Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Should Courts Guard Economic Liberties?

TO THE EDITOR:

Antonin Scalia believes the Supreme Court is correct not to revive the doctrine of economic due process, which holds that the Constitution protects substantive economic rights ("On the Merits of the Frying Pan," *Regulation*, January/February 1985). He offers two principal reasons. First, if judges endorse economic due process, they will be more likely to constitutionalize "social judgments that ought better be left to the democratic process." To the objection that in the last fifty years judges have been doing much of the latter and little of the former, he responds that the life of the law is logic, not experience.

Second, Scalia believes judges will do poorly at policing economic legislation because they are economic illiterates, and we cannot assume that courts will favor property more than the political branches, since social changes have made it "foolish to look for Daddy Warbucks on the bench." True, but irrelevant. Most people are economic illiterates; Daddy Warbucks loved free markets the same way Lee Iacocca does. But courts will respond to factional pressures differently from legislatures, not because their ideology differs but because their incentive structures differ.

Since the 1930s, when the Court concluded that legislatures could not err in economic matters, a whole new discipline has come into existence. The study of public choice—the use of economics to study politics—has shown that legislatures are often subverted by powerful special interests. Even the maximum-hours-for-bakers legislation in the pivotal *Lochner* case was designed less to help the working man than to aid mechanized bakeries at the expense of their smaller, more labor-intensive competitors. Courts are less exposed to these pressures than the more political branches of government.

Scalia seems to believe that conservatives should respond to two generations of liberal judicial activism by rolling over and playing dead. What conservatives should worry about, I believe, is whether judges are applying principles that accord with the Constitution, not whether this application leads to "too much" or "too little" review of economic regulation. If there were no principles under which to review such regulation, the courts would have to leave it alone. But there are.

The Supreme Court strikes down restrictions on so-called fundamental liberties as unconstitutional unless they serve a compelling state interest. Suppose the Court were to do the same thing with restrictions on economic freedom. Regulations that restrict personal freedom without making the affected parties better off *in their own view of the matter* have no redeeming social virtues. The government has no compelling interest in enacting such rules.

Economics provides principled ways to identify this sort of statute or regulation. Examples include state laws under which automakers may not establish or relocate dealerships without state permission, drug stores must be owned principally by registered pharmacists actively engaged in their operation, and major refiners may not operate retail gas stations.

The Supreme Court has upheld laws in all these areas. Yet judges need little economic sophistication to see that these laws reflect a breakdown of legislative processes—the capture of the legislature by special interest groups. They need only decline to wear the blinders Scalia (and the current Court majority) prescribes for them.

If judicial intervention fails in easy cases like these, there will be time enough to grant Scalia's thesis. In the meantime, however, Judge Scalia and other conservative judges recently arrived from the academy should stop dragging their feet and start providing the intellectual leadership of which they are so readily capable, and which their colleagues so desperately need.

Wesley J. Liebeler,
UCLA School of Law

ANTONIN SCALIA responds:

Professor Liebeler's first attack on my views is a nicely crafted allusion to Oliver Wendell Holmes's *bon mot* that "the life of the law has not been logic: it has been experience." It would be more apt if Justice Holmes had not dissented vigorously from the (later overruled) *Lochner* opinion that Liebeler thinks so admirable. Holmes began that dissent:

"This case [striking down a state law regulating working hours] is decided upon an economic theory which a large part of the country does not entertain. If it were a question whether I agreed with that theory, I should desire to study it further and long before making up my mind. But I do not conceive that to be my duty, because I strongly believe that my agreement or disagreement has nothing to do with the right of a majority to embody their opinions in law. It is settled by various decisions of this court that state constitutions and state laws may regulate life in many ways which we as legislators might think as injudicious or if you like as tyrannical as this, and which equally with this interfere with the liberty to contract. Sunday laws and usury laws are ancient examples. A more modern one is the prohibition of lotteries. The liberty of the citizen to do as he likes so long as he does not interfere with the liberty of others to do the same, which has been a shibboleth for some well-known writers, is interfered with by school laws, by the Post Office, by every state or municipal institution which takes his money for purposes thought desirable, whether he likes it or not."

As this excerpt suggests, it is not I but Liebeler who would have judges run our polity on the basis of a priori principles rather than be guided by the practices and traditions of the society that give content to such vague provisions of the

Constitution as the due process clause.

