REGULATION, THE AMERICAN COMMON
MARKET AND PUBLIC CHOICE

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I was asked by the sponsors of this Symposium to speak to you about the contents of my paper: "Regulation and the American Common Market" which appeared in a small book entitled: Regulation, Federalism, and Interstate Commerce.¹ I immediately accepted since I know that the only way to get books out today is to have the author go on the road for talk shows. The book is then sold not to be read, but as a souvenir of the event. So those of you who want something to take home with you to help remember an interesting weekend in New Haven can buy a copy of the book.² A better value than a plastic ashtray. Somehow, the topic of federalism has not caught on with the Johnny Carsons of the world. So this Symposium was my next best offer.

I came across the only evidence that this book had yet been noticed one early morning in January while jogging through the streets of Philadelphia. I came upon the University of Pennsylvania Law School and made my way inside to check up on that venerable outpost of American legal culture. A librarian, doubtless desirous of letting the law school community know of the important things going on in the library, had arranged a display of recent acquisitions. Each book was accompanied by a topic heading such as: "First Amendment Freedom," "Prisoner's Rights," "International Justice," and so on. In one corner of the display case was the heading "Money," and under this heading was placed my book. Somehow I felt that I had been put down. It was as if the librarian had looked across the case and seen all the freedoms and rights sitting there, and felt that it was just slightly unbalanced, that there were other aspects of law that had some

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² From: Oegeschlager, Gunn & Hain, Inc., 1278 Massachusetts Ave., Cambridge, MA. 02138, for $22.50.
role to play, and had scurried around to find a book with the missing element: "Money."

I felt put down because it had not previously occurred to me that my paper was about "money." It's not that I have anything against money, and in fact one of my deep and continuing interests has been in the regulation and control of national monetary and banking systems. It was just that I had thought that my paper, like the other books in the display case, was about freedom too, and, in particular, about the freedom obtained through the decentralization of power. But the librarian, like so many contemporary analysts, felt that freedom had to do with political guarantees and had nothing to do with an economy and its regulation.

My paper is about only one aspect of the relationship between decentralized power and freedom. It is about the argument that economic regulatory power should not be decentralized because it leads to barriers to trade. We need national power over commerce, we need a European common market—so the argument goes—because otherwise local, petty, squabbling states will erect barriers to trade and leave us all the poorer. Governments of wide geographic reach are the friends of free markets.

I began work on this topic because this view of the matter left me vaguely uneasy. I was puzzled about why states would engage in such self-destructive behavior. I had learned in law school that the states under the Articles of Confederation had engaged in policies designed to undermine interstate trade and that the Supreme Court, under the Commerce Clause, had played an important role in stopping such unneighborly behaviour by the states. The Constitution and the Supreme Court were the heroes of the story, the state the villains, a view of the world quite attractive to a young man hoping someday to qualify as a master of the intricacies of federal law and practice. But why, I wondered, had the states under the Articles of Confederation—or more generally why would small sovereignties—deny themselves the gains from trade that economics so powerfully taught me were available for the asking.

I also knew from my study of regulation that states of large geographic reach are not necessarily the friends of free internal trade. I knew that in the United States numerous federal regulatory schemes had been designed to favor one group or region over another group or region. I knew that agricultural price supports had been designed to favor the agricultural producing states over
the consuming states. I knew that the minimum wage had been
designed to handicap Southern states in low-wage competition
with the Northern states. I knew that the rate structures of the
Interstate Commerce Commission had favored the east-west
movement of goods over the north-south movement of goods. I
knew that Interstate Commerce Commission regulation of truck-
ing had restricted trucking service in interstate commerce.
Outside the United States, I was aware that in Canada the federal
government had captured a portion of the wealth of the Western
oil-producing provinces and transferred it to the East, and that in
Europe one of the policies of the European Common Market was
to cut off free trade in agricultural products in order to favor the
agricultural exporting nations. None of these policies qualify as
policies of free internal trade.

