>66</sup> These books emphasized the role of government as umpire among competing interest groups. Writing on a backdrop of utilitarian political philosophy, their authors examined the ways that interest groups could influence outcomes and in some cases distort true community choices in existing institutions.

The explosion of economics literature on social choice in the 1960s defies description in a few paragraphs.<sup>67</sup> In contrast to the political scientists, economists developed abstract but analytically more rigorous accounts of collective decision-making under strictly marginalist principles. The term "public choice" entered the legal literature in reference to works by Kenneth Arrow, Mancur Olson, James Buchanan, and Gordon Tullock, all of whom were trained economists. As a matter of pure theory, Arrow's *Social Choice and Individual Values* may be the most important to economists and political theorists. The books with the greatest policy influence, however, were James Buchanan and Gordon Tullock's *The Calculus of Consent* (1962) and Mancur Olson's *The Logic of Collective Action* (1965). Olson's formalization of interest group theory most influenced the set of legal critiques that today are associated with the terms "regulatory capture" and "deregulation."<sup>68</sup>

---

<sup>65</sup> See, e.g., R.E. Dowling, *Pressure Group Theory: Its Methodological Range*, 54 AM. POL. SCI. REV. 944 (1960).

<sup>66</sup> C. WRIGHT MILLS, *THE POWER ELITE* (New York: Oxford Univ. Press, 1956); ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (New York: Harper & Row, 1957); ROBERT DAHL, *WHO GOVERNS? DEMOCRACY AND POWER IN AN AMERICAN CITY* (New Haven, CT: Yale, 1961); and ROBERT A. DAHL & CHARLES E. LINDBLOM, *POLITICS, ECONOMICS AND WELFARE: PLANNING AND POLITICO-ECONOMIC SYSTEMS RESOLVED INTO BASIC SOCIAL PROCESSES* (New York: Harper, 1953).

<sup>67</sup> A good survey is William C. Mitchell, *Political Science and Public Choice: 1950–70*, 98 PUB. CHOICE 237 (1999). A more technical study of the mathematical and economic approaches is DENNIS C. MUELLER, *PUBLIC CHOICE III* (New York: Cambridge Univ. Press, 3d ed., 2003). An excellent although now somewhat dated study is DANIEL A. FARBER & PHILIP P. FRICKEY, *LAW AND PUBLIC CHOICE: A CRITICAL INTRODUCTION* (Chicago: Univ. of Chicago Press, 1991).

<sup>68</sup> KENNETH ARROW, *SOCIAL CHOICE AND INDIVIDUAL VALUES* (New York: Wiley, 1951; 2d ed. 1963); MANCUR OLSON, JR., *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (Cambridge, MA: Harvard Univ. Press, 1965); JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* (Ann Arbor: Univ. of Michigan Press, 1962).

Public choice theory was as cynical about legislation and regulation as Legal Realism was about the common law. The economic critique was beguilingly simple. Voluntary exchanges are efficient because everyone gains, provided that nonparties are not injured. But democracies in which each person gets a vote make very few decisions unanimously. When is a decision for the social good if some people oppose it? Prior to the rise of ordinalism in the 1930s neoclassical economists thought they had a partial answer: society is better off when resources are transferred from the wealthy to the poor, even if some wealthy object. That answer was never complete, however, because not all disputes divide the poor and the wealthy. In any event, by the 1950s most economists were rejecting any view that justified involuntary wealth transfers by engaging in interpersonal comparisons of utility.

The formal theory of political markets began with the Marquis de Condorcet's discovery in the late eighteenth century that voting processes are prone to failure of equilibrium, or "cycling." When votes are not unanimous we cannot be assured of a stable outcome. To illustrate, suppose the symbol  $p$  means "prefer" as between two alternatives—for example " $ApB$ " means that a voter prefers choice A over choice B. Then imagine a simple society with three voters and three choices, A, B, and C. The voters have these preferences:

Voter 1:  $ApBpC$

Voter 2:  $BpCpA$

Voter 3:  $CpApB$

In a majority vote between alternative A and B, A wins because both Voters 1 and 3 prefer A over B. Then, in a vote between A, the winner, and C, C wins. Voters 2 and 3 prefer C over A. Thus the "social" decision at this point indicates that C wins, because a majority prefers C over A, and A over B. A minimum condition of rational behavior in the neoclassical framework is "transitivity," which means that if an individual prefers X over Y and Y over Z, she must prefer X over Z. However, in the above illustration if a vote is taken on C versus B, B wins because Voters 1 and 2 prefer B over C. At that point we could start over again and have a vote between B and A, but that would place us in an infinite cycle. In sum, the "social" choice of as few as three individuals on as few as three issues can be "irrational," in the sense that it results in endless cycling with no final outcome. The conclusion: it may be impossible to identify the correct "social choice" from one person/one vote systems. Kenneth Arrow formalized this observation and derived a mathematical proof, usually called the "General Impossibility Theorem," or "Arrow's Impossibility Theorem," that the aggregation of votes cannot yield a stable social choice unless the vote is unanimous.

Whether Arrow's analysis applies to government policy depends on whether the policy incorporates shared rules that serve to force consensus. The vote-cycling story assumes that preferences are "naked," in the sense that each person chooses what she wants without constraint. However, if we had three scientists or even three appellate judges applying a given body of rules, their

choices would be much more constrained and cycling would occur far less often.<sup>69</sup> The Progressive and New Deal reliance on experts assumed that decision-makers were applying theory to policy, and not simply asserting naked preferences. Further, the degree of determinacy need not be all that great. For example, the Supreme Court is an ideologically diverse body that decides controversial cases in which the law is usually “soft.” If their votes were simply random they would be unanimous in 1 out of 256 cases. In fact, above 30 percent of the Supreme Court’s decisions are unanimous.

