Economic Foundations of the Regulation of Commerce

By ROBERT ELLIOTT FREER,[1] A.B., LL.M.

FROM the victory of Jeffersonian Democracy at the polls in 1800 to the victory of the New Deal in the legislative halls of Congress in 1933, laissez-faire had been the accepted key-note of the American political, economic and legal theories of the proper relation of government to industry. In truth, laissez-faire had been a major premise of the Colonial conclusion to separate from the motherland. In a land of unbounded resources awaiting exploitation and development, the Colonists deemed English regulation of trade and commerce contrary to the "Law of Nature." Today, however, one need only examine the major pieces of legislation enacted at the last session of Congress to find the American Government in a new role of partner with business in a comprehensive scheme of economic planning and industrial control.[2]

Such a complete abandonment of laissez-faire and the substitution of governmental control, even though promised on emergency conditions, would appear to make profitable a re-examination of any early exceptions in the policy of complete freedom of business from governmental restrictions to discover the real point of departure for the presently accepted policy of regimentation of business under governmental regulation.

In all civilized society industry and property are alike subject to the "police power" of the state.[3] Recent years had witnessed greater restriction on the free use of private property.[4] The Supreme Court has said "It must be conceded that all businesses are subject to some measure of public regulation."[5] But until 1933, the amount of regulation directed against industry was insignificant as compared with the detailed control exercised over the American railroads. This greater exercise of power of regulation over the railroads and other "public utilities," and in truth the very existence of the power itself, has been variously explained as resting upon their monopolistic nature, upon their exercise of the power of eminent domain, upon the enjoyment of a public franchise and upon their alleged performance of a public or governmental function.[6] In the field of economics it was said that the large amount and relative immobility of the capital employed resulted in competition which was self-destructive.[7]

Railroad property in America is admittedly private property, although it is said to be "devoted to a public use."[8] Since the "New Era" regulation of industry represents an

[1]Research Staff, Fed'l Coordinator of Transportation; Professor of Law, Washington College of Law; Lecturer, Graduate School, American University, Dept. of Economics.

[2]E.g., National Recovery, Securities, Agriculture Adjustment, Banking and other acts.

[3]C. K. Burdick, "Law of the American Constitution," pp. 225-233.

[4]E. g., Village of Euclid, Ohio v. Ambler Realty Co., 272 U. S. 365.

[5]New State Ice Co. v. Liebman, 285 U. S. 262, 273.

[6]Cf. Smyth v. Ames, 169 U. S. 469; Wolff v. Court of Industrial Relations, 262 U. S. 522 and dissent of Brewer, J., in Budd v. New York, 143 U. S. 517; Hartman, "Fair Value," pp. 11-19.

[7]R. T. Ely, "Outlines of Economics," pp. 198-199, 559-562.

[8]Smyth v. Ames, supra.

experiment in social legislation somewhat similar to the pioneer efforts in the direction of railroad regulation, the legal and economic foundations of this earlier regulation will be used as the basis of arguments both for and against the constitutionality of the laws so recently providing governmental control of industry. And since regulation of industry raises the question of the legal status of private property, the Anglo-American concept of the legal nature of property stands at the gateway to any inquiry as to the utilization of such precedents.

The Legal Nature of Property

"Property" is a generic term of extensive application employed to signify any valuable right or interest protected by law. Thus it is defined as, "any valuable right or interest considered primarily as a source or element of wealth, or an aggregate of rights which are guaranteed and protected by the government."[9] More specifically the term "property" means "the right of ownership" subject to the demands of the sovereign. Thus "property" means a "bundle of rights" in relation to something said to be owned and is distinguished from the something itself.

The term "private property" refers to the right of an individual to exclusive dominion over such things as are permitted by the State to be the subjects of ownership, or such other dominion or right of possession, user, enjoyment over particular things to the exclusion of all others not inconsistent with the law of the land.[10]

"Private property" is a creation of law; its protection is dependent upon the State. It is the force of the State which sanctions and protects the owner's right of exclusive control, and such control can exist only by the consent of organized society. The social concept that such protection of control is in the public interest gives to "private property" a "social side" as well as an individual side.[11] The common law maxim, "So use your own as not to injure the rights of others," is illustrative of the social interest recognized as limiting the individual side of "private property."

