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Reclaiming Liberty: How States Can Revive the 10th Amendment and Save the Constitution

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Key Points

- It is vitally necessary to restore the original Constitution's separation of state and federal functions. Federal and state finances should be strictly separate, as should federal and state regulatory activities.
- Restoring the 10th Amendment also requires defeating barriers to competition, and restoring economic liberty.
- Texas can be an example for other states, and create the constituency for liberty needed to restore the 10th Amendment.

Executive Summary

Starting in 2009, a historic grass-roots movement swept America to demand a return to the Constitution's framework of limited government, economic freedom, and personal responsibility. In the years since then the movement has changed the debate in our country. But the task of reclaiming liberty under our Constitution is a daunting one. Coming up with the right strategy requires a better understanding of how the progressive movement has damaged our Constitution over the past 100 years.

From its founding in 2010, the Center for 10th Amendment Studies of the Texas Public Policy Foundation focused on studying the damage done and devising ways of fixing it. The Center's first major Policy Perspective, *Reclaiming the Constitution: Towards an Agenda for State Action*, was co-written by the current author and a young former Texas solicitor general named Ted Cruz. The years since then have been ones of inspiring dialogue among defenders of liberty from every part of the country. The Center for 10th Amendment Studies has remained engaged in that debate, dedicated to its mission of studying the constitutional landscape, in order to devise a more perfect agenda for action. Now, as the Center for 10th Amendment Action, it tries to shed new light on that constitutional landscape, and presents lessons learned in a newly revised *Agenda for State Action*.

Part I of this paper offers a brief constitutional history that penetrates more deeply into the constitutional destruction wrought since the progressive and New Deal movements of the last century. That history is retold in order to help improve people's understanding of how we got where we are and how crucial it is to revive the 10th Amendment. Part II examines the state powers side of the 10th Amendment, with a focus on the problematic intermingling of state and federal functions in the various schemes known as "cooperative federalism." Part III examines the individual liberties side of the 10th Amendment, focusing on problems of overregulation and government-created cartels that drown our society in barriers to competition. Part IV sets forth a new *Agenda for State Action.*

Our Constitution was fashioned to protect the public from the power of special interests. But the progressive movement transformed it into one that protects powerful special interests from the public. The progressive agenda of preferences for special interests, often in the form of forced economic transfers, diminishes individual liberty and subordinates private property rights to government power. The results include hidden costs on individuals, expanded government power at both federal and state level, and a Constitution that is badly damaged. The fight to reverse the constitutional destruction of the progressive movement is at the root a fight to take government back from special interests and put it where it belongs, in the hands of our people.

How the 10th Amendment Collapsed

For centuries, the kings of England had granted special favors for favored courtiers, in the form of monopolies and cartels granted by the crown. These "crown monopolies" (which

continued

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ranged from the sale of playing cards to the commodity imports of the East India Company) entailed a general prohibition on anyone other than the favored courtier engaging in that activity. By protecting its key supporters from competition, the crown guaranteed them huge profits at the expense of everyone. And by prohibiting others from competing against them, the crown held back the entire economy.

When the Glorious Revolution of 1688 made Parliament preeminent, one of the first things Parliament did was to end the era of crown monopolies, by severely restricting the king's power to regulate commerce. Freeing English society from the straightjacket of crown monopolies helped to unleash the productive power of English society and pave the way for the Industrial Revolution.

When backed by government power, monopolies and cartels hurt the public because they result in fewer goods and services, and prices well above what the free market would charge. They also prevent the society's human and material resources from being allocated to the most productive uses through competition, leaving everyone worse off.

Still, granting monopolies and cartels has always been one of government's favorite ways of catering to "special interests"—which were called "courtiers" in the monarchical era, and "factions" in the *Federalist Papers*. The tendency to cartel-formation was evident in the American colonies even after the Glorious Revolution, but agreement was reached at the Philadelphia Convention not to protect the monopolies formed in the colonial era.

For the Framers, opposition to government favors for special interests was part and parcel of their enmity towards tyranny. Their procompetitive bias was enshrined in the federal structure of the Constitution, with its limited and enumerated federal powers, and exclusive state jurisdiction over most economic activity. That procompetitive bias was also carried forward in the freedom of contract that the Supreme Court defended as part of due process rights, and, which, through the 14th Amendment, was enforced upon the states. When New York sought to restrict the hours that bakers could work in their shops, the Supreme Court struck down the law as a violation of due process, in the famous case of *Lochner v. New York* (1905).

Soon after that, however, the progressive and New Deal movements championed a dramatic expansion of government power over economic freedom, supposedly justified by the need to protect the public from the dangers of competition in the free market. The progressive movement championed a variety of restrictions on labor and agriculture—two areas in which industrialization was bringing about historic changes. For example, though all the states had child labor laws on the books, the progressives were able to secure congressional passage of a restrictive federal standard, which the Supreme Court quickly struck down as exceeding Congress's power to regulate commerce "among the several States."[1]

Though the progressives were originally Republican, the progressive agenda soon reappeared as the New Deal of the Democrat's Franklin D. Roosevelt. Though the New Deal is often remembered for its large public works projects, such as the Tennessee Valley Authority, virtually all the New Deal legislation was designed to create monopolies and cartels either in labor or agriculture, through laws such as the Agricultural Stabilization Act, the National Labor Relations Act, and the Fair Labor Standards Act. Those laws imposed severe restrictions on the sale of agriculture and labor. As with the federal child labor law, they were at first consistently struck down by the Supreme Court as exceeding the federal commerce power.