*The Calculus of Consent* is less technical than Arrow’s work. It also rejected interpersonal comparisons of utility and acknowledged that unanimous choices are true social choices. Realizing that unanimity is impossible to achieve, Buchanan and Tullock explored whether the unanimity rule can be relaxed. Rules that require less than unanimous decision-making impose costs on naysayers, but sometimes an outcome resembling unanimity is possible if “side payments” compensate the losers.<sup>70</sup> In that case everyone would be at least as well off—a condition that Richard Epstein developed in an important 1985 book as a theory of eminent domain.<sup>71</sup> *The Calculus of Consent* included a complex analysis of “logrolling,” or vote trading in legislative bodies, to illustrate its harmful and beneficial uses.

*The Logic of Collective Action* appealed to a broad audience from the day it was published. Although Mancur Olson located interest group theory squarely inside of neoclassical economics, he did it in a nontechnical way that was more accessible than Arrow and less strident than Buchanan and Tullock. Olson relied heavily on the economic theory of cartels.<sup>72</sup> A cartel attempts to achieve the monopoly rate of price and output. However, an individual firm can make more by increasing output and shaving price. If everyone does that, however, the cartel will fall apart. Cartels work much better when they are small and well disciplined, with a set of common interests. Difficulties of detection and discipline in larger groups enable an individual member to “free ride” on the efforts of others or even defect. One problem with very large groups, Olson observed, is that the additional return produced by the efforts of each individual member is very small. By

---

<sup>69</sup> See Herbert Hovenkamp, *Arrow’s Theorem: Ordinalism and Republican Government*, 75 IOWA L. REV. 949 (1990).

<sup>70</sup> BUCHANAN & TULLOCK, *THE CALCULUS OF CONSENT*, *supra* note 68, at 15, 92, 95, 154–58.

<sup>71</sup> RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (Cambridge, MA: Harvard Univ. Press, 1985).

<sup>72</sup> See OLSON, *THE LOGIC OF COLLECTIVE ACTION*, *supra* note 68, at 9–24, relying on EDWARD CHAMBERLIN, *THEORY OF MONOPOLISTIC COMPETITION* (Cambridge, MA: Harvard Univ. Press, 1933). See the excellent treatment by RICHARD TUCK, *FREE RIDING* (Cambridge, MA: Harvard Univ. Press, 2008); and William C. Mitchell, *The Calculus of Consent: Enduring Contributions to Public Choice and Political Science*, 60 PUB. CHOICE 201 (1989). Much of the theory was developed in RICHARD A. MUSGRAVE, *THE THEORY OF PUBLIC FINANCE: A STUDY IN POLITICAL ECONOMY* (New York: McGraw-Hill, 1957).

contrast, in the very small group the defection of a single member can throw the entire group into disarray.

Olson's book reached two very powerful conclusions. The first one, less emphasized in the later literature, is that excessive free riding leads to underinvestment in public goods, or infrastructure. Each individual would rather not contribute anything at all, trusting that others will take care of the problem.<sup>73</sup> Olson's second theory, for which his book became famous, was that small and well-organized interest groups are much more effective in getting their message across than large groups. Much of the subsequent public choice attack on regulation was based on this premise—namely that regulation tends to benefit regulated firms, who are few in number and well organized, rather than their customers, who are likely to be numerous, diverse, and disorganized.

The most powerful rhetoric of the deregulation movement in the late 1970s and after was that regulation too often succumbed to “capture” by the regulated at the expense of the more general public. For example, Olson's theory provided a powerful explanation for why so many regulatory agencies hear the voices of regulated firms more clearly than those of consumers, -- why, for example, intellectual property law has always been so protective of producers. It also explains why individuals vote for state right-to-work laws in order to avoid the individual costs of joining a union, even though their act undermines collective bargaining and results in significantly lower wages in right-to-work states.<sup>74</sup>

Public choice theory has made the Supreme Court more sensitive to the role of interest groups in obtaining legislation. Justice Scalia has frequently spoken of statutes as the results of compromise among competing interest groups.<sup>75</sup> Nevertheless, such recognition sometimes turns the Court in surprising directions. For example, the important *Chevron* decision in 1984 recognized that statutes often reflect ambiguity resulting from deals between competing interest groups. The Court then ruled that the regulatory agency should be free to adopt any reasonable interpretation of an ambiguous statute.<sup>76</sup> The result, which occurred during the early years of the deregulation movement, has been to give agencies enormous discretion to make rules in areas where Congress has not spoken precisely on the issue.

---

<sup>73</sup> OLSON, THE LOGIC OF COLLECTIVE ACTION, *supra* note 68, at 24–28. Cf. BUCHANAN & TULLOCK, THE CALCULUS OF CONSENT, *supra* note 68, at 136.

<sup>74</sup> See Lonnie K. Stevans, *The Effect of Endogenous Right-to-Work Laws on Business and Economic Conditions in the United States: A Multivariate Approach*, 5 REV. L. & ECON. 595 (2009).

<sup>75</sup> E.g., *Romer v. Evans*, 517 U.S. 620, 636 (1996) (Scalia, J., dissenting); *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 261–63 (1993); *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999); *Pennell v. City of San Jose*, 485 U.S. 1, 15 (1988) (Scalia, J., dissenting).

<sup>76</sup> *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 840–43 (1984).

## The Rehabilitation of Private Markets

Public choice theory was not the only onslaught against the New Deal regulatory State. Beginning in the 1950s and accelerating in the 1960s neoclassical economics gradually rehabilitated private markets, eventually concluding that most of them worked tolerably well, if not perfectly. The Chicago School moved from being a “lunatic fringe,” as Richard A. Posner once paraphrased what its detractors called it,<sup>77</sup> to mainstream legitimacy. The Coasean revolution directed many writers in economics and law to the study of very tiny markets. In the process Coase’s writing served to undermine the privileged position that Legal Realism had given regulation over the common law.