I was hardly prepared, however, for what I found when I turned
to review the role of the Constitution in protecting freedom of
trade in the internal American market. First, when I went back to
review the documentation of the claim that the states under the
Articles of Confederation had in fact impeded trade among them-
Cartes, I found nothing to support the claim. The Federalist papers
keep suggesting that this was a serious problem, but if you read
carefully you are struck by the consistent failure to give examples
and the constant reference to possibilities. It’s as if the author did
not really believe the charge. This theme of the Federalists was
picked up and popularized in a book by John Fiske, whose color-
ful rhetoric made its way into Supreme Court opinions and from
thence into the legal culture. The problem is that there isn’t a
shred of evidence to support the claim, and Fiske’s unscholarly
work has been completely discredited by the modern work of Mer-
rill Jensen. The basic reason why this was not even an issue
under the Articles of Confederation was that there simply was
very little trade among the states in the eighteenth century. The
important interstate commerce that existed occurred within New
York Harbor among Connecticut, Manhattan and New Jersey,
and that commerce, aside from one spat over New Jersey’s unwill-
ingness to join the other colonies in sanctions against British ship-

3 The Critical Period in American History 1783-1789 (1888).
4 The New Nation, A History of the United States During the Confederation
either history or example.”
ping, proceeded smoothly and free of regulation throughout the period.

The Constitution contains no explicit commitment to a national common market, although numerous clauses such as the provision of a national post office, the provision of federal admiralty jurisdiction, the provision of a federal bankruptcy power, seem directed to linking the commerce of the states together. My best reconstruction of the intent of the drafters is that they expected the principal instrument of national economic integration to be the commerce power, to be used affirmatively by Congress to create national laws of commerce and trade. But when Congress assembled it was in no mood to so assert national power. The battleground became the proposals for a Bank of the United States—from a modern perspective a modest and reasonable proposal for federal support of a national payments system. With the defeat of the Bank idea and the rise of the Jacksonians, the national power over commerce languished for more than a century, then only to be revived in the New Deal for far different and more ambitious purposes.

The notion of an American common market lived on, however, in the Marshall precedents of the Supreme Court. John Marshall, the last surviving federalist, diffidently advanced the idea that the commerce power, of its own force, invalidated barriers to trade among the states in Gibbons v. Ogden. As Charles Black observed in his comment on my paper, "it is hard to believe that a world in which the [lack of a] right of New York to forbid any steam navigation to or from other states—except by two named people and their assignees—can be doubted for even a moment is one in which the Constitution is perceived, or has recently been perceived, as having had as its chief purpose the sweeping away of restrictions on commerce and movement among the several states." Marshall was able to save the cause of interstate commerce by strained reliance on a federal statute. The arrival at the Court of Taney, who as Jackson's Secretary of the Treasury had led the fight against the Second Bank of the United States, meant that the doctrine would have no importance until after the Civil War.

After the Civil War, however, the Court picked up the idea and

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5 9 Wheat. 1 (1824).
6 REGULATION, FEDERALISM AND INTERSTATE COMMERCE, supra note 1, at 61.
for fifty years attempted to police state interference with inter-
state commerce. It is a nice example of how an idea of absolutely
no merit put into a Supreme Court opinion can, over the course of
time and in response to the felt needs of a different age, acquire
the status of venerable authority. Although the Court invalidated
numerous state statutes, it is difficult to take the importance of
the negative commerce clause doctrine very seriously. For one
thing, state subsidies were never subject to judicial review, and
nineteenth century American states made extensive use of subsi-
dies to affect the flow of interstate commerce. The most spectac-
ular example is Pennsylvania, which engaged in a vast public works
program to overcome the fact that the natural flow of her riv-
ers—and hence her commerce—was north and south rather than
east and west. The motivation was purely political—to link the
commerce of Pittsburgh and Philadelphia, and to deny to New
York and the port of Baltimore commerce naturally tributary to
them.

Second, by the time the Court became serious about the nega-
tive commerce clause doctrine, it was already saddled with the
decision in Bank of Augusta v. Earle, 7 which held contracts of
corporations to be within plenary state power and Paul v. Vir-
ginia, 8 which held that contracts of insurance were not commerce.
The result was a system of constitutional doctrine and a system of
state regulation built upon that doctrine which treated (and con-
tinues to treat) the areas of banking, corporations, contracts, se-
curities, insurance and personal services as outside the protection
of the negative commerce clause. From a functional point of view,
a common market which recognizes freedom of trade in physical
goods but not freedom of trade and exchange in relation to those
goods is a very poor common market indeed.