But in the pivotal year of 1937, the Supreme Court finally bowed to the political power of the New Deal, and started approving the New Deal in a series of decisions culminating in *Wickard v. Filburn* (1942), in which the Court ruled that Congress could regulate the wheat a farmer produces for his own consumption on his own farm.[2] From then until the present day, the Court would do little more than rubberstamp every new expansion in federal power.

Many Americans have rightly pointed to the New Deal as the fatal blow to the Constitution's framework of limited and enumerated powers. But the political forces that forged the New Deal and have continued to expand it to the present day are more deeply entrenched than meets the eye, from one end of the political spectrum to the other.

Many defenders of liberty believe that the federal government robbed the states of their proper role as the vehicles of self-government. But that fatally oversimplifies what really happened. Far from being robbed of their 10th Amendment prerogatives, state governments freely gave those prerogatives away, in exchange for protection from competition for themselves and their special interests.

The New Deal expanded federal power not in order to displace state power, but to absorb it and reinforce it. Federal power was layered on top of state power, and government at both levels expanded dramatically. Indeed, virtually all the growth in the American public sector since World War II has occurred at the *state and local* level. It is no coincidence that this administrative and fiscal expansion at the state and local level resulted chiefly from an expansion in *federal* power. With federal and state power overlapping, both federal and state officials developed an enormous incentive to expand government power at both levels.

The story was one of collusion among politicians of every party at every level. Federal officials discovered that by deputizing state officials, they could expand their own power just as effectively, while escaping accountability. Meanwhile, under the umbrella of heavy federal regulation, state officials learned to exploit their citizens, and the citizens of other states, chiefly through the formation of government-backed monopolies and cartels—such as the California raisin cartel sustained by the Supreme Court in *Parker v. Brown* (1943).[3] Uncompetitive states learned to use the federal machinery as a cudgel to eliminate the advantages of competitive states—for instance, by imposing a high minimum wage on poor states. At both federal and state level, government officials won. Liberty lost.

Despite today's out-of-control government, progressive policies continue to prevail in the arena of public opinion because of the amazing success that progressives continue to have in hiding the true costs and consequences of their

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policies. Despite an abundance of studies demonstrating that the minimum wage increases unemployment and hurts the poorest of the poor,[4] more than 76 percent of Americans support an increase in the current minimum wage. This is not because Americans believe that higher wages for a smaller number of workers is worth the consequence of higher unemployment. On the contrary, Americans appear generally unaware that such policies have any undesirable costs at all, and progressive leaders encourage that woeful mistaken belief: President Obama recently went so far as to deny there is any evidence the minimum wage increases unemployment, when in fact *most* studies on the subject suggest that it does.[5]

Many progressive laws, such as the Clean Air Act and Endangered Species Act, specifically prohibit regulatory agencies from considering costs in their rulemakings. As a result, local communities have no defense against such tragedies as the endangered listing of the Northern Spotted Owl, which wiped out some 30,000 jobs in old logging communities in the Pacific Northwest without helping the Spotted Owl one wit. Other progressive laws, such as the Americans with Disabilities Act, are designed to hide the costs to the point that virtually nobody has the faintest idea what they are, or that there are any, despite the visible pervasiveness of the ADA's impositions in virtually every corner of society, in poolside wheelchair lifts, public bathrooms, redundant transportation services, specious employment discrimination claims, and even higher unemployment for the disabled themselves.[6] And for a sense of the pervasive power of progressive ideals, consider that all three laws mentioned in this paragraph were signed by Republican presidents.

The preference for denying rather than justifying costs is especially damaging to constitutional liberties because many policies involve hidden transfers of wealth from some people to others. This is true both in terms of federal-state relations, where the federal government systematically redistributes wealth from some states to others, and among citizens where

government cartel arrangements (e.g., occupational licensing, dairy regulations, etc.) force people to pay prices well above cost, without ever knowing it, only to pad profits for special interests. President Obama justifies these policies by reference to "social justice" and "spreading the wealth," but many of those policies—such as the cartelization of the agricultural sector—impose higher food prices on the working poor in order to pad profits for millionaire farmers.

The old Constitution (e.g., the Constitution as it was understood before the New Deal) was unhelpful to the progressive agenda, because it effectively prohibited the taking of private property without due process and just compensation. The progressive agenda, by contrast, is one of pervasive redistribution, so it needs a constitution that allows the government to trump private property rights at every turn. And that's just what the Supreme Court gave progressives starting in 1937, when it abandoned the "freedom of contract" of the *Lochner* era and embraced sweeping regulatory powers for both state and federal officials.[7]

The progressives' penchant for forced transfers is not limited to federal government. State governments are if anything even worse offenders, regardless of party. The New Deal's expansion of federal power did not significantly diminish state power, as Michael Greve points out in *The Upside Down Constitution*. Under the old Constitution, exclusive state jurisdiction over most economic activity created conditions of regulatory competition among the states, which tended to keep regulation to a minimum. But because the dramatically expanded federal power was layered on top of state power (rather than *displacing* state power), it stifled that regulatory competition, and replaced it with a systematic bias in favor of overregulation at every level.

Because the New Deal subordinated the state governments to the federal government, there was no need to diminish their power. Under the federalism of the progressive agenda, state governments are just deputies of the federal government, regardless what party controls them. Therefore, when the feds enhance state power they are really enhancing their own—while escaping accountability for the results. That explains why ObamaCare relies so heavily on states to expand their Medicaid programs and set up insurance exchanges: compliant states expand their reach, but only in order to faithfully implement federal policy.

