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ECONOMIC HISTORY

Intranational Trade

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How a century of legal precedent has shaped the government's power to regulate commerce between states

The Constitution divides law-making authority in the United States between states and the federal government. State governments can pass laws governing anything except matters the Constitution says they cannot, whereas the federal government can regulate only the things the document explicitly says it can.

In regards to commerce, the authors of the Articles of Confederation — the first governing document of the United States — thought states should have autonomy to regulate within their own borders according to their industry and priorities. But uncertain economic times after the American Revolution made clear the need for a federal authority too. Severing ties with Britain also lost the colonies one of their primary trading partners, as well as their chief regulator of trade across state lines.

The states soon suffered from a simple collective action problem. They erected trade barriers to protect their own citizens, which no one state had incentive to unilaterally tear down while others left theirs up, even though everyone would have been better off with freer commerce between them. States' protectionist policies grew so onerous and retaliatory that some even feared they would culminate in state-to-state combat.

The Schechter brothers with attorney Joseph Heller (center) celebrate the 1935 Supreme Court ruling in A.L.A. Schechter Poultry Corp. v. United States, *which overturned fines against them and ushered in a short-lived era of judicial limits on congressional power.*

PHOTOGRAPHY: THE GRANGER COLLECTION, NEW YORK

For this reason, the Framers of the Constitution included the second enumerated power granted to Congress in Section 1, Article 8 of the U.S. Constitution, which gives Congress the right to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." The middle provision — Congress's right to regulate interstate commerce — became a hotly debated clause in the 20th century. The debate has been renewed today in light of recent federal legislation concerning health care reform, which requires citizens within states to undertake a specific form of commerce (i.e., purchase insurance).

It's always an open question as to whether the Supreme Court will take up legal challenges to new legislation based on commerce clause grounds. Understanding the legal history of the clause can help the public put the current debate in context.

The Birth of Federal Regulation

The Commerce Clause was rarely invoked for the first 100 years of the U.S.'s history. During that time it was mostly used under the purpose the Framers envisioned: to mitigate state trade barriers that would hinder interstate commerce, such as taxes levied on goods produced in other states.

But the industrial revolution made states more economically interdependent than ever. The stakes on interstate commerce were now higher and brought new questions about what constituted interstate commerce.

Not surprisingly, the rise of the railroads — then the literal vehicles of interstate commerce — became an early test of the boundaries of state versus federal regulation. In the late 1800s, the transport of bulk items like grain, lumber, and coal was the railroads' main business. But it wasn't that profitable. Competition from water carriers forced railroads to keep rates low, and railroads increasingly used profits from local delivery services to recoup fixed costs on less-profitable bulk transport services.

The growth of local delivery business also made it affordable for railroads to draw freight business from competitors by offering favored pricing to certain shippers and

localities, a practice called price discrimination. This bred public frustration especially from farmers in far-flung geographic areas who were on the losing end of the deal.

States tried to limit price discrimination through regulation, but their rules could extend only as far as their borders. In 1886 the Supreme Court ruled that the state of Illinois had actually overstepped its bounds in regulating railroads, and Congress intervened in 1887 by creating the first-ever federal regulatory agency, the Interstate Commerce Commission. The ICC allowed railroads to continue charging a markup on local delivery services to recoup the fixed costs of bulk transport, but they could no longer offer discounted pricing and rebates to certain customers over others. The primary goal was to maximize access to services.

Though the ICC was a direct answer to widespread public frustration with railroads, it is telling that railroads supported the legislation. They sought an end to the price wars, secret rebates, and price concessions offered to customers to garner business, but also hoped the ICC would strengthen the railroad cartel. Indeed, the ICC helped the railroad industry evolve from a private cartel to a publicly managed one, noted the late economist Marcus Alexis of Northwestern University in 1982.

The ICC is now regarded as a classic example of "regulatory capture," in which regulators end up sympathizing with the regulated and enact rules in their favor. For example, in the Transportation Act of 1920, Congress allowed the ICC to regulate minimum, not just maximum, shipping rates, as well as control entry into and exit from the industry, among other issues. Contrary to the original intention of Congress to widen competition, the ICC eventually came to have the opposite effect.

The New Deal Court

The ICC would not be the last example of public agitation prompting federal regulatory action. Starting in 1933, a sweeping batch of New Deal economic sanctions was passed under President Franklin Roosevelt to deal with the Great Depression. Roosevelt, based in part on counsel from economists, thought the Depression was a product of unbridled and "unfair" competition that kept wages low and suppressed demand. The answer, in his view, was a heavier government hand in managing the economy.

The government created the National Recovery Administration (NRA) to enforce price and wage controls, in part by establishing "fair competition codes." The codes set maximum hours for the workweek, prohibited child labor, and set minimum wages. Virtually no industry was exempted.