## The New Learning in Industrial Economics

The high point of antitrust interventionism in the United States was in the 1950s and 1960s, reflecting an almost paranoid concern with industrial “concentration”—or small number of firms in a market. In 1950 Congress expanded the coverage of the anti-merger law, § 7 of the Clayton Act. Over a fifteen-year period policymakers offered a series of proposals for “deconcentrating” American industry by breaking up large firms. A final serious proposal offered by Michigan senator Philip A. Hart was presented to the Senate in 1972 as the Industrial Reorganization Act. The proposal was supported by Ralph Nader, whose study group report, *The Closed Enterprise System*, argued that the economy was dominated by noncompetitive market structures that made it impossible for smaller firms to compete.<sup>78</sup>

None of these bills passed. Increasingly the dominant writing in industrial economics, together with legal scholarship by such writers as Robert H. Bork and Richard A. Posner, began a general rehabilitation of the market.<sup>79</sup> Questioning almost every premise of the structuralist school, the new learning largely restored the classical faith that high prices would encourage new firms to come into a market, making durable monopoly rare.<sup>80</sup>

---

<sup>77</sup> Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 931 (1979).

<sup>78</sup> MARK J. GREEN, *THE CLOSED ENTERPRISE SYSTEM: RALPH NADER’S STUDY GROUP REPORT ON ANTITRUST ENFORCEMENT* (New York: Grossman, 1972). Senator Hart’s proposal is in S. 3832, 92d Cong., 2d Sess. (1972).

<sup>79</sup> E.g., Robert H. Bork & Ward S. Bowman, Jr., *The Crisis in Antitrust*, 65 COLUM. L. REV. 363 (1965); Robert H. Bork, *The Rule of Reason and the Per Se Concept: Price Fixing and Market Division* (pts. 1 & 2), 74 YALE L.J. 775 (1965), 75 YALE L.J. 373 (1966); Richard A. Posner, *Oligopoly and the Antitrust Laws: A Suggested Approach*, 21 STAN. L. REV. 1562 (1969).

<sup>80</sup> On the Chicago School revolution, see *THE MAKING OF COMPETITION POLICY: LEGAL AND ECONOMIC SOURCES* 390–442 (Daniel Crane & Herbert Hovenkamp eds., New York: Oxford Univ. Press, 2013). Macroeconomics went through a similar revolution, recounted in DANIEL T. RODGERS, *AGE OF FRACTURE* 47–78 (Cambridge, MA: Harvard Univ. Press, 2011).

In 1974 a group of influential economists and lawyers met at Airlie House in Warrenton, Virginia, in a conference that signaled a turning point in antitrust and industrial policy. The proceedings were published as *Industrial Concentration: The New Learning*. That book, widely used in antitrust and industrial policy classes for two decades, indicated just how much dominant thinking about the “monopoly problem” had shifted. Essays by Chicago School scholars John S. McGee, Yale Brozen, Harold Demsetz, and Posner argued that concentration did not threaten competition nearly as much as the structuralists had assumed. Large firm size was driven mainly by economic efficiency, and competition could be robust with many fewer firms than the now ageing Harvard School had supposed. The Airlie House conference also heard protests from defenders of structuralism, but increasingly these voices were drowned out.<sup>81</sup>

### Micromarkets and the Common Law: Coase

Few twentieth-century scholars have had more influence on legal thought than Ronald H. Coase (1910–2013). He was born in a London suburb where his parents worked as telegraph operators for the British post office. His formative economic education and what legal education he had were at the London School of Economics in the 1920s and early 1930s, during its heyday under the leadership of Lionel Robbins.<sup>82</sup> His 1937 essay on *The Nature of the Firm* lay ignored for a generation, but later it had a pervasive influence on thinking about the structure of the business firm and the rationales for vertical integration.<sup>83</sup> Coase moved to the United States in the 1950s and taught at SUNY Buffalo, and then at the Universities of Virginia and Chicago. His most famous article, *The Problem of Social Cost*, was published in 1961 while he was at Virginia, whose economics department was second only to Chicago’s in attempting to forge free market solutions to problems commonly thought to be the province of government.<sup>84</sup>

Coase’s foil was Arthur C. Pigou, Alfred Marshall’s successor as professor of economics at Cambridge University. In *The Economics of Welfare*, Pigou addressed the problem of “externalities,” or harmful effects that a person’s activities have on others. The idea did not originate with Pigou, or for that matter, not even with economists. By the 1910s the Supreme Court’s liberty of contract jurisprudence had a well-developed theory of externalities as a justification for regulation. For example, regulation of working conditions might be justified if unrestricted contracting affected other people—the “healthful quality of the bread,” as Justice Peckham put it in *Lochner* (1905).<sup>85</sup> As Coase presented

---

<sup>81</sup> INDUSTRIAL CONCENTRATION: THE NEW LEARNING (Harvey J. Goldschmid, H. Michael Mann & J. Fred Weston eds., Boston: Little, Brown, 1974).

<sup>82</sup> See WILLIAM H. BEVERIDGE, THE LONDON SCHOOL OF ECONOMICS AND ITS PROBLEMS, 1919–1937 (London: Allen & Unwin, 1960); and Herbert Hovenkamp, *Coase, Institutionalism, and the Origins of Law and Economics*, 86 IND. L.J. 499 (2011).

<sup>83</sup> 4 ECONOMICA 386 (1937); see Chapter 12.

<sup>84</sup> Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

<sup>85</sup> *Lochner v. New York*, 198 U.S. 45, 62 (1905).

Pigou's position, the government needed to intervene in such cases in order to protect bystander victims. Pigou and later Coase used the example of a railroad whose trains emit sparks that might start fires injuring neighboring farmers.<sup>86</sup> Coase famously argued that government intervention may not be necessary because private bargaining could address such problems.