The progressive's success in hiding the costs of their policies from the public accounts for the broad bipartisan support that many progressive policies continue to have to this day. Few state legislators of any party resist "cooperative" federal grant programs that subordinate them to federal policy, because those programs dramatically inflate their budgets. Enticed by federal subsidies, no less a conservative than former Senator Sam Brownback is now, as governor of Kansas, presiding over an egregiously wasteful ethanol subsidy. Farm state Republicans such as Senator Chuck Grassley of Iowa remain stalwart supporters of the New Deal's cartelization of the nation's agricultural sector. Few members of Congress would vote to repeal Medicaid, Medicare, or Social Security—all programs of dubious constitutionality that provide services which were once the exclusive province of state governments.

Supporting these pillars of the progressive agenda does not merely make them intractable. It also means embracing the constitutional destruction that paved the way for them. Up until a century ago, the Constitution put government in the role of protecting the public from special interests. But in the second quarter of the 20th century, the federal government and virtually all of the state governments simply switched sides, and jumped into the business of protecting special interests from the public, that is, from competition. That was the program of the progressive and New Deal movements, and in order for it to survive constitutional review at the Supreme Court, key elements of the Constitution had to be written out it by the Justices.

As it had been drafted, ratified, and handed down for 150 years, the original Constitution achieved a careful division of federal and state authorities, with little overlap between them. Because they had to compete for businesses and people—their own first of all—they forged regulations just robust enough to satisfy voter choice but not much more intrusive than that. The resulting political break on government interference gave added protection to economic freedom. Because most areas of regulation were left to the states, and subject to regulatory competition among them, the result was a strongly procompetitive bias in our government institutions.

This arrangement of government powers left state and federal officials few levers with which to dispense favors upon

special interests. The competitive federalism of the original Constitution thus reflected an essential tenet of the Enlightenment in England, which held both self-government and the right to enjoy one's property in economic freedom as essential protections against tyranny.

In this sense, the "progressive" movement was tragically misnamed, for in fact it was a throwback to the era of crown monopolies. In order for the progressive and New Deal movements to accomplish their aim, it was necessary to remove those elements of the Constitution that had been put in place precisely to protect against government capture by special interests. That included the whole edifice of limited and enumerated federal powers, one of the most essential design features of the Constitution, without which the rest of the document would never have been written the way it was, much less ratified by all 13 colonies.

The structural framework of limited and enumerated federal power was made explicit in the 10th Amendment. Under the 10th Amendment those powers not expressly delegated to the federal government are reserved "to the States *or* to the people" depending on the nature of the power in question. Thus the 10th Amendment has two dimensions: one concerns the allocation of state and federal powers, while the other concerns the relationship of individual freedom and government generally. In both cases, the goal was to protect people from the power of government.

It was in order to protect the people, not the states, that the old Constitution imposed "exclusivity" in the form of separate spheres for state and federal power.* The original system of exclusive state jurisdiction over most matters was essential to "competitive federalism" and its downward pressure on regulation, which created an institutional tendency toward limited government. Hence, when the New Deal layered federal power on top of state power, rather than displacing it, both sides of the 10th Amendment were effectively gutted. A concurrent expansion of federal and state power was necessary for government officials at every level to be able to satisfy special interests' voracious appetite for protected monopolies and cartels, which was—and still is—the whole point of the progressive movement.

In order for the progressive and New Deal movements to accomplish their aim, it was necessary to remove those elements of the Constitution that had been put in place precisely to protect against government capture by special interests.

The disastrous loss of "exclusivity" transformed the institutional framework of the Constitution from one biased in favor of economic freedom and minimal regulation to one biased in favor of weak property rights and overregulation at every level. Both state and federal officials wanted ways to expand their power while escaping accountability for the results. Gutting both sides of the 10th Amendment paved the way. On the federalism side of the 10th Amendment, state governments went from being responsible—and accountable—for most things, to being willing field agents of the federal government, albeit with vastly expanded budgets and regulatory fiats. And on the 10th Amendment's individualist side, federal and state officials would now conspire to protect their key constituents from competition—in other words, from the public.

The struggle to save the Constitution is not a question of states rolling back federal power. It is one of rescuing individual liberty from a conspiracy of federal and state officials whose highest priority is often to satisfy special interests. If the fight to reclaim our Constitution has any chance of attaining its epic objectives, its mission must be to destroy the twin towers of the progressive movement—cooperative federalism and the cartel state. In a word, its mission must be to revive the 10th Amendment.

* "Exclusivity" here refers to the lack of significant overlap among federal and state authority. Under the original Constitution's framework of limited and enumerated powers for the federal government, the states were thought to have a general regulatory authority (which used to be called "police power") that extended to everything not specifically delegated by the Constitution to the federal government. The federal government had no power over things not specifically delegated to it. Under the original commerce power, for example, few transactions could be subject to both federal and state regulation, because the federal power extended only to things in interstate commerce, whereas the great mass of purely intrastate transactions were subject exclusively to state jurisdiction, as the historic case of *Gibbons v. Ogden* (1824) makes clear.

Reviving the 10th Amendment requires destroying the two towers of the progressive movement—cooperative federalism and the cartel state.

This will require convincing broad swathes of the American public of two basic propositions. First, with rare exceptions, state and federal functions should be kept strictly separate, even where state and federal jurisdiction overlap. Second, again with rare exceptions, government should not limit the freedom of contract by granting protections from competition, for the same reasons that the U.S. long ago rejected protectionism in foreign trade. This paper fleshes those two principles out into legislative proposals that grass-roots can rally behind: a new Agenda for State Action.