What I said in my article regarding logic was not that it is the touchstone of the validity of court decrees, but that "there is an inevitable tug of logical consistency upon human affairs, and especially upon judicial affairs"—so that one is unlikely to have government by shibboleth with regard to economic liberties and avoid it elsewhere. Liebeler's letter obligingly makes my point. He expresses his thesis that "regulations that restrict personal freedom without making the affected parties better off in their own view of the matter" are unconstitutional by describing them as having "no redeeming social virtues." That phrase is a reference to the Supreme Court's (now abandoned) test for obscenity, which by judicial decree revolutionized our small-town social mores in a fashion the Framers could never have intended. Later, his sense for logic leads him to note that "the government has no compelling interest" in the sorts of regulations he despises. That is a reference to the "compelling state interest" test used especially in First Amendment cases (though increasingly in other contexts as well) to prevent such assaults upon our freedoms as banning the wearing in a courtroom of a jacket emblazoned with the motto "F - - - the draft" (spelled out, of course). Now perhaps Liebeler likes the trend of these noneconomic cases, and hopes that it will expand well beyond the First Amendment in the future. For those who do not, the first point of my piece was that it is folly to rely upon in the economic field, and thus validate everywhere, the principles of constitutional analysis that produced that trend.

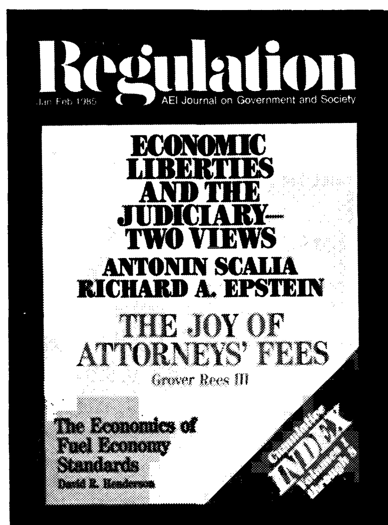
My second point was that the judges on whom Liebeler would confer such power might not share his view of economics, and might constitutionalize just the opposite of what he desires. His response is that it needs "little economic sophistication" to see that his economics are right. What does it take beyond a half-century of interventionist economics (*not* just on the interest-group-dominated floors of legislatures but in the economic councils of government) to establish that what he considers a "little economic sophistication" cannot be assumed? Especially coming from an eminent antitrust scholar, this vote of confidence in the economic acuity of the courts is—as Dr. Johnson described an acquaintance's second marriage—the triumph of hope over experience. If Liebeler is not presumptuous in his willingness to prevent his countrymen from applying economic views contrary to his own, however correct the latter may be (and, unlike Holmes, I think they are correct), he is surely misguided in assuming that judges will not prevent the application of his views instead. Experience is to the contrary.

Adding Up the CAFE Bill

TO THE EDITOR:

Although David Henderson's analysis of automotive fuel economy standards makes a number of valid points ("The Economics of Fuel Economy Standards," *Regulation*, January/February 1985), it fails to mention the most fundamental defect of CAFE: the standards actually may not save this country any fuel. True, the "average" car now consumes less gasoline than its predecessor, but it is not average consumption that counts. What does count (if anything in this program counts) is total usage by the automotive fleet, and that cannot be reliably inferred from vehicle averages.

To see this, we need only reflect on how an automobile company subject to CAFE might respond. Given enough time and resources, it will decrease fleet fuel consumption by changing engines, transmissions, and vehicle sizes, as indeed all companies have done. But a rising average mileage requirement can also be met (and in the short term, can *only* be met) by shifting the mix of vehicles sold. Here a company might (a) reduce sales of large cars, (b) increase sales of small cars, or (c) both. Although either (a) or (b) by itself can achieve a higher average, they have entirely different effects on total fuel consumption. Simply reducing large-car sales lowers total units sold and total consumption, but raising small-car sales by itself *increases* total vehicle sales and total consumption, even as it raises average mileage. This simple property of averages entirely obscures the effect of CAFE on aggregate fuel consumption.



But what do the companies actually do? I have shown elsewhere that they generally will both reduce large-car sales and raise small-car sales, the proportions depending on which segment of demand is more responsive to price changes (in the *Quarterly Journal of Economics*, November 1983). There is much evidence that companies pursued exactly this strategy during the first eighteen months of the CAFE law (until demand shifts in early 1979 made it nonbinding) and again recently as market demand has reverted to large cars.

The net effect of this "mix shift" on total fuel consumption, therefore, depends not only on average mileage, but also on total vehicle sales. If the latter are unchanged—unchanged, that is, by CAFE itself—the average is a good proxy for the total. This is the universal assumption in calculations of the effect of the standard on fuel consumption. But it is in general not true, and in fact the evidence clearly suggests a net sales increase under the price and elasticity conditions of the automobile market. This sales increase causes the naive calculation to overstate fuel savings. In fact, as previously suggested, a sufficiently large induced sales increase can completely wipe out all fuel savings. My data show that auto market conditions may be closer to this full-offset case than to the constant-sales assumption.