What became the most famous actual case in *The Problem of Social Cost* was a nuisance law dispute involving Dr. Octavius Sturges, a London physician who specialized in pneumonia and other diseases of the lungs. Sturges shared a duplex with Frederick Horatio Bridgman, confectioner to the Queen. Bridgman used a large mechanical mortar and pestle to break down chocolate and other substances. Dr. Sturges complained that the pounding machine interfered with his ability to diagnose patients with his stethoscope.<sup>87</sup> Against the argument that this dispute required State intervention, Coase argued that Sturges and Bridgman could simply have bargained with each other over Bridgman's continued use of the mortar and pestle. For example, if Sturges valued the right to be free of the pounding by £100, while Bridgman valued the right to use his machine by only £80, then use of the machine would end. If these values were reversed, however, then the use would continue. Coase concluded that in a well-functioning market the two parties would bargain their way to an "efficient" result and that this the outcome would depend strictly on relative values and not on who might win the lawsuit.

*The Problem of Social Cost* is the most cited law review article of all time. Every nook and cranny of Coase's argument has been explored. Coase made a powerful argument that legal entitlements can be traded in markets just as much as ordinary products and services. For example, the right to pollute or to be free of pollution is tradeable. As in any market, unrestrained trading ordinarily produces efficient results, something that cannot always be said of government intervention. Many areas of law that were thought to be "public" or "quasi-public," such as environmental or eminent domain law, could be reconceived as "private" to the extent that they reflected bargaining disputes among affected persons.

Coase's concern was with very small markets. *Sturges v. Bridgman* involved bargaining between a single physician and confectioner over the use of a single two-unit house. To the extent that Coase turned the problem of legal disputes into one of bargaining, it was at a microscopic level, not the large areas that are typically covered by legislation such as zoning laws. Later economists in this tradition, such as Oliver E. Williamson, wrote about economic decision-making within a single firm, including decisions about whether to make or buy

---

<sup>86</sup> ARTHUR C. PIGOU, *THE ECONOMICS OF WELFARE* 296–99, 334 (London: Macmillan, 1st ed. 1920; 4th ed. 1932). On whether Coase characterized Pigou correctly, see A.W. Brian Simpson, *Coase v. Pigou Reexamined*, 25 J. LEGAL STUD. 53 (1996); Herbert Hovenkamp, *The Coase Theorem and Arthur Cecil Pigou*, 51 ARIZ. L. REV. 633 (2009).

<sup>87</sup> *Sturges v. Bridgman*, 11 Ch.D. 852 (1877). The facts are detailed in Simpson, *Coase v. Pigou*, *supra* note 86.

inputs and of specialized contract practices with suppliers or distributors.<sup>88</sup> The “Coase Theorem,” as Chicago economist George J. Stigler later named it, is subject to many qualifications and variations. Efficient outcomes might be more elusive if bargainers have high bargaining (“transaction”) costs. Some disputes might involve many more than two bargainers, making efficient outcomes more difficult to reach. For example, if the spark-emitting railroad is not guilty of a nuisance but the aggregated farmers along the railroad’s path have the greater value, then the farmers must pay off the railroad. Organizing them and getting them to agree on each farmer’s contribution could be heroic, particularly if they differ in size, amount of injury, and so on. Each one individually might not want to pay anything at all, assuming that others would bear the burden. Mancur Olson would make this very argument just a few years later in *The Logic of Collective Action*, but it also applies to the Coasean situation if many bargainers are involved.

The Coasean literature includes both supporters and detractors, and within the fields of both economics and law.<sup>89</sup> James Buchanan, coauthor of *The Calculus of Consent*, and Harold Demsetz debated the relative costs and benefits of private bargaining compared to government intervention.<sup>90</sup> Another debate concerned “alienability,” or the transferability of legal entitlements. Coase’s argument depended on people’s ability to negotiate to the efficient solution by waiving their legal claims, something that the common law permits but statutes such as the zoning laws typically do not.<sup>91</sup>

*The Problem of Social Cost* had a significant impact on 1960s’ and 1970s’ thinking about environmental law, natural resources, and land use planning, all of which were subject to extensive regulation. In law school casebooks on property, “private” land use restrictions moved from the back burner to the front. Economically inclined law teachers drew blackboard pictures of polluting smokestacks and downwind homes, asking students about the relative merits of regulation or private bargaining to address environmental policy. Property

---

<sup>88</sup> See OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (New York: Free Press, 1975); OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (New York: Free Press, 1985). See Herbert Hovenkamp, *Harvard, Chicago and Transaction Cost Economics in Antitrust Analysis*, 55 *ANTITRUST BULL.* 613 (2010).

<sup>89</sup> For an admiring history by a participant, see Edmund W. Kitch, *The Fire of Truth: A Remembrance of Law and Economics at Chicago, 1932–1970*, 26 *J.L. & ECON.* 163 (1983).

<sup>90</sup> James M. Buchanan, *Politics, Policy, and the Pigovian Margins*, 29 *ECONOMICA* 17 (1962); James M. Buchanan, *The Relevance of Pareto Optimality*, 6 *J. CONFLICT RESOL.* 341 (1962); Harold Demsetz, *Information and Efficiency: Another Viewpoint*, 12 *J.L. & ECON.* 1 (1969).

<sup>91</sup> Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 *HARV. L. REV.* 1089 (1971).

scholars compared the rights created by zoning statutes with negotiable common law nuisance rules or private covenants.<sup>92</sup>

In 1964 Allen Kneese wrote his now classic book *The Economics of Regional Water Quality Management*, relying on Coase in a chapter dedicated to the use of private markets to make water allocation decisions.<sup>93</sup> Environmental policy turned increasingly to “market based” pollution control systems that permitted firms to bid for pollution rights or even trade them.<sup>94</sup> Under these systems the Environmental Protection Agency set “gross” standards for particular pollutants. Companies could bid for the rights to discharge them, presumably assigning them to the producer whose output was the most valuable or who had the highest pollution reduction costs.