The Trojan Horse of Cooperative Federalism

There are two main species of "cooperative federalism." In the first, the federal government says to the states, "Here is a lot of money you can have if you comply with 100 conditions, otherwise you get nothing." In the second, the federal government says to the states, "We will let you implement this federal program if you comply with 100 conditions, otherwise we will do it ourselves." In ObamaCare, the Medicaid expansion requirement is an example of the first, while the state insurance exchanges are an example of the second.

Both kinds of cooperative federalism boil down to federal coercion of state governments. At the Supreme Court, such deals have been granted special dispensation, on the wholly erroneous theory that "encouragement" in the form of mild coercion should be allowed because it does not "cross the point at which pressure turns into compulsion."

Coercion is coercion whether the penalty is one dollar or a million; it is the existence of a penalty of any scale that creates the coercion. State legislators know all too well that these programs are coercive well past the point at which pressure turns into compulsion. Whether in transportation, education, healthcare, or environmental regulation, states operate within a straightjacket of requirements that the federal government imposes as a condition of either federal money or federal permission to regulate.

A large number of states gladly accept these conditions—namely those uncompetitive states that already have similar programs under state laws, or want them, and want to be protected from the losses they will otherwise suffer from interstate regulatory competition. Moreover, state officials of every party and every state find the allure of free money and enhanced regulatory power irresistible—or politically impossible to turn down. Even for the most procompetitive legislator, freedom of choice is illusory, because constituent pressure to accept the federal "offer" is usually overwhelming.

Conditional Federal Grants

On the spending side of cooperative federalism, the stage was set by a dramatic expansion in the federal spending power after the 16th Amendment, which allowed Congress to impose income taxes without apportionment among the states. With the national highway system, the federal government began transferring to states governments a greater percentage of GDP than total federal revenue just 50 years earlier. Then, in the 1960s, two programs dramatically expanded the amount of federal "assistance"—education funds for poor local area school districts, and Medicaid, of which Medicaid is by far the most damaging, and by far the worst from a constitutional point of view. Indeed, even while upholding ObamaCare in *NFIB v. Sebelius*, the Supreme Court noted that the threat to cut off all Medicaid fund, about 10 percent of the average state's budget, was a "gun to the head."

These federal programs inflate state budgets well beyond what states would be able to sustain with their own tax revenue. From a procompetitive legislators' point of view, it can feel like coercion, but the truth is that state governments are running a *huge profit* on the racket of cooperative federalism. Because of the infusion of federal funds, states are able systematically to spend almost *40 percent more* than they generate in taxes. In fact, this state fiscal surplus accounts for virtually the entire federal deficit. Since the early 1980s, federal assistance to the states has averaged about 3.0 percent of GDP. During the same period, the federal deficit has averaged 3.4 percent of GDP.

So what's going on here? Why would the federal government raise massive deficits only to transfer almost all of that borrowed money to state governments? State governments have their own taxing authority. Why do they need so many hundreds of billions of dollars in federal "assistance" every year?

The answer is that they don't need federal help. At the most basic level, it is the federal government that needs the states' help—to expand its power while escaping accountability for the results. So it raises huge deficits in order to purchase control over state governments, by inflating their budgets to the point of utter dependency. That's how Congress buys the obedience of state officials, regardless of party, and regardless how much their constituents might prefer a state alternative to the federal program. The scheme also offers a way for uncompetitive, big-government states to eliminate the competitive advantage of small-government states. That is the real reason that state and local government have grown to such staggering lengths since the 1950s. State legislators, regardless of party, find it virtually impossible to turn down the federal offer to return *to them* the money already taken from their constituents—under the coercive threat of transferring the money to other states.

The scheme is deemed mere "encouragement" by the Supreme Court, thus giving Congress plenty of room to circumvent the prohibition against commandeering that the Supreme Court otherwise pays such strident lip service to.[8] The Supreme Court has given Congress far too much latitude in using the spending power for redistribution and, in this context, for manipulating state policies. The spending power was granted to let the federal government provided "for the General Welfare of the United States." That would seem to preclude providing for the general welfare of one state and not another, as the threat of conditional federal grants implies.

Moreover, the intermingling of state and federal finances causes endless practical problems. States are left at the mercy of congressional appropriations and dependent on federal bailouts every time there's a downturn in the economy. If the federal government wasn't sucking so much money out of the private economy to pay for these programs, the states could run them more efficiently and sustainably on their own, and there would be much more money left over for private investments. These programs, which are meant to equalize income disparities among the states, actually exacerbate them, especially through the tactic of matching funds. For example, under Medicaid, rich states can afford bloated Medicaid programs and are rewarded with federal matching funds. Poor states are penalized.

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Under the Supreme Court's fictional distinction between encouragement and compulsion, the federal government is very simply taking over state government. And what that really means is that the uncompetitive states are taking over the competitive ones in order to impose an uncompetitive baseline on everybody. The chief casualties are local choice, economic freedom, and of course the Constitution itself.

Conditional Regulatory Preemption

These problems are if anything even more pronounced in the second main species of "cooperative federalism," namely cooperative federal-state regulatory programs. Here the federal government gives states permission to implement some federal scheme so long as they do it the feds' way; otherwise the feds will come in and do it themselves. Examples include the insurance exchanges that ObamaCare requires states to set up, under threat of imposing a "federally facilitated" exchange, as well as many environmental programs, such as the requirement that states process licenses for industries that come within the EPA's unconstitutional new greenhouse gas regulations.

