Currents

Changing of the Guard

Our most careful readers will notice a new name on our masthead. For the past two years Gene Healy brought creativity, energy, and a fine pen to the position of managing editor. Despite our wise counsel, however, Gene decided to attend law school. Alas!

Our new managing editor is Darcy Olsen, who comes to us with the experience of editing several publications at Weber State University in Ogden, Utah. Darcy already has developed plans for improving your favorite magazine, including how to stay on schedule! To Gene, our best wishes; come back to see us when you are rich and famous. To Darcy, welcome; you have already graced your position with professionalism.

William A. Niskanen

U.S.-Japan Semiconductor Agreement

On August 2, 1996, the governments of the United States and Japan renewed their agreement to regulate trade in semiconductors among businesses in their respective countries. The good news is that the agreement does not contain explicit market share targets or trade controls that characterize its past incarnations. The bad news is that it establishes a World Semiconductor Council (WSC) of businesses and a Global Government Forum (GGF) to consider issues and policies important to the industry. This new arrangement constitutes another advance in the kind of government control that seriously threatens freedom to trade.

Past Policies

The U.S.-Japan Semiconductor Agreement, first signed in 1986 and renewed in 1991, was a reaction by the Reagan administration to pressure from American producers. They feared that Japan would dominate world markets in DRAMs—that is, less-complex memory chips. American producers also complained that the Japanese government was subsidizing Japanese manufacturers. They further claimed that Japanese manufacturers were dumping DRAMs into the American market and elsewhere at less than the cost of production. In fact the Americans had walked away from production of these chips in the early 1980s, finding production unprofitable. Conscientious business decisions, not unfair Japanese trade practices, were the source of the American industry's situation.

Under the original agreement the Japanese government limited the export of Japanese semiconductors to the United States. Moreover, in a nearly unprecedented move, the Japanese government agreed to limit exports to other countries as well. America interpreted the agreement as guaranteeing foreign suppliers 20 percent of Japan's domestic market—the Japanese government interpreted this "guarantee" as an "expectation."

At the time of the agreement the U.S. government created an industry consortium, Sematech. Since 1986 American taxpayers have been forced to pay nearly $900 million in government subsidies to match the research dollars contributed by the industry members themselves. This amount is much more than the Japanese government allegedly gave its companies in subsidies.

Current Conditions

Today American firms surpass Japan's in total world sales of semiconductors with a 39.8 percent share of global markets compared to Japan's 39.5 percent. Foreign producers had 29.6 percent of the Japanese market in the fourth quarter of 1995. Regarding trade in the higher-value-added microprocessors, foreign firms and particularly America's Intel controlled 77 percent of Japan's market. The fact that American firms invested more in these chips than in the lower-valued DRAMs turned out to be a good business strategy after all.

So it seems the American industry hardly needs protection, yet the Clinton administration pushed for more government management of markets. The administration argued, for example, that the fact that the United States has nearly 40 percent of the world market but only an estimated 25 percent of Japan's market proves Japanese discrimination. But this is like claiming that a particular domestic firm is guilty of discrimination because it employs a smaller percentage of a minority group than is in the population at large. No such guilt can be inferred.

In the case of semiconductor trade, one would expect American sales to be lower in the market of its only major competitor than in the markets of countries without semiconductor manufacturers. Furthermore, since Japanese firms have about 39.5 percent of world markets but only about 23 percent of the American market, they could claim that America is discriminating.

The New Agreement

The good news about the August agreement is that the Japanese government made no pretext of guaranteeing future shares of its market to foreign suppliers, nor of limiting its exports to the United States or elsewhere. The bad news is that the agreement shamelessly established the mechanisms for international collusion between governments and businesses to manage markets. The new agreement and the institutions it creates have not been debated or voted on in Congress, unlike the North American Free Trade Agreement (NAFTA) or the General Agreement on Tariffs and Trade (GATT). Yet this agreement certainly merits close scrutiny.

Ironically, the Japanese-U.S. statement declares the "importance of market principles" and "consistency with WTO [World Trade Organization] rules." Yet the governments also fostered the creation of the World Semiconductor Council between the Electronic Industries Association of Japan and the U.S. Semiconductor Industry Association. Open to producers from other countries, the WSC will "collect data on semiconductor markets, provide the governments with reports on trade flows, market developments, and cooperative activities, and will make recommendations on issues of concern." Data collection was one of the U.S. government's demands during negotiations.

Further, at least once a year the governments will meet to review data and reports from the WSC, and to consider what actions to take. Perhaps worst of all, the agreement establishes a Global Government Forum between the Japanese and U.S. governments, with an extended invitation to the governments of other semiconductor producing countries. In addition to trade liberalization, the GGF will deliberate on "environment, worker health and safety, and standardization."

There is no redeeming value in this new agreement and a strong possibility that it will, in the long-term, be worse than previous agreements. The problems include the following:

Government Cartels

The GGF continues to replace freedom to trade with government dictates. Some might argue that the GGF is a powerless discussion club, or perhaps a kind of mini-GATT genuinely seeking to eliminate trade barriers—but experience suggests otherwise. Since 1986 the Semiconductor Agreement has encouraged governments to actively manage trade.

Some might suggest that with the involvement of non-American enterprises and other governments, American interests will not be able to call all the shots. But the Japanese semiconductor industry might well adjust to managed markets in the same way that politically influential Japanese auto manufacturers adjusted to the so-called voluntary restraints on exports to the United States during the 1980s. Those restraints allowed the Japanese and American manufacturers to charge higher prices, with the former receiving $2 billion in additional profit. The restrictions on Japanese semiconductor exports to the United States in the late 1980s similarly allowed Japanese chip producers to reap huge profits.

Further, the United States and Japanese governments have invited the European Union (EU) to join the GGF. EU firms are minor producers of semiconductors but the EU is the world's second largest consumer market. EU governments historically have sacrificed their consumers to privilege producers. Further, while EU producers will be able to participate in the WSC meetings, there is no equivalent group for European or, for that matter, American or Japanese consumers who might counter proposals that restrict trade and increase prices.