This distinction in the Court’s jurisprudence created a very nice
natural experiment to provide some measure of the extent to
which the negative commerce clause was actually important in
sustaining freedom of trade. If the negative commerce clause was
important, then our law should be much more receptive to the free
movement of physical goods than to the free movement of pay-
ments, contracts, insurance and securities.

There is certainly much about the form of American law to

7 38 U.S. (13 Pet.) 517 (1839).
8 75 U.S. (8 Wall.) 168 (1869).
suggest that the negative commerce clause has been important. Corporations are organized in a particular state and must get permission from, and pay entrance fees to, each state they enter. Insurance companies have to qualify to do business in each separate state. Securities must be approved for sale in each separate state. Yet, if one looks beyond form to substance, there is little evidence that there is not a true national market in corporations, securities and insurance. The competitive pressure on the states has caused them to operate their regulatory systems in a coordinated and harmonious way that permits a corporation to easily do business throughout the nation, securities to qualify in every state, and insurance companies to do business everywhere.

Conversely, if one looks at areas where the federal government has taken a strong regulatory hand, one sees that the principle of an open national market often suffers. The most spectacular recent case was the oil price and allocation regulation, which made it a violation of state law to resell oil across state lines. Natural gas price regulation has similarly restrained the interstate market in natural gas and ironically operated to favor the producing states. The list is long, and not to the credit of the federal government.

I want to close by discussing a contemporary problem. As Murray Weidenbaum correctly pointed out in his comment to my paper, one of the strongest drives for national regulation of commerce comes from the corporate business community. They argue that federal regulation is clearly superior to state or local regulation, because it at least provides a uniform standard. How can we produce efficiently if we have to comply with hundreds of different local regulatory codes, they argue, codes that regulate the kind of pipe that can be used in buildings, the kinds of detergents that can be sold in stores, and so on. Give us a national standard, any national standard.

These arguments reflect, of course, the short-term perspective of modern management. In exchange for the short-run simplicity of a uniform standard—even an unreasonable, harmful standard—they are willing to give up the natural protection afforded by competition in the setting of the standard. Consider the use of plastic pipe in residential construction. The plastic pipe industry has long been engaged in a regulatory war against the entrenched interests

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9 Regulation, Federalism and Interstate Commerce, supra note 1, at 84.
of the metal pipe industry. Over hills, through vale, city council, county commission, they have been forced to argue the merits of plastic pipe, not always successfully. Wouldn't it be much simpler to have a national law that said: PLASTIC PIPE IS OKAY? But is it so clear, if we had already had a national law saying: USE METAL PIPE, that the plastic pipe industry would ever have been able to get started, and to prove through use the superior properties of its product? Who, after all, wants plastic in their basement?

An important current issue concerns products liability. A number of astute observers feel that current developments in state products liability law represent a "soak it to the rich out-of-state corporation" philosophy. They are concerned that rules that shift the costs of accidents from the user to the manufacturer diminish the incentives for user care. Out of these concerns and the very real and mounting costs of product liability comes a drive for a federal law of products liability.

It seems to me desirable to let the states compete in the provision of products liability rules. If the citizens of a state really want their purchase of every product to be tied to the purchase of a complex and overlapping accident protection insurance policy, why not let them have it. If they don't want it, I have no doubt that the voters can correct the courts. But this competition will only work if the voters in a state with rigorous liability rules pay the cost of those rules. If a state can purchase the goods at a national market price and then add on the insurance coverage free of charge, each state has an incentive to be the most rigorous, exporting the greatest cost to other states.

Given this view of the problem, I think the appropriate solution should not be to have a federal law of products liability. Instead, there should be a federal law that permits manufacturers to sell their products in states at prices which can take into account their differential liability exposure. If California wants to impose costly liability, then the product sold in California should carry a higher price. But if a manufacturer cannot control the distribution of his product after it leaves his factory, he cannot charge differential prices. The simplest solution would be to permit manufacturers to label their products by state, and to provide that the state of label should provide the controlling products liability law. Then each package of product plus liability law could be correctly priced. If the citizens of California then develop a strong demand for
Wyoming labeled products, I would let merchants satisfy that demand. That market demand would provide the law makers in California with some very important information.

If you think this idea is far-fetched, I would suggest that it is very close to the system that we have used in corporation law, and that it has worked very well, as Judge Winter will shortly explain.