The blackmail is much clearer in this area than in the conditional federal funds context, because the state government is clearly worse off either way. No state would ever willingly enter into a cooperative regulatory program in the hopes of gaining a bargained-for benefit, except as part of a strategy to impose a higher regulatory burden on other states in order to eliminate their competitive advantage. In competitive states with no interest in the proposed federal program, officials are worse off no matter what they do: If they implement the program according to federal instructions, they are left to face the ire of voters who may hate that program. And if they refuse, and the feds come in and do it themselves, they will face the ire of voters who will accuse them of needlessly brining federal regulators in on their heads. Either way, the federal government expands its power, and either way state officials are held accountable by voters.

When the federal government shows up with the blackmail offer of a new conditional regulatory program, it is really California and New York and their coalition of uncompetitive states using the federal machinery to do the blackmailing.

The federal government has an enormous incentive to "allow" the states to do their bidding. Just consider what happened when the state of Texas refused to implement the Environmental Protection Agency's illegal new greenhouse gas regulations. As of the effective date of the regulation, major industries covered by the new permit requirements couldn't operate until the permits were granted. EPA offered Texas the opportunity to process the permits under the new federal regulation, but Texas refused to have anything to do with it, and instead challenged the legality of the regulations in federal court. (The case is now before the Supreme Court). EPA quickly announced—as it is required to do by law—that it would perform the permitting and other administrative functions out of its regional office in Dallas. But EPA simply doesn't have the personnel, expertise or budget to do the tasks it had just, in effect, imposed on the states. So in Texas, urgently-needed permits for industrial activity simply were not processed. Increasingly desperate industrial constituents begged state officials to do the permitting for EPA, and eventually the state of Texas was forced to cave in. For the states, it's a simple choice: either spend money doing the federal government's work for it, or suffer economic losses among their constituents.

Such offers are usually thought of as blackmail, but when the federal government does it to the states, it's called "cooperative federalism." There is of course one set of state officials who have a lot to gain from this scheme, namely our familiar friend, the government of the uncompetitive state that desperately wants to eliminate the competitive advantage of competitive states. When California imposes environmental regulations that exceed the federal standards, as with fuel efficiency standards, it gets clobbered in the interstate regulatory competition. It freely, indeed desperately, wants to give away its regulatory autonomy in exchange for a higher federal standard for everyone, particularly if the higher federal standard corresponds to its own. The Obama administration has happily obliged, announcing new fuel efficiency standards that will cost Americans more, and make cars more dangerous to drive, with negligible benefit to the environment.

When the federal government shows up with the blackmail offer of a new conditional regulatory program, it is really California and New York and their coalition of uncompetitive states using the federal machinery to do the blackmailing. The victims of the blackmail are invariably state legislators who believe in freedom—and those they represent.

Overregulation and the Cartel State

Paradoxically, the individual liberty side of the 10th Amendment is if anything even more central to the federalism struggle. The 10th Amendment was meant to enshrine not just limited and enumerated federal powers, but also the principle of exclusivity—separate spheres for state and federal authority. The result of that concept was the Constitution of "competitive federalism," in which most matters of regulation were left to the states, where interstate regulatory competition created a strong bias in favor of property rights and economic freedom, and against excessive government regulation.

Under the old Constitution, individual state governments were free to form whatever cartels they liked. But without being able to control the movement of goods and people across state boundaries, any state that adopted wide-ranging cartels would be clobbered in the "marketplace" of regulatory competition, where states compete for each other's people and businesses by adopting attractive regulations. For example, a hundred years ago, all the states had laws prohibiting child labor on the books. But some states set the threshold at 14, while others set it at 16. The states with the higher threshold were worried about losing business, and cried out for a uniform federal standard. Before the 1930s, the Supreme Court refused to allow it, because the Constitution was thought to prohibit federal regulation over an area of commerce that was the exclusive domain of the states.

The New Deal frontally attacked that understanding of the Constitution. After Franklin Roosevelt's landslide reelection

in 1936, and his subsequent threat to the "pack the Court" with five additional (pro-New Deal) appointees, the Court backed down. Starting in 1937, all of the of the Supreme Court's New Deal decisions expanding the scope of the federal commerce power were related to government-created cartels either in agriculture or labor—the two pillars of the New Deal's political coalition.

The legacy of the progressive and New Deal movements is thus a body of federal and state law brimming with government-sponsored cartels of every size and description, from occupational licensing to agricultural marketing boards to naked cartels for car dealers and alcohol distributors. This holds true even in the most free-market of "red states." Justifications of public health and safety are usually just a smokescreen to obscure forced economic transfers from the public to special interests. Those cartels create staggering economic losses for the society as a whole.

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

The gross cartelization of the American economy was a natural part of the overall protectionist inclination in American economic policy at the time. There was, in fact, little economic distinction between the export cartels created by the Smoot-Hawley tariffs of 1930 and the multitude of cartels ushered in by the New Deal in domestic and federal law—except that trade protectionism proved instantaneously catastrophic in the Great Depression, and was largely discredited to the present day.

When faced with a crisis such as a recession, and its elevated rates of bankruptcy, the correct public policy is to facilitate the reallocation of human and material resources to positions of maximum productive value as quickly as possible. It was to prevent protectionism by state governments that the Constitution specifically prohibits state tariffs on international trade, and reserves to Congress the regulation of commerce with foreign nations. That is also why it is so important to let the federal Bankruptcy Code operate without government manipulation. Reorganization in bankruptcy is essential to the rapid reallocation of resources away from failing business models. It was to protect the bankruptcy law from manipulation by state governments that the original Constitution reserved the regulation of bankruptcy to Congress.