The GGF and the WSC eventually might have to include the South Korean and Taiwanese governments and producers, Japan's two chief competitors. The inclusion of these countries could head off the worst forms of managed trade. But certainly it could be expected that the major semiconductor producers and their governments would have strong incentives to ensure that Malaysia, Thailand, and China do not become major producers.

An indication of future problems with the GGF is that, like NAFTA side accords, it will consider "environment, worker health and safety, and standardization." Granted the NAFTA side accords have not proven as dangerous as critics once feared. Yet in part this is because the accords established such a highly convoluted mechanism for filing complaints that it is not likely that sanctions based on complaints will be taken. But given the way the Semiconductor Agreement has restricted free trade so far, and given the participation of the industry in the process, more unwelcome results can be expected. The inclusion of environmental and labor considerations in the GGF mandate gives the United States, Japan, and the EU an opportunity to foist their own failed regulations on potential competitors in an effort to head off competition.

Corporate Statism

Freedom to trade means that trade moves unimpeded by government interference—buying and selling decisions simply are not the government's business. There is no need for boards, councils, or consultations to manage transactions. When the government forces a business owner to make decisions in consultation with state bureaucrats or competitors, this is called corporate statism, not free enterprise.

Creeping Collusion

In the *Wealth of Nations* Adam Smith wrote, "People of the same trade seldom meet together . . . but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." The WSC will foster exactly this sort of collusion. America's antitrust laws were implemented to prevent businesses from establishing monopolies by keeping competitors out of markets. But in fact the only way a business can exclude a competitor from competing is with the assistance of government.

Knowledge is Power

Washington bureaucrats do not desire industry data to satisfy their intellectual curiosity—they want information to control markets. The Semiconductor Agreement was based on data that were manipulated to support allegations of unfair trade practices. The same misuse of data can be expected in the future.

Aiding Japanese Bureaucrats

The renewed Semiconductor Agreement also may strengthen protectionist forces in the Japanese government. Japanese bureaucrats monitored the agreement and strong armed Japanese enterprises into compliance. With data collection left to the WSC, it might seem as if those bureaucrats would lose power. However, it is more likely the case that delegating data collection to the WSC is a kind of unfunded mandate on businesses—a way to make businesses do the government's bidding.

Dumping on Freedom

The joint statement announcing the renewed agreement also is foreboding in its reaffirmation of antidumping laws which are among America's worst and most disingenuous trade practices. These laws manipulate data to "prove" that foreign firms are selling products in the American market at "unfair" prices below the costs of production. The U.S. government leads the world in using this device to restrict imports to protect its domestic producers. But the only fair price is the price on which a buyer and seller agree. The reaffirmation of the validity of antidumping laws in the renewed Semiconductor Agreement bodes ill for market liberalization.

Kiss Sovereignty Good-bye

The bottom line is that the renewed Semiconductor Agreement continues to restrict the sovereign rights of individual Americans and enterprises to trade freely and dispose of their properties as they see fit. When trade is truly free, governments step aside and individuals and enterprises do business unencumbered by political manipulation. With the Semiconductor Agreement, governments have immersed themselves ever deeper into the private sphere.

The Clinton administration will claim victory in this agreement. The critics will claim that the Japanese won this round since the U.S. government did not get the immediate micromanagement of markets that it wanted. But this agreement establishes the mechanisms to manage trade that will make consumers, and their freedoms, the long-term losers.

Edward L. Hudgins

One, Two, Tort: The BMW and Tebbetts Cases

The economic theory of the "second best" holds that when one condition for the efficient operation of a market is not met, then the requirements to best correct for this inefficiency may be complex and difficult to meet. The current state of American tort law is an excellent illustration of this point. Products liability law should be governed by contract, not by tort law. Buyers and sellers should be able to decide by contract or warranty what terms will govern in the event of a mishap. But unfortunately, for nearly four decades, the courts have not been willing to enforce such products liability contracts. Thus they are forced to rely upon complex machinations in their attempts to reach a second best solution. We see this process at work in two recent Supreme Court decisions: the first, the *BMW v. Gore* decision; and the second, the Court's decision not to hear the *Tebbetts* case.

BMW v. Gore was an Alabama case involving punitive damages filed against BMW for failing to inform Ira Gore, a physician, that the car he had purchased new, in fact, had undergone minor repairs, specifically a $600 paint job to eliminate damage caused in shipment. It was estimated by an expert and accepted by the jury that this repair reduced the value of Gore's car by $4000. The Alabama jury awarded Gore (and his lawyer) punitive damages of $4 million; the Alabama Supreme Court subsequently reduced the award to $2 million.

The U.S. Supreme Court sent the case back to the Alabama Supreme Court for a rehearing on the amount of damages awarded. Although the Court has heard several cases involving punitive damages in recent years, this is the first time it ruled that damages were excessive. Interestingly Justices Antonin Scalia and Clarence Thomas, usually on the side of free markets and economic efficiency, voted against the decision. They maintained that the issue of damages based on federalist principles should be decided by state, not federal law. In a separate dissent Justices Ruth Bader Ginsburg and William Rehnquist articulated the same point.

Many explicit state regulations require notification of repairs worth 3 percent or more of a car's retail value—and this was BMW's policy. The Alabama state court decision is obviously bizarre; no sensible legal system would punish a business with $2 or $4 million judgments for adhering to standard business practice. Of course there is substantial evidence that the legal system in Alabama is by no means sensible; large punitive damages have become a normal part of doing business there.

If the effects of these damage payments were confined to Alabama, then one might feel sorry for Alabama consumers who would be forced to pay higher prices for goods and services. In this case, Scalia and Thomas would be correct in arguing that the principles of federalism preclude the Supreme Court from interfering. Indeed, other recent punitive damage cases heard by the Court concerned local issues such as trash collection, land sales, and health insurance where the federalism argument would be stronger. But for products such as BMWs, it is impossible to limit the effects of large damage awards to citizens in one state. All consumers must pay the same prices for products in interstate commerce, or transshipment by wholesalers will equalize prices.