So where has policy gone wrong? The problem, I believe, is a false analogy between CAFE and other trade-off devices like stationary-source emission bubbles. Both seem to permit efficient intra-firm allocations of regulatory burden, but there is a fundamental difference. Whereas a bubble allows least-cost choices to achieve maximum total emissions (the regulatory objective), CAFE permits least-cost choices to achieve average fuel economy—which is simply *not* the ultimate objective. This design flaw in CAFE implies that years of effort

(*Continues on page 52*)

(*Continued from page* 3)

and billions of dollars have been spent to entirely uncertain effect. This should caution against further simple increases in CAFE (whatever other reasons there may or may not be for continuing the standards). It should also caution against similarly naive averaging techniques in other areas—as, for example, the one EPA is presently contemplating for some mobile source emissions.

Beyond this, CAFE has other peculiar effects worth noting. Henderson points out the special burden borne by manufacturers of primarily large cars, who must distort their preferred sales mix a great deal, possibly even introducing entirely new products, to avoid fines under the law. But less attention has been paid to small-car specialists, like AMC and now Chrysler, whose average mileages are safely above the standard. They must compete with diversified sellers who lower their small-car prices, recouping the losses through profits from the "tied" large-car sales that are thereby permitted. With no large cars as offsets, small-car firms are faced with a kind of regulation-induced price predation against them. Indeed, such companies might rationally decide to produce large cars, which they otherwise would not do, solely to permit them to cross subsidize. Presumably, penalizing small-car manufacturers and inducing more large-car production were not the objectives of the original CAFE law.

Some of these perverse effects and incentives could be alleviated if the standards allowed interfirm and intertemporal trading. Interfirm trading, or the selling of "excess CAFE," would permit small car producers to recover some of their losses from CAFE-induced low small-car prices. In general, such trading would promote interfirm efficiency in meeting an overall average mileage for the industry. (As previously noted, however, even this does not guarantee aggregate fuel savings.) Intertemporal trading, or "banking," is already possible, as Henderson notes, but one year's reductions are traded off for another's on essentially a one-for-one basis. In fact, the regulation should be modified to encourage earlier excesses of realized fuel mileages over the standard. A one mile-per-gallon excess in 1980 is more valuable to society than the same excess in 1985, because the higher mileage fleet would be in existence five years sooner. If CAFE "banking" is to be banking, it should not ignore time preference.

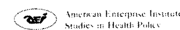
John Kwoka,
George Washington University

DAVID HENDERSON responds:

I would agree wholeheartedly with John Kwoka's analysis if CAFE applied to an auto company's *total* sales. But it does not; instead it is calculated separately for a company's sales of domestically produced cars and for its sales of imported cars. Domestic auto companies, none of which need fear going below the required CAFE on the cars they import, therefore have an incentive to increase their production of domestic small cars and reduce their imports of small cars. Doing so lowers the CAFE on their imported cars, which they can afford to do, and raises their CAFE on their domestic cars, which they badly need to do. As I stated in my article, that was why Ford dropped its German-built Fiesta and substituted its U.S.-built Escort. Thus CAFE's main effect is to alter where the small cars are produced, not how many are produced.

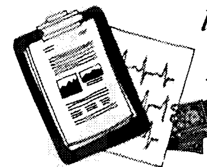
Nevertheless, I agree that the effect Kwoka discusses can occur and probably did occur in the late 1970s. The question is whether it occurs today. I think not, based on evidence from Chrysler's behavior. As Kwoka states, and as I stated in my article, if CAFE increased sales of small cars, it would drive down their prices and would hurt small-car producers such as Chrysler. But then one would expect Chrysler to be strongly against the CAFE law. Instead, Chrysler supports it adamantly. So either CAFE does not substantially increase small car production or Chrysler's management is irrational. I doubt that Iacocca is irrational enough to advocate a policy that hurts his own company, though I admit that I am more inclined to believe in his irrationality after reading an excerpt from his autobiography.

Finally, I disagree with Kwoka's statement that a one mile-per-gallon overachievement of CAFE in 1980 is worth more to society than a one mile-per-gallon overachievement in 1985. Precisely because, as he says, the higher mileage fleet would be in existence five years sooner, society would bear CAFE's costs sooner rather than later. Time preference yields the conclusion that society is better off the longer it postpones meeting the CAFE standards, not the other way around. ■



INCENTIVES VS CONTROLS IN HEALTH POLICY

Broadening the Debate



Jack A. Meyer, editor

Jack A. Meyer, editor

Do market-oriented approaches work better than regulation in containing the costs of health care? Essays place current issues of health care costs within the broader framework of a national debate on government policy. They show how lessons learned from policy disputes in other fields apply to health care and suggest that a system of incentives is superior to regulation or price controls for effective cost control.

156 pp./1985/paper $7.95
cloth $15.95

Mail orders to:

American Enterprise Institute,
1150 17th Street, N.W.,
Washington, D.C. 20036

• *For postage and handling, add 10 percent of total; minimum charge $2, maximum $10 (no charge on prepaid orders)* • *For information on orders, or to expedite service, call toll free 800-424-2873 (in Washington, D.C. 862-5869)*
• *Prices subject to change without notice* • *Payable in U.S. currency or through U.S. banks only.*