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DID AMERICA EVER HAVE A PERIOD OF LAISSEZ-FAIRE CAPITALISM?

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ABSTRACT

American textbooks in civics, history and political science are notorious for lack of economic content, and when it is present for erroneous economic history. Students are told of the era of laissez-faire capitalism, and between the lines that it was a bad thing. Further, that America made positive progress in moving away from it through reform.

To the contrary, this paper is an examination of the economic history:

1	*to show the origins and foundations of the early American system,*
2	*to question whether such an era ever did exit,*
3	*to delineate some of the changes over time, questioning whether they have been "progress"*
4	*to identify some of the major players in the process and their impacts and*
5	*to identify those changes which were gradual and those which were based on key turning points.*

Areas examined include constitutional, judicial, political movements, anti-trust, and the deterioration of private property rights.

INTRODUCTION

Bruno Leoni's 1961 classic, *Freedom and the Law*, begins: "It seems to be the destiny of individual freedom at the present time to be defended mainly by economists rather than by lawyers or political scientists." The statement is remarkable in three ways.

First, Leoni was criticizing those in his own fields, since he was both Professor of Legal Theory and Chairman of Political Science at the University of Pavia, Italy. The second is how well the statement applies in some ways almost 40 years later in America. The third is how much the reverse of Leoni's sentence would have been true 186 years earlier.

In 1775, Adam Smith was probably best known within Scottish Enlightenment circles for his *Lectures on Jurisprudence* (1762, 1766). In these, he added historical origins to John Locke's and Francis Hutchison's use of natural law to morally justify and defend private property rights.

Publication of *An Inquiry Into the Nature and Causes of the Wealth of Nations*, from which we trace the origin of classical economics, was still a year away. Thus, in 1775, mercantilism was ruling British economic thinking for last full

unchallenged year, just as Britain was ruling the American colonies for the last full year.

However, by 1775, the American Revolution was already being fought on one front with words, and started on the second in April with lead and iron. The first front was fought by newspaper editors, lawyers, politicians, pamphleteers, gentlemen, farmers, laborers, craftsmen and tradesmen.

Two generalizations might be fair. One is to say the war for American independence began as an effort to preserve traditional individual rights of Englishmen who did not live in England. The other would be the war probably began for the colonists with a rifle in one hand and a newspaper or pamphlet in the other.

Crafting the new government was tricky. Previous attempts at self-governing republics had a dismal records of failures.

What was understood was the unsatisfactory situation of British rule. A remote government, dominated by political interests which used taxation, legislation and the courts in ways perceived as contrary to the interests and rights of the citizenry. British abuses were primarily economic, as the anti-Stamp Act motto (1765) "Liberty, Property and No Stamps"[1] and James Otis's "Taxation with representation is tyranny" [2] indicate. In "The Economic Policy of the Constitution" contained with *Liberty, Property & the Foundations of the American Constitution* (1989 131) William Letwin points out Smith's *Wealth of Nations* was probably scarce in America even after the Paris peace treaty in 1783. The first U.S. printing was not until 1789.

The need for a central, coordinating government was recognized under the Articles of Confederation, but powers were to be strictly limited. The Articles created a Congress, but no national executive or judiciary.

Indeed, Article 2 read, "Each state retains its sovereignty, freedom, and independence, and every power, jurisdiction, and right which is not by this confederation expressly delegated to the United States, in Congress assembled." Thereby, dominion was to rest mainly with the respective state legislatures.

While high school history texts may explain the Constitution as a replacement for the ineffectual Articles of Confederation, Charles Hobson stated in "Republicanism, Commerce and Private Rights" (*Liberty…Constitution* 86-91) the reality was more to do with a system to curb the abuses of the states.

JAMES MADISON

One of the most fortunate events in American history may have been James Madison leaving the Continental Congress in 1783, and spending three years in the Virginia House of Delegates, where he saw the abuses by the states first hand. His

correspondents outside Virginia indicated the shortcomings of unlimited republican self-government were wide spread. Madison also wrote regularly to Thomas Jefferson, then minister to France, both about the problems observed, and to ask Jefferson to seek out manuscripts about republics and their histories, especially why they had failed.