This is where the second best argument becomes relevant. Assume that BMW and other automobile manufacturers decide not to sell in Alabama fearing the risk of large damage payments; then, Alabamans would buy cars in Georgia or Florida. Contracts for sale could stipulate that any dispute between a buyer and BMW would be heard in Florida courts and that Alabama courts would have no jurisdiction. But Alabama courts would not honor such contracts, and the U.S. Supreme Court would not force them to do so—Gore could have sued in Alabama even if he had purchased the car in Oregon. In a sense Scalia and Thomas were disingenuous in arguing for principles of federalism when they have provided no evidence that they would be willing to offer the contractual protection needed to make federalism work. Given this, we must conclude that the Supreme Court was correct to rule that excessive fines were levied on BMW.

The other recent case is *Tebbetts v. Ford* in which the Supreme Court denied *certiorari*—that is, decided not to hear the case. In this case, Rebecca Tebbetts was killed when she crashed her 1988 Ford Escort. The car met all applicable federal safety standards in force at the time; but, it did not contain airbags—airbags were required in all cars only beginning in 1990. The New Hampshire Supreme Court ruled that the Tebbetts family could sue Ford for not installing airbags; the U.S. Supreme Court declined to overturn the decision.

When the Tebbetts purchased their Escort, other Ford cars and cars manufactured by other companies were available with airbags. The family could have decided to spend more money to purchase a car with additional safety features—they did not. In a world of enforceable contracts, this would be the end of the story: The family made a reasonable decision to save a little money buying a somewhat less safe car; a decision of the sort that every consumer in the world makes every day. (We do not all buy Mercedes or Volvos; we sometimes drive from city to city even though flying is one hundred times safer; we do not all have fire extinguishers in every room of our homes, and so on.)

But we are so far from a regime of free contract that Ford did not even bother to raise any substantive arguments on this issue before the Supreme Court. The only issue Ford raised was "preemption": Did the fact that the 1988 Escort met all applicable federal standards preempt litigation in state courts over safety standards? This is exactly the sort of second best question discussed above. In a reasonable world we would have neither litigation regarding uninstalled safety devices nor federal regulation of automobile safety standards. Nonetheless, given that we have one evil—that is, federal regulation of safety standards, we may as well use it to avoid a second one. Thus from this perspective, the Supreme Court was wrong: Federal regulations should preempt state tort law and the Court should have heard the case and overruled the New Hampshire Supreme Court.

As a final matter, this case illustrates why federalism arguments should not reign in state tort law products liability cases. New Hampshire has asserted a right to allow suits against auto manufacturers for failure to meet nonapplicable standards. Other states may now assert the same right. But since Fords are sold in a national market, consumers in every state will be forced to pay higher prices for automobiles as manufacturers try to protect themselves from arbitrary ex post penalties for conduct that was proper, and legal, when it occurred.

Paul H. Rubin
Professor of Economics
Emory University

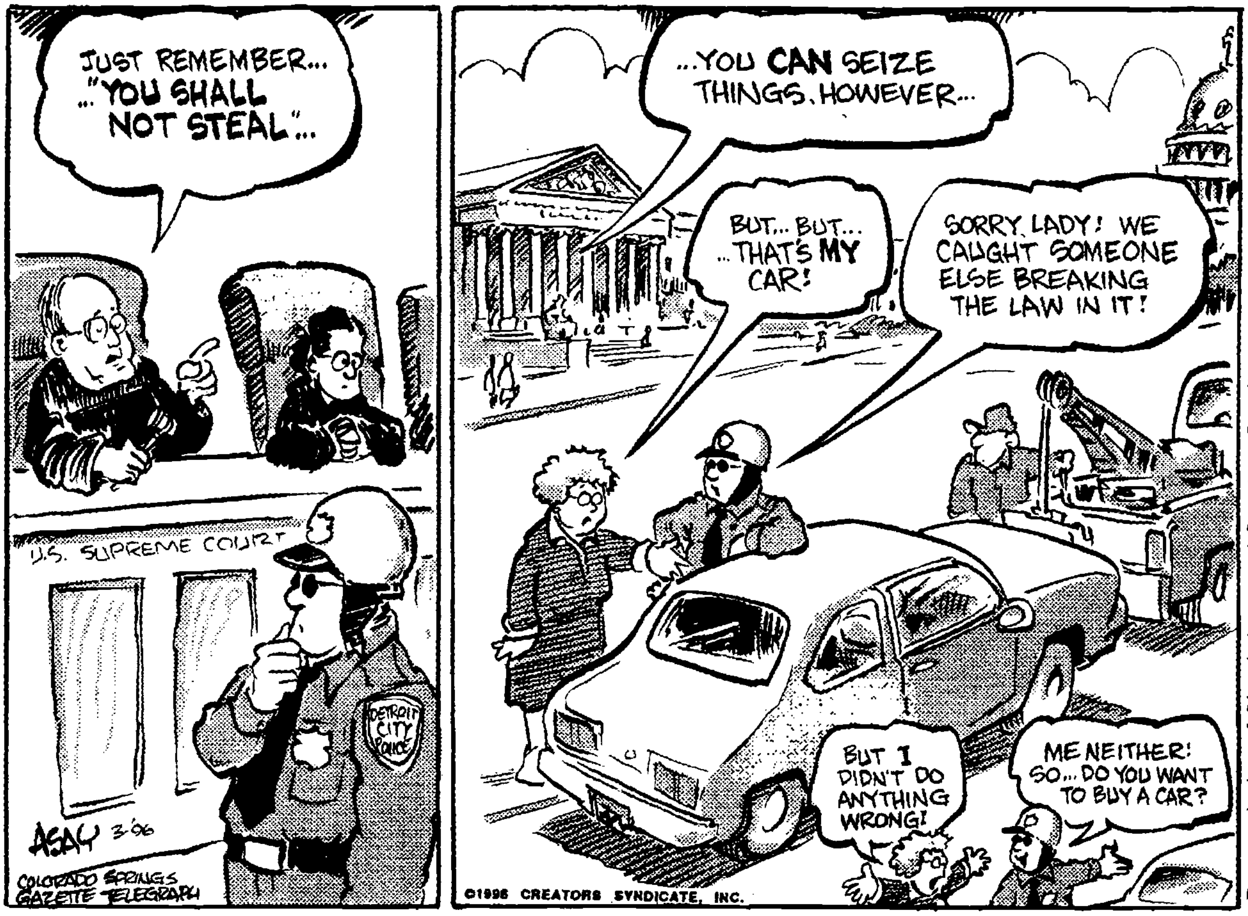
Forfeiting Reason

If ever one wanted a glimpse of judicial reasoning gone awry, one could hardly do better than turn to the three forfeiture cases decided by the United States Supreme Court late in the 1995 term. Two terms ago, when the Court issued four other forfeiture rulings, it looked like this bizarre area of law might soon be rethought from the ground up. For the moment, however, those hopes have been dashed by no less than the chief justice himself, the author of the latest opinions.