Similar developments occurred in accident law, as Chapter 7 recounts. Drawing on Coase, Guido Calabresi suggested that liability for automobile accidents should be assigned to the person who *would* have obtained the obligation if bargaining had been possible—the “cheapest cost avoider,” in the terminology of law and economics. Calabresi’s and Richard A. Posner’s work also called for rethinking of the appropriate roles of negligence and strict liability in torts and gave support to the drafters of the Second Restatement of Torts, which embraced strict liability for harms caused by dangerous and defective products.<sup>95</sup>

Neither Coase, Posner, nor Calabresi single-handedly invented law and economics. Economic analysis of law was well developed in the earlier history of legal thought, as portions of this book discuss. The *Journal of Law and Economics* was established at the University of Chicago about six years before Coase moved there and three years before *The Problem of Social Cost* was published. Posner’s ground-shifting book entitled *Economic Analysis of Law* was

---

<sup>92</sup> E.g., Robert C. Ellickson, *Alternatives to Zoning: Covenants, Nuisance Rules, and Fines as Land Use Controls*, 40 U. CHI. L. REV. 681 (1973); Edward Rabin, *Nuisance Law: Rethinking Fundamental Assumptions*, 63 VA. L. REV. 1299 (1977).

<sup>93</sup> ALLEN V. KNEESE, *THE ECONOMICS OF REGIONAL WATER QUALITY MANAGEMENT* (Baltimore: Johns Hopkins Press, 1964). See Steven G. Medema, *The Curious Treatment of the Coase Theorem in Environmental Economics, 1960–1979* (Working Paper, Dept. of Economics, Univ. of Colorado Denver, 2012); Ezra J. Mishan, *The Postwar Literature on Externalities: An Interpretive Essay*, 9 J. ECON. LITERATURE 1 (1971). See also *Coase Theorem Symposium* (pts. 1 & 2), 13 NAT. RESOURCES J. 557 (1973), 14 NAT. RESOURCES J. 1 (1974).

<sup>94</sup> E.g., Clean Air Act Amendments of 1990, Pub. L. No. 101-549, § 106, 104 Stat. 2399 (1990). An earlier example is exchangeable rights to include lead in gasoline, approved in 1982. See 47 Fed. Reg. 49,331 (1982). See THOMAS H. TIETENBERG, *EMISSIONS TRADING: AN EXERCISE IN REFORMING POLLUTION POLICY* (Washington, DC: Resources for the Future, 1985).

<sup>95</sup> GUIDO CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* 26–31 (New Haven, CT: Yale, 1970); see also RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 78 (Boston: Little, Brown, 1972). See RESTATEMENT (SECOND) OF TORTS, particularly § 402a (1977).

published in 1973.<sup>96</sup> He was a law student at Harvard when *Social Cost* was published and accepted his first academic position at Stanford Law School in 1968, focusing on antitrust law. He moved to the University of Chicago in 1969 and became an appellate judge when Ronald Reagan appointed him in 1981.

Posner's *Economic Analysis of Law* expanded the domain of law and economics to nearly every legal area. Posner included lengthy sections on the common law, family law, regulation, corporate and securities law, tax and wealth distribution, constitutional law, and federalism. His early work became associated with the position that economic efficiency is the most defensible goal for legal rules. Redistribution may be appropriate too, but it should be explicit and direct rather than disguised in costly regulations or subsidies.

Coase and Posner have become symbols of everything that people both love and hate about law and economics. Some legal scholars were put off by the extent to which Posner marshaled arguments based on expected utility for every conceivable legal problem, including such things as marriage and prostitution, as well as his willingness to assume that competition did or could exist in many areas where it seemed impossible to achieve.<sup>97</sup> But Posner has proven to be a nimble scholar. An important key to the success of his work, and to the law and economics movement generally, has been an ability to marshal its insights into a positive and evolving program for legal reconstruction, something that other twentieth-century critiques including Legal Realism and Critical Legal Studies were never able to accomplish. Perhaps the legal achievement that comes closest is John Rawls's *Theory of Justice* (1971), whose powerful anti-utilitarian argument for increasing expected welfare by improving the lot of the worst off was particularly influential in the 1980s and 1990s. Although Rawls's book has been cited more frequently than Coase's *Social Cost*, Rawls did not make nearly as dramatic a jump from classes in legal theory to applied law.

## The (Partial) Dismantling of the Regulatory State

By the 1970s a consensus was emerging that much regulation was excessive, poorly designed, or both. First, industrial economists increasingly came to believe that markets were more robust than previously thought and required government intervention less frequently. Second, public choice theory appeared to make a strong case that regulation too often led to capture, benefitting regulated firms rather than the consumers it was declared to protect.<sup>98</sup> Regulation seemed much more costly than anticipated and produced less appealing results. In 1982 appellate judge Stephen G. Breyer, who had been a professor of administrative law at Harvard Law School and would later become Associate Justice of the

---

<sup>96</sup> POSNER, *ECONOMIC ANALYSIS OF LAW*, *supra* note 95, at 78.

<sup>97</sup> *E.g.*, A. Mitchell Polinsky, *Economic Analysis as a Potentially Defective Product: A Buyer's Guide to Posner's Economic Analysis of Law*, 87 HARV. L. REV. 1655, 1680–81 (1974).

<sup>98</sup> *E.g.*, George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974).

Supreme Court, wrote a highly influential book, *Regulation and Its Reform*.<sup>99</sup> The book was all the more influential because Breyer was not a member of the Chicago School or even a fellow traveler. He was a Democrat, appointed to the bench by Jimmy Carter and elevated to the Supreme Court by Bill Clinton. Breyer illustrated how certain markets, such as trucking and air travel, had been “mismatches” from the start because these industries were either structured competitively or capable of being made so. Indeed, a principal effect of trucking regulation had been to make it nearly impossible for new firms to enter a market in which entry should be quite easy.