James Madison is properly identified as the "Father of the Constitution." The results of his observations, correspondence and research, are in his clear influence in the checks-and-balances system, the Bill of Rights, the limits imposed on Congress in Article I, Section 9, and on the states in Article I, Section 10.

THE CONSTITUTION

Where Madison's legacy has gone awry is in the subsequent interpretations. Federal powers have been enhanced through broad interpretations of the necessary and proper clause and the commerce clause, and even whether the Preamble is enforceable or justiciable. What is missed here is the Article I, Section 1 says, "All Legislative powers *herein granted* shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives." (emphasis added).

The perceived abuses by the British were from laws and taxes of Parliament. The Articles of Confederation were drafted to significantly limit the authority of the Continental Congress. The abuses by the states were acts of the legislatures.

Therefore, Article I, Section 1 can not be given historical interpretation different from its literal meaning. That is, what follows in Article I is a list of powers, which are the only powers Congress has.

As further proof, note Article II, Section 1 does not contain this literal restriction, "The executive Power shall be vested in a President of the United States of America." Likewise, Article III, Section 1 begins, "The judicial Power of the United States, shall be vested in one Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish."

Over the last two centuries, the interpretation of Article I, Section 1 has come to parallel Articles II and III. As is well known, the common justifications or rationalizations for broad interpretations of the powers of Congress are based on the meaning of Article I, Section 8:

- *the general welfare clause, "Congress shall have the Power To … provide for the general Welfare …"*

- *the commerce clause, "To regulate Commerce with foreign Nations, and among the several States…"*
- *plus the necessary and proper clause, "To make all laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this constitution in the Government of the United States, or in any Department or Officer thereof."*

The "general Welfare" now justifies everything from public assistance to attempts at social engineering. "Commerce" now includes innumerable non-commercial activities, intrastate as well as interstate; and "necessary and proper" has come to have a punctuation period after the word "proper" with minimal regard toward the limitation to the accompanying list of specified areas of authority.

Today, Article I, Section 1 might be read, "The legislative Power shall be vested in a Congress of the United States of America." This is as if the Preamble was justiciable as far as "…promote the general Welfare..." is concerned, with no identification of which definition of general welfare is to be used, be it Karl Marx's or Adam Smith's invisible hand. This broad interpretation is certainly not in keeping with the literal wording of the Constitution. Neither is it in keeping with the historical circumstances within which the framers of the Constitution worked; nor is it in keeping with the way the federal government generally operated in the Jeffersonian-Madisonian portion of the early Constitutional period.

ORIGINAL INTENT?

But, the framers of the Constitution did not intend later generations would be directed in day-to-day details by the deliberations at the Philadelphia convention. The best details on the deliberations, Madison's notes, were not published until 1840, over half a century later, and post humous to every delegate. As Stephen Macedo argues in *The New Right v. The Constitution* (1987 11-13) other than recording votes, no formal minutes are known to exist and informal notes could have been later edited. Even if this was not the case, the framers were not agreed, and since some were more active and vocal than others, which "intent" should be followed? Further, every delegate may not have clearly understood the importance and consequences of each vote, and what was said in a speech may have been more for political consumption or in the form of a wish than a serious proposal.

MR. MARSHALL'S SUPREME COURT

The first chief justice, John Jay (1789-1795), began the process of establishing the independence of the Supreme Court. President Washington sent the draft of a proposed treaty with a request for a legal opinion. Jay sent it back with a reply that that was not the Supreme Court's job. However, it was under the fourth chief justice, John Marshall (1801-1835), the court became of consequence and centralization of power in the federal system.

John Marshall was a Federalist. He was Secretary of State when Federalist president John Adams appointed him chief justice in early 1801, after Adams had already lost the November, 1800 election to Thomas Jefferson.

It was Adams's attempt to fill the judiciary with Federalist appointments that Brought about Marbury v. Madison (1803). What is remembered is Marshall's decision, which denied Marbury his appointment. In the process, judicial review was established, whereby the Supreme Court created the precedent, for itself, of the power to rule a law unconstitutional.