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When the reallocation of resources reaches the highest "exchange velocity" that can be achieved, all potential productivity gains are realized with the minimum pain and suffering, and society prospers.[9]

In the context of government-created cartels, by contrast, that crucial reallocation of resources is slowed, and everyone loses in the long run. Cartel members may enjoy substantial artificial profits from cartel pricing, but by definition they are not allocating resources as competitively as they could, and because potential real profit is thereby left on the table, and the society's wealth creation is diminished. The effect is even worse when protectionism pervades the domestic economy than in the context of trade, because a trade barrier at least theoretically leaves the domestic economy free, whereas protectionist policies in the domestic arena stifle productivity in every corner of the economy. All of the reasons that protectionism hurts those it seeks to protect, in addition to everyone else, operate with even more devastating effect in the case of government-created cartels within the domestic economy.

Cartels are usually doomed in a free market because cartel members can always break ranks and charge a price somewhere between the competitive price and the artificially

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elevated cartel price; and even if discipline is maintained among cartel members, a new competitor can always enter the field and gobble up market share by offering a more competitive price.

The perfect solution to this problem, from a cartel conspirator's point of view, is to get the government to join the price-fixing conspiracy. That solves the problems of both cartel discipline and new entrants—and automatically shields the conspirators from the criminal penalties they would otherwise face. Therefore, the exception to antitrust enforcement for government-sponsored cartels paradoxically excludes from the enforcement of our antitrust laws the one category of conspiracies and combinations in restraint of trade that most cries out for antitrust enforcement.

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

The prohibition on public competition also effectuates a forced transfer by allowing providers of necessary goods and services to charge much higher prices for a lower supply of inferior quality than the market would otherwise deliver. And because the subject of cartels tend to be necessaries rather than luxury goods, the effects are grossly regressive, and hit working families hardest. The regulation of dairy is a perfect example: America's working families have no idea that they are paying far more for milk every week than if dairy farmers were allowed to compete in a free market.

As Congress learned to exploit its newfound power to regulate all economic activity under the sun, particularly through the use of administrative agencies, the primitive overt cartel was gradually supplanted with more intrusive and complex regulatory schemes—schemes which paradoxically hide the costs of progressive policies even more effectively than overt cartels.

Overregulation produces cartelized markets just as effectively as the more overt government-created cartels discussed in the rest of this section, for the simple reason that overregulation constricts supply and raises prices above competitive levels. High regulatory costs raise a barrier to entry for new competitors. They also give large firms a competitive advantage over smaller ones less able to absorb the costs.

How Overregulation Leads to Crony Capitalism

Though the political target of many regulatory schemes is "big business," it is big business that often benefits most from overregulation, for the simple reason that regulatory costs are more easily absorbed at larger scales. According to the federal government, regulatory costs per employee are 36 percent higher for small businesses than for larger ones.[10] Thus, overregulation tilts the competitive playing field against smaller new entrants.

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

As the administrative state has continued to develop apace, overregulation has become a secure blanket for all sorts of hidden cartels. These cartels are the inevitable consequence of regulations that are dizzyingly complex and heavy-handed, which special interests are quick to take advantage of them and become vested in.

To cite just one example, consider the Department of Education's conditions on institutional eligibility for federal student aid. In order for a student to qualify for federal student aid, he must attend a degree-granting college or university subject to federal rules governing everything from the definition of "credit hour" to how schools must track graduating students' income and job performance in the years after they graduate. The infusion of federal money creates essentially a national cartel for degree-granting colleges and universities, which receive protection from nontraditional education institutions, and which can tap into huge federal subsidies, thus being able charge tuition well above what a competitive market would bear.

This example demonstrates both the intractability of overregulation at the federal level and the promise of attacking overregulation at the state level. Once established in federal law, cartels become almost impossible to extirpate. The 1947 repeal of key parts of the National Labor Relations Act resulted from the fact that, by abusing the powers granted them under the New Deal, labor unions soon turned the country against them. Similarly, the airline deregulation launched under the Carter administration and carried to fruition under President Reagan responded to the overwhelming evidence that the cartels created by federal airline regulations were benefitting only the airlines at huge expense to everyone else. Welfare reform likewise responded to the overwhelming national consensus that sweeping reform was needed. Otherwise, examples of federal regulation being successfully reformed or repealed are few and far between—chiefly because there are few examples of how much better the regulation could be.

In the states, by contrast, the impact of deregulating this or that industry is immediately visible. Because of the mobility of both labor and business, breaking a cartel or an excessive regulation in one state immediately brings benefits to that state, and puts pressure on its uncompetitive neighbors. The greater a state's success in freeing up its economy, the greater the economic benefits will be, and the more compelling its example will be to other states.

The massive government cartelization of the American economy hangs like a millstone on the productive energy of the society. It is a testament to the dynamism and ingenuity of Americans that the economy manages to produce any growth at all. But the anemic recovery of the Obama era should sound a warning siren that the economy's capacity to bear cartels and overregulation is not limitless. In the meantime, the constitutional destruction wrought by the progressive agenda has led to the progressive degradation of property rights and economic freedom in a regulatory spree of biblical proportions, with no end in sight.

According to the federal government, regulatory costs per employee are 36 percent higher for small businesses than for larger ones.

A New *Agenda for State Action*

The fight to reclaim our Constitution agenda should begin in the states, with concrete and manageable reforms aimed at reducing the power of special interests and reviving economic freedom and individual liberty. Every problem should carry a presumption against central government solutions, and in favor of free society, precisely the bias the Constitution was designed to achieve.