The strict controls on competition proved difficult to enforce. Producers began finding ways around the codes, such as a group of immigrant brothers in Brooklyn who ran a business slaughtering chickens and selling them to retailers within the state of New York. The Schechter brothers were charged with selling unfit and diseased chickens at discounted prices, among other violations. They were convicted by the government and fined before they appealed the decision. Since their chickens were being sold solely within New York State lines, the brothers said, the federal government had no authority to regulate them through the NRA.

The Supreme Court agreed in 1935's *A.L.A. Schechter Poultry Corp. v. United States*. The Court interpreted the Constitution to mean that Congress could regulate commerce between states; Congress could not, however, delegate those authorities to the president. The Roosevelt administration held that transactions which wouldn't ordinarily have a substantial effect on interstate commerce may do so in an "emergency," when the national economy is more interdependent. But even though the national economic emergency may justify extraordinary measures, wrote Chief Justice Hughes in the Court's ruling against the government, it did not justify an expansion of the government's constitutional powers.

The political implications became as evident as the legal ones. After the *Schechter* ruling, Justice Louis Brandeis made a point of pulling aside one of Roosevelt's aides to warn that the decision was "the end of this business of centralization." His words were prophetic, as 1935 and 1936 saw a series of "Black Mondays" in which the Supreme Court repeatedly struck down attempts by Congress to enact New Deal programs.

But the president would not take this lying down. In early 1937 Roosevelt pitched a proposal to add another justice to the Supreme Court for each existing justice over the age of 70, to ease the case burdens of the older judges, he said. The real goal was to pack the Court with justices sympathetic to New Deal policies.

Soon thereafter, a justice switched sides on another New Deal constitutionality case and the Court ruled in favor of the government. The justice's change in position became known as the "switch in time that saved nine." The justices held that Roosevelt's threat did not affect the outcome of the case, but many legal scholars are not convinced.

In the years that followed, the seemingly chastened Court overturned many of its previous rulings limiting federal government power. An era was born in which the Court deferred to Congress on all matters of economic regulation. The new trend was amplified in 1942 in what was arguably the single greatest expansion of federal regulatory power in the history of Commerce Clause case law.

At the time, the nation's wheat growers were restricted to a limited crop size under a Depression-era policy created to moderate (some say raise) national wheat prices. Roscoe Filburn, a farmer in Ohio, exceeded the limit to feed his

The Commerce Clause of the U.S. Constitution grants Congress the power to, "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." But what constitutes interstate commerce?

livestock and family. He was fined and ordered to destroy the extra wheat, but he appealed. The wheat was intended for private use and would never come to market, he said, so the government's wheat limits should not apply.

The Supreme Court agreed with the government in 1942's *Wickard v. Filburn*. The extra wheat Filburn grew constituted wheat he would not buy commercially, the Court said, and therefore affected the interstate wheat market. Furthermore, though Filburn's actions alone were not likely to have a noticeable effect on interstate commerce, if many individuals followed suit the cumulative effect surely would be substantial.

For the next 50 years, legislation passed by Congress assumed a continually expanding interpretation of its authority to regulate, and every related case taken by the Supreme Court was decided in the government's favor. Not that there was much public objection to this trend.

Congress's broader interpretation of Commerce Clause authority led to some widely lauded legislative achievements such as the Civil Rights Act of 1964 and other enhancements of civil liberties. The courts, by comparison, looked rudderless in commercial cases. Lower courts lacked a clear framework by which to interpret the many cases that rested vaguely on the Commerce Clause, and different federal appeals courts reached conflicting conclusions. Congress was effectively the arbiter of the lines between federal and state power during this period.

Defining the Limits

A pivotal 1995 case came as a surprise. After a 12th grade boy carried a loaded gun into his school, he was convicted under the federal Gun-Free School Zone Act of 1990 (GFSZA) that made it illegal for an individual to possess a concealed firearm within 1,000 feet of a known school zone.

The government had justified the GFSZA under its authority to regulate interstate commerce. Yet the link between gun violence and commerce, let alone the interstate variety, was not obvious. Previous Commerce Clause rulings had established that an activity would need to affect interstate commerce on one of three levels for Congress to regulate it. First, the activity could relate to the channels of interstate commerce, such as railroads, waterways, or streets. Second, it could affect the "instrumentalities" of commerce, or the people and things that are conduits of economic activity. That left only the third and hardest to define class of activity: those with a "substantial effect" on interstate commerce.

This is where the government made its case. Guns likely lead to violence, it contended, which would disrupt the educational process and impair the future productivity of affected children. If enough people did it, the health of the economy as a whole would be impaired.

But under the federal government's logic, the Court argued, Congress would have the power to regulate any activity that might conceivably lead to a violent crime. It was hard to imagine anything that couldn't meet this threshold. It was not enough to "pile inference upon inference" to connect an activity to interstate commerce. In actuality, the GFSZA neither dealt with a commercial activity nor required that the gun possession it prohibited be in any way connected to interstate commerce. The Court ruled in 1995's *United States v. Lopez* against the government and the GFSZA was invalidated.

