THE LEGAL DIMENSION OF THE PRIVATIZATION MOVEMENT

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In my most provocative remark this afternoon, I will assert that the focus of this symposium is inconsistent with the ideals of the Federalist Society. In setting up this event, I will say, the Federalist Society (of all organizations!) has fallen prey to the Beltway Syndrome. Because this may turn out to be my only provocative remark, I will wait until the end of my talk to explain it. In the interim I will discuss the important, if less flashy, issue of privatization, that is, the turning over to the private sector functions that governments might, and often have performed.

The merits of privatization vary by context, and are a major topic in themselves. I will leave the merits of the debate to experts in public finance and organizational behavior. Because this is a conference commemorating the United States Constitution, I will instead devote the brief time allotted to a legal discussion, mostly of the possible constitutional constraints on how elected officials might choose to allocate functions between the public and private sectors. Most of my remarks will involve, as they say around the Quadrangle Club at the University of Chicago, strictly positive analysis. That is, I will describe constitutional law as it is, not as I would necessarily like it to be.

Mention of some political personalities will help give body to the constitutional issues that I will touch upon. Think of someone who would like to socialize far more of the American economy; think, perhaps, of Michael Harrington, the nation’s leading socialist, or of Gerry Frug, the Critical Legal Scholar at Harvard who has urged cities to operate banks and insurance companies. Would any provision of the federal Constitution, or perhaps a state constitution, prevent them from accomplishing their goals? Conversely, I think of someone who would like to move sharply in the opposite direction, who would privatize prisons, streets, and other traditional governmental functions; think of Stuart Butler of the Heritage Foundation, or Robert Poole, Jr., the editor of Reason. Would any constitutional provisions frustrate their pursuit of a privatization agenda?

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The United States could conceivably have a constitution that would enact the social statics of a particular theorist who had a well-developed view of the proper role of the state. If that theorist were James Buchanan or Robert Nozick, the constitution would severely limit the role of the public sector. If the theorist were Sidney Webb or Oscar Lange, the constitution would mandate that many services be publicly produced. By extension, a constitution inspired by the ideas of Richard Musgrave, Paul Samuelson, or James Tobin, would mandate maintenance of some particular "mixed" economy.

My general thesis, which most of you will find indisputable, is that our constitutional arrangements, both as written and as interpreted, are not of a confining character. Our constitutions give elected officials enormous scope within which to alter the mix of the public and private sectors. As a result, the allocation of functions in the American economy is largely determined by electoral politics, not the content of hard-to-amend constitutional text.

I. CONSTITUTIONAL BARRIERS TO SOCIALISM

I will discuss the possibility of constitutional obstacles to a Michael Harrington or a Gerry Frug achieving his dream of a more "public" economy. These obstacles might arise in either of two ways: first, in constitutional provisions that restrict governmental powers, and second, in provisions that create individual freedoms whose protection by force would make government enterprise impossible.

I invite you to scan the United States Constitution to find specific language that bars the United States, or a state or local government, from entering into the production of a particular good or service. There are, in fact, a few such provisions. This shows that, when the framers had a mind to, they knew how expressly to deny powers to governments. The most obvious of these provisions is the clause in the first amendment that denies Congress the power to establish a religion. That enterprise — religion — is one that government cannot undertake. As Richard Willard has reminded me, there are a few other constitutional restrictions of this sort, mostly obscure ones that appear late in article I. For example, the Constitution denies both the federal government and the state governments the power to confer a title of nobility, and forbids the states from coining money. One would look in vain, however, to find anything like a general "free-enterprise" clause forbidding governments from assuming productive functions traditionally carried out in the private sector.

3. Id. at § 10.
A critic might assert, however, that the framers saw no need to expressly deny governmental powers because they intended to restrict Congress to powers expressly granted it, principally those mentioned in article I, section 8. Had the Supreme Court construed express federal powers narrowly, it would indeed have greatly restricted the scope of federal (although not state) enterprise. To Richard Epstein's dismay, I am sure, the Court has never strictly policed the list in article I, section 8. Moreover, the Court's deference to Congress' interpretation of federal powers is not some recent mischief of the Warren Court, but dates back to the Marshall Court's decision in *McCulloch v. Maryland*, which sustained Congress's power to charter the Bank of the United States, a federal undertaking arguably unauthorized by article I.

I have no special competence to enter into a debate over the propriety of a decision such as *McCulloch*. I simply offer the observation that it is now bedrock constitutional law that the Court is inclined to defer to Congress's definition of the scope of federal powers. Since Justice McReynolds's lone dissent in *Ashwander v. Tennessee Valley Authority*, no Justice has argued otherwise. Justice Black's opinion in the *Steel Seizure Case* nicely illustrates the point. Although Justice Black held that President Truman lacked the power unilaterally to take over the steel mills, he asserted in dicta that it was "beyond question" that Congress would have had that power had it wanted to exercise it. In short, if Michael Harrington were to succeed in pushing through legislation designed to socialize the steel industry, it is virtually inconceivable that the Supreme Court would hold that program to be beyond the power of the United States.