Thus an owner's right to use his property as he wishes is conceived to be limited to such uses as are not adverse to the public welfare. Regulation of the owner's use of his property to be valid must bear some reasonable relation to an obvious need for protecting the public welfare from impairment by private use of that property by the owner in his own interest.[12]

The decline of external commerce of all nations today due to a rennaissance of Nationalism and the imposition of trade restrictions in the form of prohibitory tariffs recalls conditions in Europe and England after the decline and fall of the Roman Empire. It was also in this period of history that the English Common Law was building. As our concepts of the nature of property come to us from that Common Law, an outline of Medieval conditions would seem helpful to an appraisal of present regulation of property.

English Medieval Conditions and Society

In the early Middle Ages there was almost no external trade or commerce in Europe or between England and the Continent. Such trade as there had been had died with the disintegration of the Roman Empire. Without external trade, so-

[9]50 Corpus Juris p. 730.
[10]Ibid., p. 731.
[11]Cf. Hartman, "Fair Value," pp. 4-5.
[12]Ibid., pp 15-17, 27

ciety was organized into small rural feudal groups, each, so far as possible self-sustaining and self-sufficient.[13] In England, theoretically at least, these feudal groups or manors were organized into a hierarchy of authority with the central control in the king from whom every land holder was presumed to hold his title in trust for the crown. In Europe, the manors were so strong and the kings so weak that there was no central authority recognized.[14] In both places the small property holder held his property conditioned upon his service to his lord or baron. In other words, his use was for the good of his group as well as for his private subsistence.

The stimulation in England of some internal commerce after the Norman Conquest and its unifying influence brought about a division of labor around the Manors; that is, one vassal was designated to make armor for the others, another to make agricultural implements, etc. Further growth of commerce brought references in the year books of the Fourteenth Century to "common callings."

The Common Callings—The term "common" in connection with occupations in England in the fourteenth century was not confined to "common carriers" and "common inns." The early year books contain references to common purchaser, common merchant, common huckster, common brewer, common tavern, and common surgeon. Later year books reveal common farrier, common smith, common lighterman, common mill, common boatman, and common ferryman, as well as common carrier and common inn.[15]

[13]Ogg & Sharp, "Economic Development of Modern Europe," p. 62.

[14]Ibid., pp. 17-39.

[15]Adler, "Business Jurisprudence," 28 Harvard Law Rev., 135, 146, 149. See also Cheadle, "Government Control of Business," 20 Col. Law Review, 438, 550 and Smith and Dowling, "Cases on Public Utilities," p. 2.

The old cases and notes thereon in these year books make it plain the the words "common smith," for example, referred to one who made a business of that particular occupation. A common smith was one who held himself out to serve everybody who might seek his services for the shoeing of horses, the forging of weapons, and so forth. No special contract was required to be made with one who held himself out as a common smith—the custom of the realm implied a contract with specific duties imposed upon the smith to perform his services in a careful and honest manner and for a fair price. The criterion applied to determine whether such implied contract existed was whether he worked for particular persons only or whether he plied his trade for everyone. "Common" meant "public" in the sense of offering to serve all of the public tendering a fair price for the service rendered rather than in the sense of performing the work of the state.[16]

The Concept of Just Price—In the Middle Ages, as we view conditions through our earliest law books, as well as through our economic histories, we find an era of strict control. To quote Ogg & Sharp, "The gild, the feudal lord, the town, the church, the king—all imposed rules and fees and other obstacles so that of freedom of business enterprise there was hardly a shred."[17]

The English law of this period was largely customary, and one of the most deep-seated concepts of economics embodied in English law and morality was the idea that all goods and services—everything—had a just price. It was both a sin and a violation of law to charge more than this just price regardless of the state of supply and demand for goods and services.

[16]Ibid.; Holmes, "The Common Law," p. 203.

[17]Page 65.