As states start to liberalize their economies, they will be quickly rewarded with fantastic increases in economic productivity, as the success of the Texas Model has shown. As the cartels' constituencies are supplanted by constituencies for economic freedom and limited government, it will be possible to attack the federal leviathan—the agriculture and labor cartels of the New Deal, the entitlement programs of the Great Society, and the overregulation of the modern administrative state.

The focus should be in repairing the constitutional damage where it has been greatest—at the framework of limited and enumerated federal powers enshrined in the 10th Amendment, and its focus on both state powers and individual liberties. Reform should begin at the local and state level, to create examples of success and the momentum for further reform. Then the effort should work on the federal level.

There is a crucial role for grass-roots organizations in the reform effort. An agenda that revives constitutional limits on government power will threaten the perks of the special interests that started taking over government in America

in the progressive and New Deal movement. They were as successful as they were because, while every special interest has its lobbyists, the public interest is all too often left with no representation at all. Grass-roots organizations can make their presence felt on behalf of the public, reminding our elected officials that their solemn duty is not to give voice to special interests, but to protect the public against them.

Defeat "Cooperative Federalism"—Insist on the Separation of State and Federal Functions

The disastrous intermingling of federal and state fiscal and regulatory functions in "cooperative federalism" schemes has caused profound institutional dysfunctions that cannot be repaired except by separating the two spheres of government. Insist on the separation of federal and state functions. Cooperative federalism always boils down to federal commandeering of state government. It should always be considered unconstitutional and should be resisted as such.

- State officials should resist any federal program that places conditions on the states' receipt of either federal money or federal permission to regulate in a given area. When Washington comes calling with an invitation to accept such a "cooperative" federal-state program, the states' answer should be automatic: "Do it yourself, or let us do it ourselves."[11]

- At the federal level, all three branches need to start scaling back the reach of such federal programs. The Supreme Court's *NFIB* decision created an important distinction, namely that between conditions on how the states spend federal money under a cooperative program, which are allowed, and conditions meant to affect collateral state policy issues, which can be considered coercive. That is an important precedent, with application across the landscape of cooperative federal-state programs. The Supreme Court will hopefully begin to apply this distinction more systematically in future challenges to coercive federal funding programs. For example, the federal penalty for noncompliance with No Child Left Behind—namely the loss of all Title I funds for poor local school districts—is almost certainly unconstitutional under the Court's decision in *NFIB v. Sebelius.*[12]

Action Agenda

General Approach: State officials must resist "cooperative federalism" programs by insisting on the separation of state and federal fiscal and regulatory functions. But it is crucial for states to coordinate their resistance to such "cooperative federalism" programs. Washington is taking over state governments through a strategy of divide-and-conquer. "Cooperative federalism" put each state in a prisoner's dilemma: no state knows what the others are going to do, and it often seems futile to stand up to Washington alone. That's why resistance to federal overreach is not enough. Resistance must be coordinated across the states.

LEGISLATIVE PROPOSAL: Multistate Commission on State-Federal Relations

- If a significant block of states refuse to comply with conditions in a federal funding program, or refuse to implement a federal regulatory program, the chances are much greater that Washington will be forced to revisit the program and give the states more latitude. Starting with a core group of 7-10 states, a Multistate Commission on State-State Relations should be formed to study, recommend, and coordinate responses. Multistate grass-roots organizations would have a crucial role to play in pushing the multistate legislative initiatives. The Commission should start with two major legislative initiatives: The first on coercive federal funding programs, and the second on "cooperative" programs that force states to serve as deputies of the federal government, such as the insurance exchanges under ObamaCare and State Implementation Plans under the Clean Air Act.[13]

LEGISLATIVE PROPOSAL: Fighting Back Against Coercive Federal Funding

- The current orientation of state government institutions is to go after every last dollar in federal funding, regardless how onerous the conditions attached to those funds. It is time to start fighting back against those conditions. In the 83rd Texas Legislature, a bill was presented (HB 1379-Toth) that would have:

    - created a statutory definition of "coercive federal funding program" and "coercive condition";

    - required the state attorney general and state comptroller to jointly designate major sources of federal funding in the state budget as coercive in accordance with the definition;

- required the Office of State-Federal Relations to coordinate an agency-wide effort to escape the conditions attached to programs officially designated as "coercive"; and

- required that where a federal agency advises the state that funds may be terminated due to noncompliance with applicable conditions, state AG would be required to sue to block the termination of funds, on the basis of the Supreme Court's ruling in *NFIB v. Sebelius*.

LEGISLATIVE PROPOSAL: Non-Compliance with Federal Regulatory Mandates

- State law cannot prohibit federal officials from enforcing federal law. But it can prohibit state and local officials from serving as eager deputies of the federal government. States often jump at the chance to do the federal government's work for it, for example through State Implementation Plans under the Clean Air Act. In the 83rd Texas Legislature, a bill was presented (HB 928-Krause) that would have prohibited state and local officials from complying with any new federal gun control regulation that relied on state and local officials for implementation, such as a federal background-check requirement. Such bills can be filed with respect to several carefully selected current and potential future federal regulatory programs.

Defeat the Cartel State: Attack Barriers to Competition Wherever They Appear

On the other side of the 10th Amendment coin, it is vital to revive individual liberty and economic freedom, particularly in the freedom of contract. Individual liberty should not be limited in order to protect special interests from competition, except in the rare cases where the potential for public injury cannot by adequately guarded against by existing law. To create a constituency for liberty, reform should begin at the state level and proceed to the national. Texas should begin by carefully studying and implementing a version of the initiative embraced in Indiana to reduce the burden of occupational licensing.