The Constitution of course speaks not only of powers, but also of rights. This symposium is largely about economic liberties. Would one of the constitutional clauses that protect those sorts of rights stand as a bulwark against socialization of the economy? As a positive matter, I predict that these clauses are but a flimsy picket line that socialists could easily overrun. The public use clause of the fifth amendment could conceivably be construed to bar a Michael Harrington program to condemn the steel mills, but the unanimous *Midkiff* decision is a recent reminder that the Supreme Court is

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7. The Court's only recent decision that refused to defer to congressional definition of federal power is National League of Cities v. Usery, 426 U.S. 833 (1976). Interestingly, the Court there acted to protect not the private sector, but rather the states, from the reach of federal power. Even this proved to be shortlived, as *Usery* was overruled in Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985).
likely to defer to legislative choices in the use of eminent domain powers. The contracts clause and the takings clause, as Frank Easterbrook explained this morning, basically only constrain governments from retrospective rearrangements of rights, not from prospective enterprises. Like the public use clause, these clauses cannot conceivably be construed to prevent a government from establishing and building an enterprise by means of consensual transactions. Because these clauses at most limit coercive takeovers, not friendly ones, they are not a staunch defense against socialist programs. For example, if the corporations and ESOPs (employee stock option plans) that currently own the steel mills would not object to being acquired by the national government, these clauses would not even come into play.

Would that workhorse of the Constitution, the due process clause of the fourteenth amendment, empower an opponent of socialism to torpedo legislation setting up a state enterprise? Even during the Lochner era the Supreme Court held otherwise. In a little-known case, Green v. Frazier, the Court unanimously rejected a substantive due process challenge to a North Dakota statute that authorized the establishment of state banks, state grain elevators, and other state enterprises.

What about state constitutions? Do they contain provisions that would inhibit the establishment of state enterprises? In some ways, the states are even less restricted than the federal government. In general, the states have plenary powers, not limited powers. As remnants of Prairie Socialism of the Progressive Era, North Dakota runs a bank and Wisconsin offers life insurance; neither state’s constitution explicitly authorizes its activity. Many states do have constitutional provisions that have been interpreted to limit to “public purposes” the spending of state and municipal revenues from taxes and bond issues. These provisions do prompt litigation, some of it friendly actions by bond counsel. As anyone who follows the latest government ventures in building stadiums and convention centers knows, however, these clauses currently are not major inhibitions on government entrepreneurship.

In sum, Michael Harrington and Gerry Frug can take heart. Little in either the United States Constitution or the state constitutions stand in their way.

10. 253 U.S. 233 (1920). See also Jones v. City of Portland, 245 U.S. 217 (1917) (Maine statute that empowered cities to sell heating fuels did not deprive taxpayers of due process of law).
II. CONSTITUTIONAL CONSTRAINTS ON PRIVATIZATION

Stuart Butler and Robert Poole can also take heart. The legal situation is basically symmetrical. Courts would be unlikely to find constitutional impediments to a wide-reaching program of privatization.

The courts have construed some constitutional clauses as mandating governmental provision of certain services. Functions that are inherently "legislative," for example, cannot be delegated to private decision-makers. Because article II identifies the President as commander in chief, the federal government could not delegate the conduct of a war entirely to the Pinkertons. A statute that farmed out the conduct of criminal trials from courts to contractors would likely fall for improperly delegating judicial functions.

Nevertheless, the United States Constitution generally lists powers that the federal government may exercise, not that it must exercise. Article I, section 8, simply states that "Congress shall have Power to... establish Post Offices... raise and support Armies," and so on, not that Congress has to perform these functions.

Interestingly, state constitutions are more likely to require the public provision of important services, in particular, "common schools." A clause of this sort might mistakenly be construed to require government production, as opposed to government provision, of basic education, an interpretation that would jeopardize experiments with school vouchers. As another example, the California Constitution prevents the alienation of public tidelands; as a constitutional matter, these lands are forever socialized. As with the federal Constitution, however, these sorts of clauses are exceptional in state constitutions.

In some contexts courts would hold that programs privatizing formerly governmental functions would have to be structured so as not to violate constitutional clauses that recognize individual rights. Recently there have been experiments with the hiring of contractors to operate prisons. Those who analyzed these programs from a constitutional perspective usually assume that prison functions are in principle delegable, but caution that

private prisons must meet constitutional standards, for example, the eighth amendment prohibition of cruel and unusual punishments.17

This example illustrates the centrality of the state-action issue to the privatization debate. Suppose the decisions of homeowner associations, for example, would be regarded as state action. That holding would reduce the momentousness of privatizing, say, the function of architectural review from municipalities to homeowner associations because that switch would not much affect the legal climate surrounding the review process.

In short, in a few contexts there are constitutional barriers to the achievement of privatization, and in considerably more contexts there are constitutional restrictions on the terms of privatization. Nevertheless, like Michael Harrington, Stuart Butler's chief obstacle is electoral politics, not constitutional doctrine.