What is sometimes forgotten is the story of how the new Secretary of State, James Madison, avoided sending out Marbury's and others' appointments. It was commonly expected at the time that Marshall would issue a Writ of Mandamus ordering Madison to comply. Jefferson administration officials let it be known that if the Writ was issued, Mr. Chief Justice Marshall would be impeached. This may have not only avoided the Writ of Mandamus; it might also have made Marshall's decision more flexible.

However, John Marshall's personality dominated the court for a third of a century. His opinions lead the court in majority after majority. The influence of Marshall's writings and precedents on future courts is material for an entire book by itself.

He was guided by two beliefs. The first was the need for a strong central government superior in all respects to the states. The second was the need to curb the powers, or otherwise weaken the state governments and "states' rights."

CHECKS-AND-BALANCES

These objectives were not as easy as they may initially appear. Article VI of the Constitution contained the supremacy clause, declaring the Constitution and federal law to be the supreme law of the land. But, while this gave the central government a check on the states, the states also maintained a constitutional check on the over centralization or abuse of power at the federal level. At the Constitutional Convention, as a result of the compromise between the Virginia (large

state or House of Representatives) Plan and the New Jersey (small state of Senate) Plan. each state's senators were to be elected by the respective state legislature.

Thereby, the House was always intended to be a populist forum and subject to special interest group influence. However, any bill passed by the House that was not in the best interests of the states or their legislatures could be assumed to be dead on arrival in the Senate. Thus, the states were to maintain their own check on federal power, a sort of Article VI in reverse.

Today's direct popular election of Senators dates from the Seventeenth Amendment, ratified April 18, 1913. What is of consequence, is the destruction of this important element of the checks-and-balances system has resulted in the Senate become a mirror of the House of Representatives and the subordination of the states to an extent not intended by the framers of the Constitution.

The key to Marshallian statism was the precedents established. The opinion in McCulloch v. Maryland (1819) rationalized for the first time a broadest interpretation of the commerce clause. In Gibbons. V. Ogden (1824), an attempt by a state to grant a monopoly, gave the Marshall court all the justification needed to legitimize federal intervention into, and overruling of state laws. Fletcher v. Peck (1810) and Darmouth College v. Woodward (1819) were landmarks in the clarification of contract law. Predictably, in both cases, the Marshall court, via the chief justice's opinion, sided against the states' legislatures. The point can be made the precedents have been of more importance for their influence on later courts than they were for the particular cases involved.

CIVIL WAR

Protectionism and labor supply: the Civil War did not have a pro-literal Constitution verses anti-literal Constitution side. The Union favored statism. Confederate "State's Rights" actually favored state's abuses ala the legislatures under the old Articles of Confederation. As Clint Bolick (*Grassroots Tyranny* 1993) so aptly pointed out: "The very notion of states' rights is oxymoronic. States have powers. People have rights. And the primary purpose of federalism is to protect those rights."

Though some conservative advocates of "states' rights" have attempted to equate their anti-centralization of power position with protection individual rights, Bolick has very convincingly proven their position is merely a shift in the source of the governmental interference and abuse. Indeed, the Confederate Constitution had only 22 differences with that of the U.S., virtually all minor. The Civil War is most important as another turning point in the relationship of economy to government, and

thereby the rest of American society, because the broad interpretation-statists won. The war was started over differences in economics.

POPULISM

The first of two successive socialist movements in America, beginning in the last half of the 19th century, served to further and to enhance statism, more by effect than by design. Populism was a picture of contradiction in itself. By 1860, there was a populist cry for government efforts to speed the growth of the railroads, so the entire nation could have access to the benefits of this latest technological wonder. They won, and the taxpayers began to pay for the first of what would become four subsidized transcontinental rail lines.[3]

By the 1870s, the populists were demanding government regulation to halt the abuses of the railroads. Populists had gained control of the state legislatures in Iowa, Wisconsin, Minnesota, and Illinois and were passing bills regulating the railroad rates. The Supreme Court upheld the constitutionality collectively in The Granger Cases: Munn v. Illinois (1877) and Peik v. Chicago and Northwestern R. Co. (1877), but later partially reversed itself in Wabash, St. Louis and Pacific Railway v. Illinois (1886) on the grounds only the federal government, not the states, could regulate interstate commerce. This was later reinforced in the Railroad Commission Cases: Stone v. Farmers' Loan & Trust Co. (1886) and in Chicago, M. & St. P. R. Co. v. Minnesota (1890). So, populism shifted to a national focus in the form of lobbying for the Interstate Commerce Commission. With the quiet backing of railroaders who understood regulatory capture theory, they succeeded in 1887[4].