A case in 2000 echoed the *Lopez* ruling. A female student at Virginia Tech was sexually assaulted and sought federal recourse under a portion of the 1994's Violence Against Women Act (VAWA) that allowed victims of gender-motivated crimes to file a federal case against attackers. The VAWA exceeded congressional power, the Supreme Court ruled in *United States v. Morrison*, which named one of the alleged attackers as the defendant. The violent act of one party against another was not economic in nature — despite the potential economic harm that might result for the victim — and therefore had no conceivable impact on interstate commerce.

Morrison also strengthened the *Lopez* result. In contrast to the *Lopez* case, the VAWA legislation provided ample evidence of the economic effects of gender-motivated violence. But the Court stood that Congress could not regulate noneconomic crime of one person against another based solely on the possibility that the cumulative effect of many similar acts of that crime could affect interstate commerce. This differed from the *Wickard* case, in which cumulative effects of economic activity were deemed appropriate federal jurisdiction. To allow Congress to regulate any activity that in any remote way affects commerce would be to confer onto Congress general police power over the nation, the Court said. That could somewhat eradicate the federated structure secured by the Constitution.

Although the Court seemed to be ending its long-standing deference to Congress, remnants of that deference remained. The Court ruled in 2005's *Gonzales v. Raich* against an ill California resident who had grown marijuana for medicinal use, which was valid under California law but prohibited nationally. There was indeed an established, albeit illegal, market for marijuana, the Court said. Like the Depression-era wheat farming in *Wickard*, a booming black market for marijuana could raise prices and draw homegrown product into the market, counteracting the government's efforts to limit commercial transactions in the drug. Justice Scalia wrote in a clarifying opinion that Congress could regulate purely intrastate activities, even if they don't "substantially" affect interstate commerce, if they could otherwise undercut its ability to regulate interstate commerce.

What's at Stake

Justice Sandra Day O'Connor's dissent in *Raich* reiterated that the Supreme Court's role is to enforce the outer limits of Congress's Commerce Clause authority to protect state sovereignty from a gradual encroachment of federal power.

It is difficult to imagine in advance how any precedent might be applied in the future toward this end without knowing the specifics of the cases that will arise.

Take, for example, health care legislation passed in March 2010, the most recent arena in which Commerce Clause breaches have been alleged. The law requires all U.S. citizens to purchase health insurance or be subject to a fine. Critics point out that health insurance is strictly intrastate; it is regulated by states and historically has never been purchased across state borders.

The other side recalls the *Wickard* and *Raich* rulings, in which the Supreme Court allowed Congress to regulate activities that aren't strictly interstate commerce but have the potential to "substantially" affect interstate commerce, or that impede Congress's regulation of a market the Commerce Clause might say is valid to regulate, such as that for health care.

But the health care question contains something new. The Commerce Clause says Congress has the right to regulate certain activities — but can it regulate the failure to engage in an activity like the purchase of health insurance? What if said inactivity "substantially" affects a regulated class of interstate commerce? It's not immediately clear how the legal precedents established by the Supreme Court apply in these examples.

Answering such questions may not be easy. Many of the same debates held by the Framers over the proper balance of authority are still very much alive today. **RF**

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Charitable Giving *continued from page 23*

endowed society's most famous institutions. Those gifts have also enabled prototypes, such as the nation's 911 emergency response system and the Pell Grant program that sends poor students to college. Nonprofit grants from Carnegie and other foundations even gave the private, nonprofit National Bureau of Economic Research an initial leg up in the 1920s. More recently, Warren Buffett announced his gift of $31 billion to the Bill and Melinda Gates Foundation. That's more than twice — in 2006 dollars — the combined amount Carnegie and Rockefeller gave in their day.

While individuals make up three-fourths of charitable giving, less than 2 percent of households actually give according to a traditional religious "tithe" — 10 percent of income. The norm is 1 percent to 2 percent of average income.

Contributions to groups that supply basic needs, such as homeless shelters or food banks, grew by 3.7 percent after a decline the previous year. Religious giving barely budged, with a 0.3 percent decline. "Combination organizations," such as United Way and the United Jewish Appeal, received more in contributions in 2008; giving to that category fell by 4.2 percent in 2009.

People give money when they feel secure based on the value of their assets, and the connection between changes in the stock market and giving has strengthened. Estimates associate a 10 point increase in the Dow Jones Industrial average with $16 million more in charitable giving, and a $1 billion increase in personal income associated with $15 million more. "We particularly see the DJIA more important in the post-World War era, as more households own financial assets," Osili says. "We are watching personal income closely. Based on historical patterns of recovery, personal income will have a robust impact on giving."

The outlook for giving remains uncertain. Wider participation in financial markets affects philanthropy today more than in previous downturns, and policy changes could also inhibit gifts. But philanthropic professionals are pinning hopes for recovery on other dissimilarities: higher per-capita income, a greater percentage of college graduates, and more households supporting secular causes. **RF**

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