Guilty Things

Under forfeiture, law enforcement officials can seize "guilty property" almost at will. Originating in the Old Testament and the medieval doctrine of "deodands"—in the idea that animals and even inanimate objects involved in wrongdoing could be sacrificed in atonement or forfeited to the Crown—modern forfeiture law earned its credentials through early American admiralty and customs law, enduring and expanding thereafter with little restraint. It has always been used against "morals" crimes, but not there alone. Today, as during Prohibition, it has come into its own in the endless War on Drugs. Police and prosecutors love forfeiture as a "tool of the trade" and a source of vast revenues that directly enrich their coffers. Victims of all kinds, especially innocent victims, are left reeling in the wake.

The very names of the relatively few cases that make it to court tell the story: *United States v.*



By permission of Chuck Asay and Creators Syndicate.

$405,089.23 in United States Currency; United States v. 92 Buena Vista Avenue; United States v. One Mercedes 560 SEL. Civil forfeiture actions are brought against *the property*, not against the individual. They are *in rem* proceedings—not for the purpose of gaining jurisdiction over a real person but for the purpose of seizing property for forfeiture to the government. Fantastic as it may sound, it is the property that is charged.

Under this law, officials can seize a person's property, real or chattel, without notice or hearing, upon an *ex parte* showing of mere probable cause to believe that the property has somehow been "involved" in a crime. Neither the owner nor anyone else need be charged with a crime because the action is against "the thing." The showing could allege that the property is contraband, that it represents the proceeds of crime (even if in the hands of someone not suspected of criminal activity), or that it was somehow "used" in crime. And probable cause may be based on nothing more than hearsay, innuendo, or even the paid, self-serving testimony of a party with interests adverse to those of the property owner.

Once the property is seized, the burden is upon the owner, where permitted, to prove his innocence—not by a probable-cause but by a preponderance-of-the-evidence standard. In defending his innocence, the owner must prove a negative, of course. Moreover, he will be up against the overwhelming resources of the government. And if he has been involved in any activity that might lead to criminal charges, however trivial or baseless those charges may ultimately prove to be, he has to weigh the value of the property against the risk of self-incrimination entailed by any effort to get it back. As a practical matter, the burden is often too high for many innocent owners, who end up walking away from their losses.

Sex in a Car

In the first of the Court's latest cases, *Bennis v. Michigan*, Mrs. Tina Bennis found herself on the wrong end of a Michigan law when Detroit police charged her husband with engaging a prostitute in the family car. After convicting him of gross indecency, the state brought an action to have the car forfeited as a public nuisance due to its "use" in the crime. A victim of her husband, Mrs. Bennis was now a victim of the state, which took her half-interest in the car. There being no innocent-owner defense available to her under the statute, Mrs. Bennis contested the forfeiture by claiming, among other things, that it deprived her of her property without due process of law as protected under the Fourteenth Amendment.

In writing for the majority of five that found Mrs. Bennis's claim without constitutional merit, Chief Justice Rehnquist sought the aid of authority—of "long-standing practice"—no fewer than ten times over his brief eleven-page opinion. In fact, the opinion is little but a sustained argument from authority, from "a long and unbroken line of cases" that includes one in which a woman purchased a car from a dealer who, while entrusted with the car, allowed it to be used for the illegal transportation of liquor, resulting in its forfeiture to the state; and another in which a leased yacht was lost after it was used by the lessee to transport marijuana in direct violation of the ship's lease. In a recent book, *Forfeiting Our Property Rights*, published for the Cato Institute, Congressman Henry J. Hyde catalogues a long list of far worse cases: police who stop motorists and seize their cash on the spot; agents who destroy boats, cars, homes, and airplanes, and even kill and maim in the name of forfeiture. Such is the history of a body of law that is "too firmly fixed in the punitive and remedial jurisprudence of the country to be now displaced."

What that law says is that Mrs. Bennis is effectively out of court. The essence of her due process claim, Rehnquist notes, "is not that she was denied notice or an opportunity to contest the abatement of her car; she was accorded both. Rather, she claims she was entitled to contest the abatement by showing she did not know her husband would use [the car] to violate Michigan's indecency law." It is here, precisely, that "a long and unbroken line of cases holds that an owner's interest in property may be forfeited *by reason of the use to which the property is put* even though the owner did not know that it was to be put to such use." Thus, the process Mrs. Bennis was due was essentially pointless: once it had been determined that the car had been so used, nothing Mrs. Bennis could have said at any proceeding would have made a difference; for as the Court said in 1827 in the famous case of *The Palmyra*, "the thing is here primarily considered as the offender."

Disquieting Implications

Through the years, not surprisingly, the Court has struggled mightily with that fiction. Even in *Bennis*, for example, Rehnquist tries to correct a 1993 Court observation that in a 1921 case the Court had "expressly reserved the question whether the [guilty-property] fiction could be employed to forfeit the property of a truly innocent owner." That observation "is quite mistaken," Rehnquist says, for the 1921 Court expressly reserved opinion about whether forfeiture "can be extended to property *stolen* from the owner or otherwise taken from him *without his privity or consent*." One may ask whether there is any real difference between those two reservations. But regardless, the distinction Rehnquist then draws between property that is "used without the owner's consent," where the question of forfeiture's application is reserved, and property that is "used in a *manner* to which the owner did not consent," where forfeiture is applied, should be utterly irrelevant. For if the *property* is guilty—that is forfeiture's premise—it matters not at all whether it was stolen or merely "entrusted."