Analogous to this concept was one that usury (the taking of any interest at all) was a legal and moral wrong.[18]

In the later medieval period, trade was marked by the dominance of the trade and craft gilds. The operations of middlemen or wholesalers were considered wrong, and laws against forestalling, engrossing and regrating, hinged upon this concept. These economic ideas, sanctioned by the law and morality of the time, were the backbone of the restrictive legislation directed against the free use of private property and the free conduct of business enterprise. Minute regulation was had of the price of everything, as illustrated by the assizes of bread and ale by which the prices for these commodities were permitted to fluctuate only as the price of the raw materials entering into their production.[19]

Tolls and duties were collected upon every possible pretext for the use of highways, bridges, ferries, fords, and the crossing of boundary lines.[20] All of this regulation by the state and its designated agencies, public and private, was felt to be for the benefit of the public as a whole. The governmental idea of the common good was to protect the consumer in his opportunity of obtaining, without favor and at reasonable prices, proper services and staple goods through minute regulation.[21] It was true that some of these tolls and duties were designed to raise revenues, but, since the ideas of public finance of the day did not distinguish between "the wealth of the crown" and "the wealth of the nation," it was widely believed that the public good demanded a wealthy government capable of performing its duty of protecting its subjects.[22]

To sum up: Mercantilistic philosophy was the economic order of the day. Private property was subjected to regulation to promote the national welfare through securing a favorable balance of trade and a larger supply of precious metals for England in the prosecution of the revived trade between nations.[23] The economic, political and legal theories of the middle ages emphasized the social side of private property and the owner's "bundle of rights" was largely contracted in the process of regulation.

Revival of Trade and Birth of Laissez-Faire

The sixteenth and seventeenth centuries opened vast new territories to commerce and the eighteenth century brought reaction against the minute regulation of the earlier mercantilistic policy. In a day when the "social compact" theory of Government was beginning to become a force, and when Adam Smith was espousing the physiocrat's politico-economic theory that the individual should be free to enjoy the fruits of his labor without regulation to the end that a national wealth built upon the prosperity and wealth of individuals might be created,[24] the doctrine of laissez-faire became the economic background of the relationship between government and industry.

The laissez-faire policy was one of hands off by the government. Public regulation was limited to the maintenance of national defense and local law and order. The emphasis was distinctly individualistic, both as to political and economic freedom in the closing days of the

[18]Ibid.

[19]Ibid., p. 66. In ancient times Hammarabi in Babylon and Diocletian in Rome had fixed prices of food stuffs but only in the face of famine.

[20]Ogg & Sharp, supra, p. 66.

[21]Ibid., pp. 65-66.

[22]Ibid., pp. 68-75.

[23]Ibid., pp. 72-75. See also Lutz, "Public Finance," pp. 8-12.

[24]Ogg & Sharp, supra, pp. 78-82; Lutz, supra, pp. 10-12.

eighteenth and the dawn of the nineteenth centuries.

The new money economy considered competition the regulator of prices and the life of trade, the individual the key-note of the nation's wealth, and all unnecessary restriction taboo. Under this economic theory, the State was presumed to prosper in the aggregate as the individual effort and individual accumulation and use of property was successful in a regime of free production and free commerce.[25] In this dawning day of democracy of political and economic endeavor the owner's "bundle of rights" in private property enjoyed an immense expansion. The pursuit of individual gain and production for exchange were the dominant factors in industry. The theory of competitive price underlay the economic theory of the period. The social side of private property was subordinated to the individualistic acquisitiveness sanctioned by the new economic and legal theory. The theory of just price was replaced by that of market price.

Railroads and the Re-Birth of Regulation

It was about thirty years after the victory of laissez-faire that the first railroads were established in America. They were built by private capital. It was inevitable that they should be; for while the people demanded new avenues of commerce they were opposed to increased taxation. The State legislatures, responding to the popular demand for railroads, granted private enterprise a free hand and much public aid. To quote Dr. Hartman, "The power of eminent domain was granted and liberally construed. Public lands were freely given. Public funds were either invested in the securities of the company or were given to the promoters outright. Charters and franchises were lavishly bestowed and prodigally drafted."[28] Taxpayers' suits to restrain the use of public funds were dismissed with the judicial finding that the railroads were "public highways."[29]

The age was one of exploitation and speculation, and the governmental efforts were directed toward making the undertaking inviting to the capitalists of the day. In this behalf, the public nature of the enterprise was widely advertised and the investor assured that he was a public benefactor.[30] The railroads did bring great advantages to the country but they brought a "problem" also.

The public demand for railroads and the accompanying opportunities for speculative profits to the promoters inevitably led to an overproduction of railroads and a concomitant competitive warfare between them.[31] The results were wide-spread evil and wholesale abuse.