Mancur Olson’s thesis about interest group capture, the Coasean literature on bargaining alternatives to regulation, and the social choice/voting literature all coalesced in the 1960s and 1970s to make a powerful intellectual case for dismantling New Deal regulation. But very likely the most important factor was a poor track record, including the high public costs of administration and the even higher private costs of compliance. Small businesses and new entrants complained that the regulatory process favored large firms. Consumer benefits were often illusory. In addition, as Landis’s 1960 *Report* had already pointed out, there were way too many “jurisdictional” squabbles, inconsistent mandates, or other costly trade-offs, often caused by self-serving intervention by Congress.

Bruce Ackerman and William T. Hassler confirmed many of these problems in *Clean Coal/Dirty Air* (1981), a now classic discussion of how political processes can corrupt good intentions. As one reviewer put it, the book revealed “power-conscious congressmen, scheming staff persons, intrepid industry lobbyists, overzealous environmentalists, and insecure bureaucrats who connive, cajole, and caress one another into supporting a law and a set of regulations that may actually produce an increase in the nation’s air pollution at an enormous cost to businesses and taxpayers.”<sup>100</sup>

Deregulation of railroads, trucking, and airlines produced lower consumer prices and greatly increased the entry of new firms. In other areas it had less success. Most occurred in stages, and pinpointing a single year in which an industry was “deregulated” is impossible.<sup>101</sup> Trucking and railroad regulation

---

<sup>99</sup> STEPHEN G. BREYER, *REGULATION AND ITS REFORM* (Cambridge, MA: Harvard Univ. Press, 1982). For a more critical history of deregulation, but focused more on environmental deregulation and less on transportation and telecommunications, see THOMAS O. MCGARITY, *FREEDOM TO HARM: THE LASTING LEGACY OF THE LAISSEZ FAIRE REVIVAL* (New Haven, CT: Yale, 2013).

<sup>100</sup> BRUCE A. ACKERMAN & WILLIAM T. HASSLER, *CLEAN COAL/DIRTY AIR, OR HOW THE CLEAN AIR ACT BECAME A MULTIBILLION-DOLLAR BAIL-OUT FOR HIGH-SULFUR COAL PRODUCERS AND WHAT SHOULD BE DONE ABOUT IT* (New Haven, CT: Yale, 1981), reviewed by Jack L. Landau, 12 *ENVTL. L.* 271 (1981).

<sup>101</sup> The history of banking and other financial deregulation is not discussed here. See LAWRENCE G. GOLDBERG & LAWRENCE J. WHITE, *THE DEREGULATION OF THE BANKING AND SECURITIES INDUSTRIES* (Frederick: MD: Beard Books, 2003); CHARLES W. CALOMIRIS, *U.S. BANK DEREGULATION IN HISTORICAL PERSPECTIVE* (New York: Cambridge Univ. Press, 2000). For good writing on the link between the recent (at this writing) financial crisis and financial

were low-hanging fruit because the industries were competitively structured. Deregulation began in the late 1970s and early 1980s, just at the end of the Carter administration.<sup>102</sup> The Interstate Commerce Commission, created in 1887 and America's oldest major federal regulatory agency, was dismantled in 1995.

Passenger air travel regulation under the Civil Aeronautics Board (CAB) was a true maze of price regulation, restrictions on service, and subsidies for struggling carriers. The CAB's explicit concern was "unfair" competition, but that came to mean any competition at all. For example, the CAB made it illegal for Aloha Airlines to include rental cars in traveler vacation packages, because this would give Aloha an "unfair advantage" over its competitor Hawaiian Airlines.<sup>103</sup> One wonders how a practice can be anticompetitive when customers like it and any firm can do it. During the high point of CAB regulation in the late 1970s, airlines were forbidden from offering movies, and even the size of the sandwich in passenger meals was regulated. In 1977 the dispute over sandwich size prompted Alfred Kahn, who had just been appointed director of the CAB, to wonder "is this what my mother raised me to do?" Kahn, an economist from Cornell University, went on to become one of the great economist proponents of deregulation.<sup>104</sup>

The airline industry was deregulated in several steps, beginning with the Airline Deregulation Act of 1978, which authorized the CAB to approve deviations from regulated fares.<sup>105</sup> The United States also negotiated several "open skies" agreements with foreign countries, allowing greater access by foreign carriers into U.S. markets. The CAB itself was abolished in 1984.<sup>106</sup> Today, pricing is left to the discretion of each carrier, enforced only by the antitrust laws, and then only rarely. No one regulates the size of sandwiches, which have largely disappeared in any event.

The story of telecommunications deregulation is more complex. The national telephone system took the first steps in the late 1970s, when the courts began to doubt AT&T's long-held position, supported by the Federal Communications Commission, that its network should not be forced to interconnect with anyone. Previously, in the 1956 *Hush-A-Phone* decision the FCC had gone so far as to forbid a firm from selling an entirely non-electronic plastic cup that fit over a phone mouthpiece so that a caller could whisper into it

---

deregulation, *see* WHAT CAUSED THE FINANCIAL CRISIS (Jeffrey Friedman ed., Philadelphia: Univ. of Pennsylvania Press, 2011).

<sup>102</sup> Motor Carrier Act of 1980; Motor Carrier Act of 1980, Pub. L. No. 96-296, 94 Stat. 793; Staggers Rail Act of 1980, Pub. L. No. 96-448, 94 Stat. 1895.

<sup>103</sup> Aloha Airlines, Inc. v. CAB, 598 F.2d 250, 254 (D.C. Cir. 1979).