Not even Rehnquist appears willing to follow the logic of the argument, however. Thus, he answers Justice Stevens's suggestion, in dissent, that this law "would justify the confiscation of an ocean liner just because one of its passengers sinned while on board" with a dodge: "When such application shall be made it will be time enough to pronounce upon it." (Let the record show that hotels and apartment buildings are today forfeited when their owners are unable to prevent drug transactions in them.) And in a move that only muddies the foundations of this law, Rehnquist notes that "forfeiture also serves a deterrent purpose distinct from any punitive purpose." Absent any knowledge of what her husband was up to, it is hard to imagine what Mrs. Bennis might have done, under the threat of forfeiture, to deter his assignation. That she was punished by the law, however, is beyond any doubt.

Does Forfeiture Punish?

Or is it? We come thus to the other two cases in this term's forfeiture trilogy, *United States v.*

Ursery and *United States v. $405,089.23 in United States Currency*, which were consolidated in a single opinion because they raised the same question: Do civil forfeitures constitute "punishment" for purposes of the Fifth Amendment's Double Jeopardy Clause? Notwithstanding the admission just noted from *Bennis*, Rehnquist concluded, this time with all but Justice Stevens on board for at least the judgment, that civil forfeitures do not constitute punishment and so are not subject to the strictures of the Double Jeopardy Clause.

That clause prohibits the government, as the Court recently put it, from "punishing twice, or attempting a second time to punish criminally for the same offense." In *Ursery*, the sixth circuit had cited double jeopardy to reverse Guy Ursery's conviction and sixty-three-month sentence for manufacturing marijuana because Ursery had already been punished by the forfeiture of his home following its use in the crime. In *$405,089.23*, the ninth circuit had cited double jeopardy to reach the converse result, reversing the forfeiture of money and other property involved in money laundering and in a conspiracy to aid and abet the manufacture of methamphetamines because the owners of the property had already been punished following their convictions for those crimes—life in prison and a ten-year term of supervised release in one case, life in prison and a five-year term of supervised release in the other.

In reaching their decisions, however, the two circuits had misread three recent opinions, Rehnquist says. In *United States v. Halper* (1989), the Court had held that a disproportionate civil penalty was punishment and thus implicated the Double Jeopardy Clause. In *United States v. Austin* (1993), the Court had held that civil forfeiture under the drug statute before it "constitutes 'payment to a sovereign as punishment for some offense' and as such, is subject to the limitations of the Eighth Amendment's Excessive Fines Clause." And in *Department of Revenue of Montana v. Kurth Ranch* (1994), the Court had held that a marijuana tax motivated by a "penal and prohibitory intent" makes the proceeding that imposes it on someone already convicted of possession "the functional equivalent of a successive criminal prosecution" in violation of the Double Jeopardy Clause.

But none of those cases, Rehnquist notes, involved *in rem* forfeitures for double jeopardy purposes. What the circuits should have done, he says, is follow three cases that begin with *Various Items of Personal Property v. United States* (1931) and end with *United States v. One Assortment of 89 Firearms* (1984). In *Various Items*, the Court laid down the rule: Because forfeiture is against "the property," which is "held guilty and condemned as though it were conscious instead of inanimate and insentient," it is "no part of the punishment for the criminal offense." Thus, double jeopardy does not apply. In *89 Firearms*—where the owner of the "defendant weapons" had already been acquitted of charges of dealing firearms without a license—the Court found that the government's subsequent forfeiture action did not violate the Double Jeopardy Clause because Congress intended forfeiture to be a remedial civil sanction, because forfeiture reached a broader range of conduct than its criminal analogue, and because it furthered such "broad remedial aims [as] discouraging unregulated commerce in firearms."

If this all sounds result-oriented, and not a little circular, it is no accident. The Court says, in effect, that forfeiture is civil and remedial, not punitive, because Congress and courts from time immemorial have said it is. More than circular, however, the argument is often incoherent. Thus, when the Court says that a forfeiture may be subject to the Double Jeopardy Clause if it is "so punitive" as to be equivalent to a criminal "proceeding" [sic]—as if punishment of *any* degree, as distinct from restitution, did not require the greater scrutiny of a criminal proceeding—we have yet another indication of a court without a systematic theory of remedies. Indeed, "remedial," for the Court, pertains not simply to righting or remedying wrongs—as in making victims whole—but to advancing public purposes like "discouraging unregulated commerce." In the end, it comes as no small relief to discover Justice Stevens noting, in dissent, that the Court's conclusion that forfeiture is punishment "for purposes of" the Excesses Fines Clause but not "for purposes of" the Double Jeopardy Clause makes "little sense."

The beauty of discerning only distinctions and differences, of course, is that you can find a reason for every result—or, less charitably, a principle for every fact pattern. Unlike the search for *organizing* principles, it is a method ideally suited for ad hoc jurisprudence. But perhaps the concurrence of Justice Kennedy best illuminates this law. Forfeiture is "not directed at those who carry out the crimes," Kennedy says, "but at owners [like Tina Bennis] who are culpable for the criminal misuse of the property." (And Kennedy dissented in *Bennis*!) Wrong on both counts, Kennedy then adds that forfeiture "does not depend upon or revive the fiction that the property is punished as if it were a sentient being capable of moral choice. It is the owner who feels the pain and receives the stigma of the forfeiture, not the property." Fortunately, the fiction today is gone. Only its implications remain, to give pain to property owners—but not for double jeopardy purposes.

Roger Pilon
Director, Center for Constitutional Studies
Cato Institute

A Libertarian Inside, Looking Out

"This is the most unheard of thing I have ever heard," quipped a friend upon learning that this advocate of limited government and free markets had accepted a White House appointment as chief of staff to a member of the Surface Transportation Board (STB), successor to the Interstate Commerce Commission (ICC).

After seventeen years of crafting public policy positions for America's freight railroads—tethering reluctant executives to free market principles—I did, indeed, accept government employment. My boss is Gus A. Owen, a Republican and entrepreneur from Orange County, California whom I found intellectually seductive from the moment we met. It was Commissioner Owen, one of three STB members, who effectively lobbied Congress to limit the terms of every STB commissioner, and to require that at least one board member have private-sector business experience.

It was also Commissioner Owen who recently prevailed upon Congressman Tom Campbell (R-Calif.) to introduce legislation to limit the terms of virtually every other regulator, particularly unelected regulators and entrenched bureaucrats with no public accountability. "We must provide greater opportunity for talented people with private-sector experience to serve their nation and ensure they return promptly to the private sector," the commissioner emphasized. Never before have I encountered a regulator who translates the cost of regulations into the number of computers a firm cannot buy as a result.