Populism folded after the disastrous endorsement of "Free Silver" Democrat William Jennings Bryan in the presidential election of 1896. Between the Civil War and the end of the century, the states remained generally unchecked by the Fourteenth Amendment in federal courts. States intervened, regulated on behalf of special interest, granted monopolies and generally abused in economic matters. In effect, the Tanney court's famous Dred Scott v. Sanford (1857), actually a "property right" decision, was reversed in the Slaughterhouse Cases (1873) and Loan Association v. Topeka (1875).

PROGRESSIVISM AND JUDICIAL EROSION

By about 1900, the progressive movement replaced the populists as the leading socialist-statist influence in American politics. Generally, progressivism was more middle class and less of an agrarian revolt than its predecessor; it had more

"academic" (and pseudo-intellectual) respectability, and tended to see government less as a means to solving the problems of society and more as the solution itself.

Judicially, the process did not gather much momentum until later in the century when the Supreme Court began to abrogate its constitutional checks-and-balances obligations over a series of cases. Through the early 1920s, with a few exceptions both before and after, the high court applied concepts of "natural and historical law" in the protection of property rights.

This "legal formalism" is most commonly known as "substantive due process" and was a tripartite rule most often applied to challenges of legislation regarding property and contract rights. The three tests were:

- *whether the public benefits were in balance with the costs of the restrictions,*
- *whether the legislation's objectives and the means employed were legitimate, and*
- *a "means-ends test" of whether the objectives would likely be achieved.*

The best known cases implementing substantive due process were Allgeyer v. Louisiana (1897), Lochner v. New York (1905), Adair v. United States (1908), Coppage v. Kansas (1915) and Adkins v. Children's Hospital (1923). The most notable exceptions, where regulatory acts were upheld, were: Muller v. Oregon (1908, working hours for women) and Block v. Hirsch (1921, World War I rent controls).

This had changed by the mid-1920s, as a new weaker test, whether the legislation had fair opportunity to be debated, was introduced: Euclid v. Amber Realty (1926, zoning regulations). The growing influence was the "sociological jurisprudence" of justices Oliver Wendell Homes, Jr. (1902-1939), appointed by Theodore Roosevelt, and Louis D. Brandeis (1916-1939), appointed by Woodrow Wilson. Brandeis had been chief architect of Wilson's progressivist "New Freedom" program.

By 1934, in the New Deal, the court drifted still further from the literal wording, into "non-interpretivism" of the Constitution, replacing it with what is call "judicial restraint" and the weakest test, whether the legislation in question is "not unreasonable." Key cases were Nebbia v. New York (1934, minimum retail price for milk) and West Coast Hotel v. Parrish (1937, minimum wages for women and minors).

The Supreme Court has since acknowledged it is not popularly elected, but the state legislatures and Congress are. Therefore, under judicial restraint, the Court concluded that unless there was a specific reason to question an act of a legislative body, democratically elected representatives should be given a free hand in passing laws, regulations, and taxes: Williamson v. Lee Optical (1955) and Ferguson v. Skrupka
(1963). This is to say, free to legislate unchecked, just as Madison had found in study of the histories of failed republics.

ANTITRUST AND GOVERNMENT GROWTH

As a consequence, Progressive statism had strong, sustained growth in the years before World War I. Weaknesses in the Sherman Anti-Trust Act of 1890 became apparent in the Beef Trust case of 1902, Standard Oil Co. of New Jersey v. United States (1910, fifteen years after John D. Rockefeller had retired), and American Tobacco Co (1911). Theodore Roosevelt used antitrust weakness as partial justification for creating the Department of Commerce and Labor in 1902. In four years, 1909-1913, William Howard Taft's administration brought 44 Sherman Act indictments. Anti-trust was tightened through the Clayton Act modifications of 1914 and partially duplicated through the Federal Trade Commission (1914). Given the outcome of the Microsoft case earlier this year, economists may debate whether anti-trust in this country is industrial planning masquerading as industrial planning, but it is a very real force irrespective of who wins the argument.