<sup>104</sup> Quoted in MCCRAW, PROPHETS OF REGULATION, *supra* note 51; *see* ALFRED E. KAHN, THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS (New York: Wiley, 1970).

<sup>105</sup> Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705. *See* STEVEN A. MORRISON & CLIFFORD WINSTON, THE EVOLUTION OF THE AIRLINE INDUSTRY (Washington, DC: Brookings, 1995).

<sup>106</sup> CAB Sunset Act of 1984, Pub. L. No. 98-443, 98 Stat. 1703 (1984).

and keep his words confidential. The appellate court reversed, thus cracking the long-held rule prohibiting all “foreign attachments” to the monopoly telephone network.<sup>107</sup>

During the 1960s several firms that provided two-way radio services tried to interconnect electronically with the AT&T system. Carterfone, a technology developed by Thomas Carter, enabled truckers to use Citizens’ Band radio to access the phone system to talk to their families or others while on the road. AT&T objected to the interconnection, but in 1968 the FCC changed its position and permitted Carter to proceed.<sup>108</sup> The case damaged AT&T’s reputation because it publicized the extent to which AT&T’s regulatory actions could actually inhibit innovations that consumers wanted.

In the early 1980s AT&T was to a very significant extent deregulated by the antitrust laws rather than legislation. An appellate court held that antitrust law required the AT&T network to interconnect with rivals.<sup>109</sup> MCI, then a very young company, was permitted to provide long distance services in competition with AT&T. At about the same time AT&T agreed to be broken up in order to resolve an antitrust action brought by the government. The decree severed local operating companies from long distance.<sup>110</sup> The principal protagonist was William F. Baxter, a Stanford law professor who was head of the Antitrust Division during Ronald Reagan’s first term. AT&T also severed its Western Electric division, thus ending an era in which purchasers of telephone service were required to lease their phones from AT&T. The result was a flood of new entrants into the markets for devices such as telephones, fax machines, and the like, and also into long distance communications.

The deregulation movement has not been confined to great New Deal edifices. It also included purely local regulation. As initially approved by the Supreme Court’s 1926 *Euclid* decision, zoning involved fairly rigid government specifications of land use, with a checkerboard of parallel streets and a strong preference for single-family homes.<sup>111</sup> These earliest zoning statutes were “cumulative,” meaning that higher uses excluded lower ones, but not vice versa, with single-family homes ranking highest and heavy industry lowest. Beginning in the 1950s and 1960s, however, more communities turned to “exclusionary” zoning, which excluded in both directions. One significant downside was the increased use of zoning to exclude on the basis of wealth or race, mainly by

---

<sup>107</sup> *Hush-A-Phone v. United States*, 238 F.2d 266 (D.C. Cir. 1956).

<sup>108</sup> *In re Carterfone, Inc.*, 13 F.C.C.2d 420 (1968).

<sup>109</sup> *MCI Commc’ns. Corp. v. AT&T*, 708 F.2d 1081 (7th Cir.), *cert. denied*, 464 U.S. 891 (1983).

<sup>110</sup> *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982). For an excellent history of deregulation in telecommunications and media, see TIM WU, *THE MASTER SWITCH: THE RISE AND FALL OF INFORMATION EMPIRES* (New York: Vintage, 2011).

<sup>111</sup> *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365 (1926). For a brief history, see STUART BANNER, *AMERICAN PROPERTY: A HISTORY OF HOW, WHY, AND WHAT WE OWN* 183–92 (Cambridge, MA: Harvard Univ. Press, 2011).

requiring very large lots or eliminating multifamily housing. Some state courts overturned these provisions, holding that communities could not use zoning to exclude their “fair share” of a regional cross section of the population.<sup>112</sup> Federal law never went that far.

Zoning regulation historically tied particular parcels of land to specific uses. Not only was this process inflexible, it also required planners to be expert predictors of future economic development. A great deal of land in rapidly growing communities was zoned when it was still being used primarily for agriculture. Although deviations were possible, a landowner had to show some kind of need or hardship. Beginning in the 1950s, however, some communities began to permit areas within the zoned community to “float,” and have their uses determined later. Early decisions were skeptical, sometimes exhibiting overt hostility to market-driven outcomes. One 1960 decision, widely reprinted in law school property casebooks, reflected this antimarket bias: under a floating zone provision “the development itself would become the plan, which is manifestly the antithesis of zoning.”<sup>113</sup>

Two subsequent initiatives changed the course of urban land use planning in the United States. One was statutes that provided for significantly greater flexibility, permitting the market rather than public planners to determine housing needs. The other was the dramatic revitalization of “private” zoning-like restrictions. The best-known example of the first is the “planned unit development,” or PUD, which abandoned the 1920s’ notion that single-family homes should be on equal lots located on parallel streets. The PUD form gave private developers the ability to negotiate the layout of planned subdivisions. Already in 1949, Prince George’s County, Maryland, authorized two builder-planned communities, with varying building styles, irregular streets, common land areas, and community facilities.<sup>114</sup> The thinking was that economically interested developers had every incentive to make their developments as attractive as possible to customers, and thus could be expected to respond better than government planners to anticipated housing needs.<sup>115</sup> The PUD approach incidentally favored larger home builders, reflecting a reality in which ever more homes were built by firms who constructed more than a hundred homes per year.<sup>116</sup>

---

<sup>112</sup> The leading case is *Southern Burlington County NAACP v. Mount Laurel Twp.*, 67 N.J. 151 (N.J. 1975).

<sup>113</sup> *Eves v. Zoning Bd. of Adjustment*, 401 Pa. 211, 217 (1960).

<sup>114</sup> See Fred W. Tuemmler, *Zoning for the Planned Community*, URB. LAND 3 (Apr. 1954).