Yes, in a libertarian world there would be no STB. But neither would there be an Interstate Commerce Act. When Congress shuttered the ICC in 1995, it left on the books hundreds of pages of surface transportation regulatory law dating back to 1887. Without a successor to the ICC, other federal agencies or district court judges—many with a fondness for central planning—would interpret those statutes.

Assume that the Justice Department, not STB, held authority over railroad mergers. Instead of Union Pacific and Southern Pacific being permitted to merge, as STB in July unanimously authorized, those who worship antitrust law and define competition in the most narrow terms would have prevailed.

Indeed, during oral argument the department's chief trustbuster Anne K. Bingaman predicted collusion if the number of competing major railroads in the West were allowed to drop from three to two. Not so, insisted Commissioner Owen who pointed to aggressive, government-subsidized truck and barge operators who have been devouring the muscle of third rail competitor Southern Pacific.

"You suggest that Southern Pacific continue to sell real estate in order to meet financial obligations," Owen reminded Bingaman. "Do you then conclude that hocking the silverware is an appropriate means to support a lifestyle, rather than bringing income into line with expenditures?"

Turning to the Justice Department's envisioned collusion between a merged Union Pacific-Southern Pacific and its principal competitor Burlington Northern-Santa Fe, Commissioner Owen insisted that a duopoly does not mean collusion. "Over the past quarter century there have been dozens of rail mergers and many resulted in duopolies," he lectured. "Can you provide evidence of collusion?"

The Justice Department could not because as history confirms, rivalry—not collusion—results when two rail competitors confront relatively high fixed costs and unyielding product, geographic, truck, and barge competition.

Upon casting his "aye" vote for this merger, Commissioner Owen congratulated an interest group that few except Ayn Rand might have noticed: "They are the people making possible more efficient transportation, American competitiveness in world markets, and more secure jobs—the investors who spend less than they earn and lend the difference to companies such as Union Pacific."

Other recent public pronouncements from this Randian commissioner should be equally encouraging to advocates of free markets:

- No business, including railroads, should be required by government to spend money on marginally profitable or money-losing operations.
- Just because a small business succeeds and grows larger, it should not automatically be penalized by having to endure more costly regulatory oversight.
- Adults are responsible for their own actions, even when they belong to labor unions and are employed by railroads.
- Capitalism is about building and creating. It always has been, it always will be.

Neither Commissioner Owen nor I is looking to slam home runs. This is not to say they cannot be hit. Ronald Reagan's legacy is his grand slam that shifted the burden of proof from those who desire to shrink government to those who wish to expand it. Mere mortals such as we are content with single base hits and the occasional drilling of a double.

Indeed, it would be useful to eliminate all of the Interstate Commerce Act if other agencies and states simultaneously are preempted from filling the breech. It is equally crucial to reduce the regulatory burden through surgical attacks on the Code of Federal Regulations.

In a recent proceeding we learned that both the Department of Transportation and STB often are required to make environmental assessments. We also discovered a separate office, letterhead, and transportation regulatory role for a federally financed protector of a single species of bird. And we fret that no railroad may abandon rural track and permit nature to reclaim the land, or relocate a line through an already industrially dense corridor, without first financing extensive, costly, and time-consuming environmental assessments.

I am nevertheless convinced that advocates of limited government and free markets can weave think tank dreams into reality; transforming capitalism from an unknown ideal into a self-evident truth. But first, more of us temporarily must overlook private-sector opportunities and commit our minds and energies to the task.

Frank N. Wilner
Chief of Staff
Surface Transportation Board

Decree Number 888

One of the graces of American economic regulation is that the regulators often give advance notice of intended actions. Thus in April 1996 when the Federal Energy Regulatory Commission (FERC) issued Order 888 to restructure the electric power transmission industry, the largest surprise in many ways was the date. (That the action would occur was advertised well in advance.) Many companies and interested individuals had offered comments on FERC's draft proposals—the commission took the occasion, and nearly one thousand pages, to respond.

Thus we deceive ourselves in thinking we have achieved a modern democratic means of government—FERC's actions may be little different from the arbitrary acts of a king, and the order itself not different at all.

The stated purpose of Order 888 is to remove impediments to competition in the wholesale bulk power market and to bring more efficient, lower-cost power to the nation's electricity consumers. The order claims to remedy the discrimination third parties face during attempts to gain access to the monopolized transmission system. To achieve this the commission required that all public utilities that own, control, or operate facilities used for transmitting electricity in interstate commerce file with FERC nondiscriminatory transmission tariffs containing minimum terms and conditions for access. Utilities also are required to take transmission service, including ancillary services, for their own wholesale electricity transactions under the open access tariffs. Order 888 also requires utilities to maintain certain information systems and to isolate their marketing and transmission departments from one another. Yet FERC assured utilities that they would be allowed to recover the "transition costs" or "stranded costs" incurred by moving from a regulated monopoly into a competitive market. The order then claims to "clarify" federal/state jurisdiction over transmission in interstate commerce by essentially claiming jurisdiction over all transmission activities. For the time being, however, the order leaves in place the existing "retail" or direct sale authority to the states.

Before Order 888, FERC directly affected about 5 percent of all electricity transactions. Now FERC will affect perhaps 95 percent, if not all transactions. It is, however, a proper role of the federal government to open markets closed by state actions—this is the very purpose of the Commerce Clause. FERC has opened natural gas transmission markets in much the same way though Orders 436, 500, and 636—all three orders have been upheld by federal courts.

Why therefore should we fear Order 888? Because in Order 888 federal economic regulation far transcends its constitutional foundations. Of course this is a testable hypothesis: Does the Constitution contain provisions that deal with the circumstance in question, and if so, does the government have prescriptive authority to deal with it? Some argue that electricity generation and transmission, the laws of physics related to transmission, and the technologies resulting from these modern ideas are beyond the scope of the Constitution. The federal government, therefore, must improvise and use its authority to accommodate such new technology. The Commerce Clause provides the means for the federal government to structure electricity markets, prices, and related economic rights.