Banking crises, first during the Recession of 1893 and then the run on the banks of 1907-1908 provided the stimulus for the Federal Reserve Act of 1913. Upton Sinclair's fictional *The Jungle* was used in the justification of the Food and Drug Administration (1906).

As previously mentioned, direct popular election of the Senate started with the ratification of the Seventeenth Amendment in 1913. Three months before, the Sixteenth
Amendment had been ratified, providing for a federal income tax, and thereby, the ability of the federal government to finance its own growth.

PROGRESSIVISM AND THE CONSTITUTION

Perhaps most overlooked in the progressive era, the Constitution itself was attacked. In 1913, Charles A. Beard wrote *An Economic Interpretation of the Constitution* in which the false assertion was made that the document was drafted

along lines of social class, particularly to personally aggrandize the framers' own commercial interests. While Beard admitted verification would have to be left to later historian, the work was largely unchallenged for 30 years. Finally, in 1957, Forrest McDonald published the definitive refutation of Beard's thesis in *We The People*.

The presidential election of 1912 was a contest between two supporters of progressivism. Theodore Roosevelt, unable to regain the Republican nomination from his hand picked successor, William Howard Taft, bolted the G.O.P. and founded the Progressive Party, identified by its bull moose mascot. Taft was to finish third and Roosevelt second, with the victory going to an academic progressive, former history professor, former Princeton University president, New Jersey Governor Woodrow Wilson (1913-1921).

Another candidate in 1912 was Eugene V. Debs of the Socialist Party, who received six percent of the vote, the most of any of his party's candidates. Though it never received more than a few percent of the popular vote, both the major parties came to adopt platform ideas from the Socialist Party. As Milton Friedman had demonstrated (*Free to Choose* 311-312) the 1928 Socialist platform of Norm Thomas became the basis of the New Deal, which began in 1933.

NEW DEAL

The New Deal's influence went beyond the executive and legislative branches. While some aspects of the Roosevelt program were overturned, the New Deal itself was upheld by the Supreme Court in the previously mentioned Nebbia v. New York (1934), Ashwander v. Tennessee Valley Authority (1936), National Labor Relations Board v. Jones & Laughlin Steel Co. (1937) and United States v. F. W. Darby Lumber Co. (1941). The worst case of economic intervention was probably Wickard v. Filburn (1942), in which the court ruled though no commerce was involved, commerce was "affected" and that was sufficient. As Macedo summarized it *(New Right* 51): "The problem with Wickard, of course, is that it sacrifices property rights closely bound up with personal autonomy to a policy rather loosely related to Congress's commerce power." With the court supporting government intervention in the economy under the commerce clause, based on theoretical or indirect effects, governmental powers to regulate become virtually limitless: Kentucky Whip & Collar Co. v. Illinois Central R.R. Co. (1937), United States v. Carolene Products Co. (1938), Ziffrin v. Reeves (1938), United States v. Appalachia Electric Power Co. (1940).

In the post-New Deal years, the Supreme Court has adopted a new pattern. Where Marshall court centralized federal powers over commerce at the expense of

the states, subsequent courts supported regulation, or interference, at both the federal and state level.

The largest extension of New Deal socialism was the Great Society of Lyndon Johnson, beginning in 1964, which significantly enlarged Social Security, unemployment, welfare, public housing and urban renewal. New programs were started, the largest and most famous being Medicare, Medicaid and food stamps.

At present, little doubt can reasonably exist that the federal government is generally moving away from property rights protection, while the U.S. Supreme Court is supporting some non-economic rights. In the recent trend, economic rights have diminished, as chronicled by James Bovard (*Lost Rights* 1994). This includes property seizures, diminished privity of contracts, taxation policies, subsidization, land use regulation, water rights regulation, and laxness towards state and local abuses.

The states have utilized the opportunity to abuse, such as the Michigan Supreme Court case, Poletown Neighborhood Council v. Detroit (1981). The negative affects of these may well out-weigh the benefits of industry deregulation of the late 1970s and 1980s.