<sup>115</sup> ROBERT W. BURCHELL & JAMES W. HUGHES, *PLANNED UNIT DEVELOPMENT: NEW COMMUNITIES AMERICAN STYLE* 6–13, 41–43 (New Brunswick, NJ: Rutgers Univ. Press, 1972).

<sup>116</sup> See EVAN MCKENZIE, *PRIVATOPIA: HOMEOWNER ASSOCIATIONS AND THE RISE OF RESIDENTIAL PRIVATE GOVERNMENT* 8–11 (New Haven, CT: Yale, 1994); and see the contemporary essay by the chief land planner for the Department of Housing and Urban Development. Byron R. Hanke, *Planned Unit Development and Land Use Intensity*, 114 U. PA. L. REV. 15 (1965).

The other development was the dramatic rise of private restrictive covenants, or “servitudes,” as zoning substitutes. The result was the kind of tiny markets that Coase had imagined in the *Problem of Social Cost*. Under a servitude system the relevant land use decision could be made by an owners’ association that controlled a few units rather than the thousands that might be under a city’s zoning board. The popularity of restrictive covenants increased after the Supreme Court’s decision in *Buchanan v. Warley*, discussed in Chapter 3, which struck down racially exclusive zoning.<sup>117</sup> Home developers then turned to private racially restrictive covenants, which the Supreme Court initially upheld in 1926.<sup>118</sup> It changed its mind in 1948 in *Shelley v. Kraemer*.<sup>119</sup> Developers also began to use private covenants to control other aspects of subdivisions, such as housing size, density, placement on lots—many of the same things that zoning controlled. In its important 1938 *Neponsit* decision the New York Court of Appeals approved a subdivision covenant scheme that created a private homeowner’s association to manage the subdivision and required individual property owners to pay an ownership fee.<sup>120</sup> *Neponsit* helped create the legal framework for private contractual alternatives to zoning. Initially the growth of such subdivisions was slow. In 1964 fewer than five hundred subdivisions in the United States were managed by private homeowners’ associations. By 2000 the number had grown to roughly 225,000.<sup>121</sup>

The impact of these “private residential governments” is manifold. First, often there is more “regulation” as such than even zoning ordinances provide. For example, private subdivisions often control building materials, landscaping, pet ownership, and permissible uses much more elaborately than zoning typically does. At the same time, however, the regulations are both private and contractual, in the sense that everyone agrees to them as a condition of buying a home in a particular development. In a very real sense residential land use law had moved from the public back into the private legal sphere.

## Conclusion

The legal world in the United States today is more “private” than it was from the New Deal through the 1960s. Some of that development was clearly a socially beneficial response to regulatory excesses. But democracy’s movements often lack moderation. On the way to whatever short-lived equilibrium it may attain, it gyrates between extremes.

Deregulation has had a significant effect on American infrastructure, privatizing parts of it and diminishing what is left over. A common complaint about expansive regulation is overinvestment in infrastructure. In the early 1960s Harvey Averch and Leland Johnson famously argued that because regulated firms

---

<sup>117</sup> *Buchanan v. Warley*, 245 U.S. 60 (1917).

<sup>118</sup> *Corrigan v. Buckley*, 271 U.S. 323 (1926).

<sup>119</sup> *Shelley v. Kraemer*, 334 U.S. 1 (1948).

<sup>120</sup> *Neponsit Property Owners’ Ass’n v. Emigrant Indus. Sav. Bank*, 15 N.E.2d 793 (N.Y. 1938).

<sup>121</sup> MCKENZIE, *PRIVATOPIA*, *supra* note 116, at 11.

are guaranteed a profitable rate of return on their investment they are tempted to enlarge the base on which this return is computed. They “gold plate,” or overinvest in infrastructure such as pipelines, electric lines, telecommunications, and transportation facilities.<sup>122</sup> Deregulation has largely removed that incentive. In sharp contrast, the actors in the markets envisioned by Ronald Coase do not invest if they cannot appropriate the results. Although the great public works projects of the New Deal era may have given us too many train stations, courthouses, universities, schools, highways, or other public facilities, privatization has provided too little. And the distributional impact should not be forgotten: infrastructure is often of greater benefit to the poor than the wealthy.

The deregulation of residential communities has had a similar effect. Private residential governments have reduced the value of the traditional community as a public good. Once the private subdivision has its own private park, recreational facilities, and security force, its owners are less likely to vote tax increases to support public parks or increase the government’s police force. Robert Reich termed this phenomenon “the secession of the successful.”<sup>123</sup> A few courts have relied on esoteric historical rules such as the “public trust” doctrine to force subdivisions to open truly scarce facilities to a larger population. For example, in 1984 the New Jersey Supreme Court required a private homeowners’ association to open its privately owned beach to the public.<sup>124</sup>

Nonetheless, the deregulation movement has not taken us back to some idealized notion of the nineteenth century, although some proponents may long for that. Thanks to urbanization and technological development, the world is critically more dependent on infrastructure today than it was a century ago. And of course the environment is the ultimate infrastructure, because everyone participates but each person individually benefits more by corrupting than by improving it. For these reasons the deregulation movement may largely have run its course, even though some ideological support remains. Infrastructure provides the platform on which social and legal systems develop, and societies with better platforms have the advantage. The trick is to develop shared resources in ways that facilitate economic and social growth for all members of society rather than favoring particular interest groups. This is one of the biggest challenges facing democratic legal systems in the neoclassical era.

---

<sup>122</sup> Harvey Averch & Leland Johnson, *Behavior of the Firm under Regulatory Constraint*, 52 AM. ECON. REV. 1052 (1962).

<sup>123</sup> Robert B. Reich, *Secession of the Successful*, N.Y. TIMES, Jan. 20, 1991, section 6 at 16.

<sup>124</sup> *Matthews v. Bay Head Improvement Ass’n*, 95 N.J. 306, 471 A.2d 355 (N.J. 1984).