So let us test these claims. The Constitution is a historical document, so the test of course must be historical. Has there been historical consideration of the power of government to allocate economic rights, set prices, and control the applications and uses of new technology? If the actions related to these matters already are detailed in the Constitution, then we do not need new institutional mechanisms to accommodate the present situation.

First a brief history is in order. In the early seventeenth century Parliament was increasingly upset by the fact that Queen Elizabeth and her successor King James I were granting and selling patents for all manner of purpose. The grant of economic monopoly was of course good business for the Crown which could gain from the sale of monopoly rights, as well as from revenues derived from controlling the sales of goods and services thus patented. The issue festered and finally in 1624 became the subject of what today we might call "antitrust law." Of course this law was directed specifically at the ability of the Crown to grant monopolies. The law was addressed to "your excellent Majesty" and stated:

> ...upon misinformations and pretenses of good, many such grants have been unduly obtained and unlawfully put into execution . . . be it declared and enacted that all monopolies and all commissions, grants, licenses, charters, and letter patent heretofore made or granted . . . of or for the sole buying, selling, making, working, or using of anything within this realm . . . are and shall be utterly void....

The law, however, contained several exceptions—this one is familiar:

> Provided nevertheless . . . that any declaration before mentioned shall not extend to any letters patent or grants of privilege for the term of one and twenty years . . . to the first and true inventor or inventors of such manufactures which others at the time of the making of such letters patent or grants did not use....

So in 1624 the English Parliament did two things: it forbade the Crown from granting monopolies, and allowed the Crown to grant limited-term monopolies to the first inventor of a new technology or "patent." (In 1624 the term "patent" was used interchangeably with the term "monopoly.")

Therefore it is significant that certain words do not appear in the Constitution. In particular the word "patent" does not appear in the Constitution. It does not even appear in the so-called Patent Clause. Instead the Patent Clause only gives Congress the ability to grant an exclusive right for a limited time to the actual inventor of a useful art. The Patent Clause of the Constitution very much mirrors the language of the 1624 parliamentary statute prohibiting monopolies. The Framers knew that the general power of granting patents—that is, monopolies, was very powerful. Indeed most of the original colonies were formed from exclusive patents granted by the Crown. One of the main objectives of the American Revolution was to eliminate the Crown's power over general patents on the commercial, public, and personal liberties of the colonists.

The granting of only a narrow power of patent to the federal government was no accident. James Madison's notes from the Constitutional Convention demonstrate that alternative and more extensive powers were considered and explicitly rejected. For example on April 18, 1787 the delegates to the Constitutional Convention tabled an amendment "to grant charters of incorporation in cases where the public good may require them, and the authority of a single state may be incompetent to act." The term "charter of incorporation" was simply another variation of the term "patent" or "letter patent," making open and public a right or charter issued by the king. Thus, two powers often exercised by Congress today were specifically considered and rejected: (1) the power to create institutions in the interest of "the public good"; and (2) the general power to act on matters that were, for whatever reason, beyond "the authority of a single state" to act.

While modern readers of the Constitution tend to read the Commerce Clause in isolation from the concurrent Patent Clause, both clauses must be read together in order to make sense of either one. Congress has the power to regulate commerce among the several states, but has no power to create or grant exclusive rights or any of the other general powers of the patent that were held by the Crown, except the specific power of patent to protect inventors' property. It was the states, not the federal government, that inherited the general powers of patent to create "monopolies, and all commissions, licenses, grants, charters, and letters patent."

So one asks: If Congress has the power to "regulate" interstate commerce but has no general power to create monopolies or patents, what rights or powers does it have? The answer is simple: If the federal government is specifically denied the power to create but granted the power to regulate, then it must regulate by destroying what others have created. Since the states can create monopolies, the power of the federal government lies in its ability to remove monopolies created by the states. Under the Articles of Confederation the states had issued laws that protected local commerce—this was a threat to the economic viability of each and all of the states. Thus the federal government was given the limited power to remove these obstructions.

This is also what the so-called Welfare Clause is all about. Structurally, the welfare language of the Constitution is not even in the list of powers granted to Congress; it is merely a preamble to the articles. We also know from contemporary writings that the welfare language is there—not as a grant of power—but as explanation for, and indeed *as apology for* the violation of 150 years of parliamentary struggles with the king. The struggles were so intense that the granting of even a limited version of the general patent power, as represented by the Commerce Clause, required explanation.

Now let us move ahead 209 years and look again at Order 888 and what FERC claims it might do next. Clearly the present situation, in all relevant respects, is addressed in the Constitution. It may be true that electric power transmission per se was not an issue at the time of the writing of the Constitution, but the notion that new technology could change the nature of commerce certainly was understood. Also understood was the ability of government to make mischief in the name of "public good," especially by creating monopolies for that purported purpose.

In at least one respect FERC's Order 888 to open markets is a power specifically addressed in the Constitution. Opening (transmission) markets closed by state action was the exact power granted to the federal government. But much of the order and indeed many of the commission's powers beyond its ability to open markets are not the prerogative of the federal government. This is because the explicitly limited form of patent powers granted the federal government does not include enumerated powers to fix rates or regulate by positive action. Under the Commerce Clause the federal government may prohibit what is wrong, and thereby may set standards for what is proper state action through defining what is improper. But due to the limited nature of the patent powers granted, the federal government has no positive power to prescribe rates or tariffs, nor to allocate markets. Thus while the basic purpose of Order 888 is certainly constitutional, many of the order's details, like many federal economic regulations, are not.

To see what can happen when governments exercise general patent powers, consider one of the conclusions reached in those one thousand pages of analysis of public good. The order is organized around a detailed discussion of specific issues, one of which is "flow-based contracting and pricing." At present, owners of transmission lines typically rent use of those lines to transmission customers using contracts that charge a specific rate for the use of the facility. This is "contract-based pricing." In contrast, "flow-based pricing" would not rely on such diverse contracts, but instead would price transmission based on the way in which electricity "actually flows." The commission concluded:

> We will not, *at this time*, require that flow-based pricing and contracting be used in the electric industry. In reaching this conclusion, we recognize that there may be difficulties in using a traditional contract path approach in a nondiscriminatory open access transmission environment, as described by Hogan and others . . . we believe *it is premature* for the com-

> mission to impose generically a new pricing regime without the benefit of any experience in such pricing. We welcome new and innovative proposals, but we will not impose them in this rule.