Alternatively, in non-economic personal freedoms, there have been positions of stronger support for some rights, such as First Amendment free speech in the famous flag-burning case of Johnson v. Texas (1989) and in Ninth Amendment rights of privacy, like Griswold v. Connecticut (1965) and Roe v. Wade (1973). In the executive branch, the deregulation movement also reached into personal liberties with the repeal of the broadcast of "Fairness Doctrine" in 1987, though efforts were made in Congress to reimpose it.

With some validity, the common thinking is the socialism of the political left is the largest threat to economic rights in American society. However, as was pointed out in a 1994 libertarian book review (Powell 9), some prominent conservatives have launched attacks as well. These include Russell Kirk on the Declaration of Independence, Irving Kristol and Jeane Kirkpatrick on Thomas Paine, Robert Bork on individual rights outside of those listed in the Bill of Rights, and Chief Justice William Rehnquist on distinguishing between right and wrong.

Too many other aspects remain to be covered in one short paper. Many of those mentioned above deserve far more space than present practical limitations allow. A "Part II" will have to be left to next year to discuss these.

As examples, they include the destruction of the Jacksonian spoils system. Often depicted as politically corrupting evil, spoils made office holders more responsive. Resulting from the assassination of James Garfield in 1881 and the succession of Chester Arthur, who was so bad, as a sitting president he could not get the Republican nomination in 1884, serious questions can be raised as to whether and how big a favor it was when Senator George H. Pendleton of Ohio introduced the Pendleton Act in 1883. It gave the federal government the civil service system

and the public a political, economically uncaring -- due to the altered incentives, unresponsive, entrenched bureaucracy.

A solid case could be made for the Great Depression of the 1930s having been avoidable. Economic historians might talk of the recession of 1929-1930, if the Smoot-Hawley Tariff Act of 1930 had not been passed and the Federal Reserve acted sooner in the banking crisis in 1929 and had not hiked interest rates in 1931.

Another area is in recent American history. In 1995, Senate Bill S-1 banning unfunded federal mandates was passed and signed into law. Previously, Congress has simultaneously both distorted the economic system and further centralized power through the passage of a phenomenal 174 state, local and business spending mandates within the previous 20 years. This was a constitutional question under the Tenth Amendment.

Numerous current kindred issues could also be discussed, as subjectively being less than key economic turning points, but still significant influences. Examples could include technological, transportation and communication innovations, or the linkage of politically popular concerns, such as crime, to diminution of personal rights, including property, under the Second, Fourth, Fifth, Ninth and Fourteenth Amendments.

In turn, the rise and fall of these issues could be linked to taxing and spending patterns, especially including Keynesian autonomous spending, at the federal, state and local levels. An examining of more quantitatively specific effects of civil rights, welfare, retirement, family leave, health care, environmentalism, trade restrictions, et cetera, will eventually have to be done. The final question to be addressed is: what events today can be identified and influenced that will have a major affect in the future?

The need for economic understanding in this area can best be explained by the continuous references by writers in law, history and political science to there having been, and changes subsequent to, an era of "American Laissez-Faire Capitalism." Shays' Rebellion, Hamilton's "Report on Manufactures" justifying protective tariffs, Whiskey Rebellion, Fries' Rebellion, Louisiana Purchase, Homestead Act, Civil War, Reconstruction, ICC, FTC, FDA, New Deal … just when was this era?

ENDNOTES

[1] This first appeared in colonial newspapers as "The united voice of all His Majesty's free and loyal subjects in America – liberty, property and no Stamps."

[2] In *Rights of the Colonies* (1764 64) Otis actually said, "No part of His Majesty's dominions can be taxed without their consent. Thus, "Taxation without representation is tyranny." is an attributed abbreviation, as is "No taxation without representation."

[3] A fifth and last, the Great Northern, was built without governmental support. It was also the only one that did not go bankrupt.

[4] How well capture theory worked for the railroads was evidenced by the appointment of Thomas Cooley, a lawyer with years of experience representing railroads as the first commissioner, and by the ICC's solution to the long-haul, short-haul differential by raising the long-haul rates. Populism was composed of a number of factional groups: People's (Populist) Party, Greenback Party, Farmers' (Northern, Southern and Colored) Alliances, Knights of Labor and the Grange movement were the most important.

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