III. SYSTEMIC BIASES IN FAVOR OF PUBLIC ENTERPRISE

Because the constitutions provide legislators with such a broad policy space, those of us who are interested in more experiments with privatization should pay more attention to the biases toward socialization that exist in non-constitutional parts of the legal structure.18 Government tax and spending programs often discriminate against private firms. Internal Revenue Code provisions are perhaps the most important of these. Cities currently build sports stadiums in large part because, unlike private corporations, they can finance these with bonds whose interest is exempt from federal income taxation. Because a homeowner who itemizes deductions can deduct municipal taxes but not homeowner association dues, there is a tax bias favoring public provision of local public goods.

Government spending programs tend to exhibit a similar bias in favor of public provision. For example, as proponents of school vouchers point out, state spending in support of primary and secondary education is heavily biased in favor of public schools. Similarly, a public university, such as the University of California, receives deep public subsidies, while a private university, such as Stanford, which offers much the same service, receives markedly shallower government support.

IV. The Privatization of Rulemaking

Before coming to my punchline, I would like to suggest how privatization can proceed beyond what is sometimes imagined. Even skeptics of government competence commonly assert that government has a central, perhaps even an exclusive, role in the establishment of property rights. For example, Robert Nozick and Ronald Coase have both implied that it is up to the state to define the entitlements that one person has against another.\footnote{R. Nozick, Anarchy, State, and Utopia (1974); Coase, The Problem of Social Cost, 3 J. Law & Econ. 1, 15 (1960).} Once the state had carried out this basic function, these authors would mostly rely on consensual transaction to effect further adjustments.

This legal-centralist view, although common, is false as an empirical matter. In fact, the state does not have a monopoly in the creation and enforcement of entitlements.\footnote{See generally Ellickson, A Critique of Economic and Sociological Theories of Social Control, 16 J. Legal Stud. 67, 81-90 (1987).} A timely illustration is how players of pickup games arrange entitlements to use basketball courts. Without state assistance, players develop informal customs that establish exclusive temporary property rights to use courts, thereby preventing the potential tragedy of court congestion during games. Typical basketball norms limit games to a particular number of baskets, entitle only the winning team to play a second game, and set procedures for the selection of their opponents. That these rules are informally created does not detract from their bindingness. Anyone considering violating these norms could anticipate becoming the target of self-help remedies, ranging from negative gossip to mild forms of violent retaliation.

The ultimate in privatization is thus the privatization of rulemaking. In some contexts, of which basketball courts may be one, there may be reason to think that private rulemaking will outperform government rulemaking. Advocates of privatization should therefore encourage the legal system to adopt the private systems of property rights that emerge in these contexts. There is plenty of precedent for this. For example, the Uniform Commercial Code tends to rely on merchant practices as a source of law.

V. How the Federalists Have Succumbed to the Beltway Syndrome

I have now reached my final point, which I advertised as my most provocative. The "Beltway Syndrome," as you know, is the propensity of those who live in and around Washington, D.C. to exaggerate the importance of the federal government to people who live beyond the Beltway. Perhaps
because the Federalist Society is headquartered in Washington, it seems to have fallen prey to this disease.

Take a look at the program for this symposium. It refers in numerous places to "the Constitution." I emphasize the word "the." As I have reminded you in various parts of my remarks, we have many, not just one, constitutions in this country. Each of the fifty states has a constitution (and some municipalities also have charters whose provisions may restrain government enterprise). A discussion of "Constitutional Protections of Economic Liberty" should not proceed as if only federal constitutional rules mattered. The Federalist Society, if it were true to its name, should be especially interested in promoting the development of diverse state (and local) constitutional regimes. If states were to compete along this dimension, citizen preferences about various constitutional regimes would be revealed to some degree by how migrating firms and households "voted with their feet" among states.

Suppose, for example, that the New Hampshire Constitution were to stress welfare rights. Most members of the Federalist Society, I suspect, would predict that working class families would prefer the New Hampshire legal regime. If this prediction were to be correct, and if one can assume that states desire to attract residents, then state competition in the drafting and interpretation of their constitutions might prove to be a powerful force for the protection of economic liberties.

Lawyers, judges, and law schools have all paid far too little attention to state constitutional texts. There have been scores of articles on federal takings law, for example, but almost none about how the takings clauses in state constitutions should be interpreted. As another example, the constitutions of many states start with a section that recognizes a person’s "inalienable right" to engage in "acquiring, possessing, and protecting property." Perhaps this symposium should have included a session on the interpretation of this language.

Groups committed to the decentralization of power should help nurture and publicize differences in sub-federal legal regimes. As a penance for falling prey to the Beltway Syndrome on this occasion, I recommend that the Federalist Society select for a future conference this topic: Taking State Constitutions Seriously.

21. Of the participants here, I credit Frank Easterbrook and Craig Stubblebine in particular for recognizing this point.