It is clear from the above example (and numerous others in the order) that the commission has in mind some new form of pricing for the transmission industry. "Well," says the believer in the ability of the federal government to do things for the public good after a fair announcement of intention, "this is certainly fair game." The commission uses good procedure—no doubt required by other federal laws such as the Administrative Procedures Act—takes public comment, and uses notices, hearings, and all other due process procedures. Indeed for our present purpose we can also assume the commission will assure the public that at the end of the process prices will permit utilities to recover their costs by accepted legal standards for compensation for takings.

The only real problem is that the federal government has no positive power to perform the contemplated actions. And if we look in more detail at just what the commission has in mind by "flow-based pricing," we can understand exactly what the colonists feared. The commission did not delve into much detail about what flow-based pricing might entail, but explicitly refers us to an author who does—one "Hogan." This is a reference to William W. Hogan, a professor at Harvard University. By what undoubtedly is not mere accident, only a month after the commission issued Order 888, Professor Hogan addressed the meetings of the Federal Energy Bar Association in Washington, D.C. with a detailed speech titled "Reshaping the Electric Industry: Markets, Rules, and Pricing."

Here is some of what he and, by inference, FERC intend:

> The nondiscrimination rules will require comparability of terms and conditions for monopoly provision of services in essential facilities . . . reliability will be maintained . . . but everything else will change. For example, by now everyone knows that the old truth of the contract path for transmission was only a workable fiction with no relation to reality. . . . *Efficient markets depend upon well defined and meaningful property rights*. . . . The transmission network is an *essential facility* for which it is difficult to define *property rights* . . . . Physical property rights to match with physical flows have proven to be elusive. There is an alternative through a mixture of physical flows and financial contracts that can . . . create the equivalent of property rights. . . . There is no workable system of property rights governing use of the transmission grid that would support a decentralized electricity market.

And so in hinting of its intention to move from contract-based pricing to flow-based pricing, FERC appears determined to replace the present system of property rights with something else it prefers instead.

This is of course a very large leap. How does the federal government which has only the tightly confined patent power to grant limited-term monopolies to inventors derive an ability to reallocate property rights? Surely not from any analysis of the "public good" since the ability to use the general patent power based on analysis of the public good was one of the powers specifically considered and denied to Congress. Under the Commerce Clause, the federal government can remove obstructions to commerce created by state actions. But the state action at issue is the granting of exclusive territories for transmission, coupled with perhaps other state exercising of general patent powers in retail services and electricity generation. The commission remedied these consequences of state actions by opening transmission markets.

But the technical problems upon which Hogan, and by adoption FERC, claim to base their proposed change to flow-based pricing derive not from state actions creating service territories, but from private property rights in some claimed relationship to the laws of physics. One must admit that state governments have great power, especially since they have inherited many of the general patent powers of the English Parliament; but, not even states can create private property rights or modify the laws of physics.

Thus FERC's contemplated move to mandate flow-based pricing is objectionable for at least four distinct constitutional reasons. First, Congress and hence the commission have insufficient power to create pricing regimes at all; this power is among the general patent powers not granted the federal Congress. Secondly, the premise for federal action under the Commerce Clause to open markets closed by state actions fails here because the premises for creating flow-based pricing—the existence of private property rights and laws of physics—do not entail prior state action at all. Third, the analysis relied upon is no more legitimate than some claims about the public good. Congress has no patent powers, including under the Commerce Clause, to act based merely on claims about public good, and indeed was specifically denied such power. The welfare language in the Constitution does not confer these or any other powers; it merely explains the presence of other specifically enumerated powers. Fourth, Congress has powers related to technology including the ability to grant limited-term exclusive rights to inventors; but, the proposed actions on flow-based pricing do not propose to create limited-term exclusive rights for a new invention. And in any event FERC has no statutory authority to grant either patents or copyrights.

Finally note in the text cited above how Hogan uses the words "essential facility" in reference to electric power transmission facilities. The naive reader might think this is an obviously true assertion—the transmission lines somehow seem to be "essential" to the carriage of electricity between generation and distribution facilities. Well, true enough—some such facility must be used when generators are not connected directly to distribution lines. But that is not the economic or legal meaning of the term "essential facility." Instead, the legally significant meaning derives from parts of the antitrust laws that essentially make it illegal to create a monopoly by "refusal to deal." Monopolization is illegal and if a monopolized facility is "essential" to the delivery of a service, then refusal to permit use of that facility also is prohibited. A facility must meet the following standards to be considered essential: the facility must be essential—that is, required for the transaction; the facility must be controlled by a monopolist; the competitor must be unable to duplicate the facility or do without it; the use of the facility must be required for the service and not merely convenient; and of course, the facility must have refused to deal.

Neither FERC nor Hogan has claimed or demonstrated that any of these conditions exist when it comes to the grid, and indeed most of them clearly do not. In the first place there has been no refusal to deal. The very presence of the contract-based flows being attacked in public discussion results specifically from a willingness of owners of transmission facilities to deal; to offer services of transmission lines at openly stated contract-based terms. It may be inconvenient but it is hardly impossible for competing providers to build their own transmission lines or to build plants closer to markets. Moreover, while there is a presumption that transmission is a monopoly, and perhaps a fact to the extent that states grant exclusive patents in the form of franchises, there is no evidence that electricity transmission is a natural monopoly. Indeed, there is good reason to believe otherwise (See Jerry Taylor's article in this issue). And thus, to the extent that there is a monopoly resulting from state action—that is, granting of exclusive franchises—there is also a ready remedy in the Commerce Clause for such an event: The federal government can void state franchises when they obstruct interstate commerce. Thus even if the technological premises of flow-based pricing were true, there is no need to invent a new remedy such as pricing power for the federal government.

Order 888 provides a very clear and current example of the dangers of general patent power. Clearly FERC is preparing the ground for reallocation of property rights in order to secure the purported "public good." If a federal commission can reallocate property rights on these grounds in energy transmission, then there is simply no limit remaining on federal power.

Paul Ballonoff
President
Ballonoff Consulting Services