Cut-throat competition was the order of the day between the railroads and gigantic struggles for preeminence in fertile territory took place. Armed force was even necessary to protect the property of one railroad from another's guerrilla warfare where both were striving to possess a right of way through a canyon, wide enough for only one, and granting to the victor a monopoly of the only favorable pass through the mountains.[32]

Railroad competition for traffic was marked by rebating and discrimination between persons and

[25] Ogg & Sharp, supra, pp. 78-82; Lutz, supra, pp. 10-12.

[28] "Fair Value," p. 7.

[29] Olcott v. Supervisors, 83 U. S. 678; Pine Grove v. Talcott, 86 U. S. 666.

[30] Hartman, "Fair Value," p. 7.

[31] Sixth Annual Report, I. C. C. (1892) pp. 3-4; First Annual Report I. C. C. (1887) pp. 5-10.

[32] C. F. Carter, "When Railroads Were New," pp. 269-28.

places.[33] The reason for this was inherent in the physical and economic characteristics of the railroad. A railroad is constructed in a particular location and can only be used in that location. The road is intended to carry traffic and is available only for the carrying of traffic. Its fixed property and office force must be maintained whether the traffic is large or small, at practically the same expense, and this cost together with interest on the enormous aggregation of capital necessary to build it, constitute the largest part of railroad expense in any given year. The "out-of-pocket" cost of moving the traffic being generally much less than the amount received for carrying it, the road's managers will go to almost any length to obtain tonnage, as every additional ton carried helps reduce the total cost per ton and adds to the profit.[34]

Despite the overproduction of railroads, it was only at "competitive points"—those served by two or more roads or affected by a competition of markets—that the railroads were actual competitors. At these points rates were generally made very little above the actual cost of moving the traffic, and maintained at such figures only by "pooling" traffic or earnings. At "local points," which far outnumbered the competitive points, competition left the rate either unaffected or induced its increase to offset the low rates at competitive points. Railway competition thus fostered discrimination between places.[35]

Competition between the roads for business also induced discrimination between individuals. One person was so located that his business had to be transported over a particular railroad; another could avail himself of two or more roads. The shipper having the choice of routes generally obtained a lower rate.[36] The same might have been said of shippers having control of a large volume of traffic.

These preferential rates and the non-compensatory rates to competing points which often resulted from rate-wars were considered by the public to be evidence that all other rates were too high,[37] and the legislatures of the mid-western "granger" states, adopted, in the decade following 1870, maximum rate laws fixing a "just price" for railroad service.

All of these laws were legally tested,[38] and in a period when private interests were so emphasized and in which private property enjoyed unparalleled freedom, it was not strange that there should be some confusion in finding a legal base upon which to uphold regulation of the privately owned railroads.

The Legal Basis of Railroad Regulation

The advocates of regulation met the railroads' attempt to escape governmental restriction by insisting that they were highways and they cited historical instances running back two thousand years of governments providing avenues of commerce.[39]

In upholding the public purpose of railroads under the attacks made upon the issuance of bonds to aid their construction, the Supreme Court had held that it was a matter of no importance that these highways had been built through the

[33] 49th Congress Sen Rep. No. 46 (1886) "Cullom Committee Report."

[34] Twelfth Annual Report, I.C.C. (1898) pp. 16-17, see also Ely, supra and Taussig, "Principles of Economics," Vol. 2, p. 368 et seq.

[35] Ibid p. 16 and Seventh Annual Report, I.C. (1893) pp. 9, 39, 217.

[36] Twelfth Annual Report, I.C.C. (1898), p. 16.

[37] Second Annual Report, I.C.C. (1888), pp. 19-22.

A very satisfactory sketch of the reasons why federal legislation was postponed is on pages 2-10, First Annual Report, I.C.C.

[38] C.B. & Q. v. Iowa, 94 U. S. 155; Peik v. C. & N. W., 94 U. S. 164, and others.