- There should be a heavy presumption against any law that entails a prohibition on anyone offering a good or service to the public.

- Laws and regulations—particularly the state codes—should be scoured for all licensing schemes, marketing boards, and similar laws that protect any particular group of people from competition. All such schemes should be converted to non-exclusive certifications, if possible issued by private associations.

Action Agenda

LEGISLATIVE PROPOSAL: End Special Privileges and Obstacles to Freedom

In Indiana an effort is underway to create a "Eliminate, Reduce, and Streamline Employee Regulation" committee (ERASER) to study occupational licensing. ERASER is a refinement of the Regulated Occupations Evaluation Committee (ROEC) which was created in 2011 to study and make recommendations about regulated occupations.

In Texas, an approach based on the Indiana model would create a commission to assess regulated industries and occupations. Every existing occupational and commercial license requirement would be assessed once every ten years, according to certain criteria. In accordance with existing Texas law, the one-year review period applicable to every proposed new occupational and commercial license requirement would be used to study the proposal according to the same criteria. The commission would be required to report its findings and recommendations to each Legislature. Assessment criteria should include:

- **Self-Assessment of Cost:** Proponents of every new and existing license requirement should be required to commission an independent economists' evaluation of the costs of the requirement, focusing on (1) unemployment impact and (2) price premium that the public pays above what competitive cost might be. For existing licenses, license fees would be used to pay for the relevant study; for proposed new licenses, the cost study would be commissioned as part of the documentation required of bill proponents.

- **Risk Analysis:** What is the risk of harm that consumers face in purchasing the good or service covered by the license?

- **Informed Consumer Choice:** To what extent are individuals adequately informed and able to make their own risk-benefit analysis?

- **Self-Regulation:** Is the profession able to self-regulate without government intervention?

- **Legal Alternatives to Licensing:** Can non-exclusive certification or registration (government or non-government) adequately inform and protect the public?

- **Cost-Benefit Analysis:** Are the social costs of the proposed or existing regulation justified by the public safety justification.

On the basis of the commission's recommendations, bills would be filed to liberalize the profession in question. In most cases, the bill would only need to eliminate the applicable prohibition on selling the relevant goods or services without a license.

Conclusion

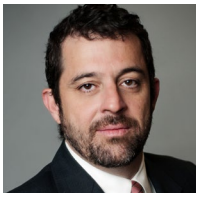
The history of our Constitution suggests that the separation of federal and state functions will be a vital part of restoring the Constitution to a sustainable, workable plan for liberty. That should be a fundamental goal of our movement. Just as important, freeing individual liberty and economic freedom from the barriers to competition created for special interests will help start to reverse the constitutional damage of the progressive and New Deal movements, restoring a Constitution of state regulatory competition and free exchange.

The real obstacles to the constitutional revival we seek are the supporters of the progressive agenda—willing and unwilling, witting and unwitting—across the political spectrum. That is why we must focus on exposing the fraud of progressivism—its hidden costs, uncompensated takings, and forced transfers. If Americans can finally see the long debate over our Constitution as a choice between a government of special interests, and a government of the people, they will choose the latter, and thereby reclaim our government and our Constitution for a free people. ✯

Endnotes

[1] *Hammer v. Dagenhart*, 247 U.S. 251 (1918).
[2] 317 U.S. 111 (1942). Other major decisions included were *National Labor Relations Board v. Jones & Laughlin Steel*, 301 U.S. 1 (1937), which sanctioned a federally imposed system of collective bargaining in factories and shops across the nation; *U.S. v. Darby*, 312 U.S. 100 (1941), which upheld national labor standards for the first time; and *U.S. v. Wrightwood Dairy*, 315 U.S. 110 (1942), which allowed the federal government to regulate intrastate sales of milk that were in competition with the interstate agricultural price-support cartels of the New Deal.
[3] 317 U.S. 341.
[4] Michael Tanner, "Obama's 2014 War on the Poor," *National Review Online* (1 Jan. 2014).
[5] Ibid.
[6] Richard Epstein and Mario Loyola, "The Disabling of America," *The American Interest* (June 2012).
[7] *Lochner v. New York*, 198 U.S. 45 (1905) had enshrined the "freedom of contract" as part of due process, and made it applicable to the states through the due process clause of the 14th Amendment. *Lochner* was essentially overruled by *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937), in which the Court upheld Washington state's minimum wage law. Subsequent Supreme Court decisions expanded federal power to regulate economic activity, leading to *Wickard v. Filburn*, 317 U.S. 111 (1942), in which the Court abandoned all effective limits on the federal commerce power, in effect abandoning the effort to protect economic freedom.
[8] See, e.g., *Printz v. United States*, 521 U.S. 898 (1997).
[9] Ronald Coase, "The Problem of Social Cost," *Journal of Law and Economics* (Oct. 1960).
[10] U.S. Small Business Administration, *The Impact of Regulatory Costs on Small Firms*, 8 (Sept. 2010).
[11] See e.g., Mario Loyola, "Do It Yourself, Washington," *National Review Online* (6 Nov. 2013).
[12] Mario Loyola, *Loosening the Federal Straightjacket: How the NFIB Decision Impacts Federal Funds in State Budgets*, Texas Public Policy Foundation (Sept. 2010).
[13] Under many federal environmental regulations, such as the Clean Air Act, states are given "permission" to implement federal standards if they devise State Implementation Plans that are approved by federal regulators; otherwise the federal regulator imposes a Federal Implementation Plan.

About the Author



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

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

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