[39] Hartman, supra, p. 17.

agency of a private corporation since the function performed was that of the state and the use public. Their reasoning was to the effect that the creation of highways is a "public duty" no matter who performs this "work of the State."[40] In one case the Supreme Court said: "All railway property of every description, real, personal and mixed, are but a trust fund for the political power and the corporation but its trustee."[41]

In validating railway rate regulation, therefore, the Court rested its decision on the performance of a public function,[42] and in the light of its former holdings no question was entertained as to the propriety of distinguishing railroading from other industry. Laissez-faire might serve in ordinary industry but private property devoted to railroad use was subject to a restricted ownership in the public interest. As to such property it was held that the power to regulate its use and the charges therefor "was inherent in every sovereignty, to be exercised by the legislature from time to time at its pleasure," and so essentially a governmental power that one legislature could not, "though for a valuable consideration," confer a right to charge rates "beyond the control of subsequent legislatures."[43]

Businesses Affected With the Public Interest

The increasing importance in the life and commerce of the American people of such things as grain elevators, stockyards, insurance, banks, cotton gins, etc., brought a demand for their regulation. Various states have adopted restrictive measures concerning one or more of these occupations. In Munn v. Illinois,[44] the Supreme Court upheld regulation of grain elevators as "affected with a public interest" because of their vital import to the commerce of the nation. Many subsequent regulations of other businesses have been held so affected with a public interest,[45] and as many more have been held to be strictly private.[46] In Wolff v. Court of Industrial Relations, Chief Justice Taft, speaking for the Court, articulated rather clear lines of demarcation between several classes of business and the extent of regulation appropriate to each.[47]

In Cotting v. Kansas City Stockyards, Justice Brewer indicated the reason for the distinction made between the degree of regulation appropriate to be applied to the railroads on the one hand, and a business merely affected with a public interest on the other, to be in the railroads' undertaking to perform the work of the state, in which work they may be subjected to the same rules of action as the state.[48] But in Block v. Hirsh, the Supreme Court considering a Congressional declaration of "public interest" and emergency existing in the War-time housing shortage, upheld regulation of "rental property" in Washington fully as restrictive as railroad rate regulation.[49]

A characteristic of the "New Deal" legislation of the last session of Congress appears in the "Declaration of Emergency" included in each of the important enactments. While such declaration of the "facts" may "not

[40] See: Budd v. N. Y., 143 U. S. 549 and Cullom Committee Report, supra.
[41] Talcott v. Pine Grove, 1 Flipp. (U. S.) 120.
[42] Smyth v. Ames, 169 U. S. 466.
[43] Boyd v. Alabama, 94 U. S. 645.
[44] 94 U. S. 113.
[45] Evans," Cases on Constitutional Law," 2d. Ed., p. 1338-1339.
[46] Most recently the ice business, New State Ice Co. v. Liebmann, supra.
[47] 262 U. S. 522; Railroads and public utilities: exceptional survivals of the days of common callings, e.g., inns, grist mills, etc.; and businesses not public at the start but which have risen to a position of such importance in the public life as to require some regulation; upon the facts of the case depends the inclusion or exclusion in this class.
[48] 183 U. S. 79, 93.
[49] 256 U. S. 135, 156-157.

be held conclusive by the Courts," it "is entitled at least to great respect."[50] If the declaration is of facts "publicly notorious," no further proof of emergency may be needed to show that "All the elements of a public interest justifying some degree of public control are present";[51] but proof of the economic conditions enables the Court to determine not only whether any regulation is required, but also the appropriate degree of regulation necessary to be applied to protect the "social side" of the "private property" employed in a business "affected with a public interest."

The large amount of capital employed in many industries today and its relative immobility suggest that some economic factors formerly held to be "peculiar to railroads" may not have been at all peculiar to that form of industry but only to a certain stage in the evolution of many industries. Competition in many industries to-day resembles the railroad rate cutting of the years following the depression of 1873, while cooperation and combination in others reminds of the "railroad pools" which generally followed the railroad rate wars of that period.

Since the World War many "clogs" operating to block the freedom of competition assumed as the basis of "orthodox political economy" have become apparent[52] In fact, the hearings before the Congress[53] in 1919 and 1920 considering the return of the railroads to private operation indicated that at that time "the sufficiency of the competitive principle under prevailing conditions" was "openly and insistently questioned."[54]

This article, however, is neither an appraisal of economic theory, nor an analysis of present economic conditions; its sole purpose is to suggest the importance of economic conditions as criteria in measuring both the need for and extent of the regulation to be applied at any stated time to any given industry or business.

[50]Ibid., p. 154.

[51]Ibid., pp. 154-156.

[52]Sharfman "The American Railroad Problem," p. 22.

[53]66th Congress, S. R. 304 and H. R. 4378.

[54]Sharfman, supra, p. 22; and for a review of discussion relating to reconsideration of Anti-trust Laws, see: Vol. XLV, Harvard Law Rev. 566, Jan. 1932.