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Classical competition and freedom of contract in American laissez faire constitutionalism*

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It is impossible to tell the history of American antitrust law and economics during the so-called formative era (1890-1915) without a preliminary understanding of the economic rationale underlying that major phase of American constitutional law commonly called laissez faire constitutionalism, or *Lochner* era. The essay is a preliminary effort to locate such a rationale in the almost perfect overlap between classical political economy, especially the notion of competition as the supreme organizing principle of thriving societies, and classical liberalism, in particular the notion of liberty of contract. It is argued that the well-known Progressive interpretation of the *Lochner* era fails to recognize the true meaning and extent of this overlap. The protagonists of our story are economists Adam Smith, John Stuart Mill and Francis Wayland, and Supreme Court Justices James Wilson, Oliver Wendell Holmes and Rufus Peckham.

INTRODUCTION: UNDERSTANDING ANTITRUST THROUGH LAISSEZ FAIRE CONSTITUTIONALISM

By the expression formative era of American antitrust law it is meant the period from the late 1880s to 1914, that is, from the early debates about the Sherman Act to the enactment of the Clayton and FTC acts. The contribution of economic ideas to the formative era is usually viewed as important, yet circumscribed. As it is universally acknowledged, professional economists took no direct part in the passing of the Sherman Act and only intervened in the post-1911 debates (the year 1911 being another key one for antitrust history, with the famous *Standard Oil*¹ decision), leading to the 1914 reform. Most of them actually rejected the first federal antitrust statute as useless at best, and noxious at worst, for the healthy working of the American economy, common law being considered necessary and sufficient to this aim.

This does not mean that economic ideas played no role during the formative era. On the contrary, it is widely recognized that they influenced both the legislative process and the early decades of judicial enforcement. Yet, this influence is frequently restricted to two well-definite ideas. First, a

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¹ *Standard Oil Co. of New Jersey v United States*, 221 US 1 (1911).

general principle taken from classical economics, namely, the principle of *laissez faire*, or the idea that free competition, absent government or other external interference, is the best regulator of economic affairs, generating the best possible outcome for society. Second, a specific piece of analysis taken from the so-called “new school” of progressive economics, namely, the idea that competition could be wasteful in the case of businesses requiring massive investment in fixed capital. The combination of the two ideas raised the issue of whether the preservation and diffusion of “big business” should be looked favorably from the viewpoint of general prosperity. The standard story has it that during the formative era the analytical content of the antitrust enterprise gravitated around these two polar views of competition: classical *laissez faire* and wasteful (or ruinous) competition. Legislators and judges at all levels endorsed one or the other, so much so that it is widely recognized that economic theory did leave its mark on antitrust law. However, it is also argued that the impact of economics did not go beyond that. Hence, the eventual position of legislators and judges on antitrust matters depended on a bunch of different motivations – legal, political, electoral, social – which could well lead them to either support or downplay antitrust law regardless of economic principles.

A few antitrust historians have recognized that the contribution of economics to the formative era went beyond those two ideas. A whole set of economic principles, which taken all together constituted a fully fledged worldview, or paradigm, of economic relations, inspired both the enactment and the enforcement of the Sherman Act. This set also lay behind the critiques raised against the Act. And it was only when the paradigm came under fire that reform proposals of antitrust statutes, as well as a new approach by antitrust courts, gained momentum. The paradigm I am referring to was the classical one. *Laissez faire* was hardly the only legacy classical economics bestowed American antitrust during its early years. By including a deep philosophical commitment to individualism and natural law, combined with a strenuous defense of property rights and the liberty of contract, it is argued that the classical paradigm provided a complete characterization of economic relations that passed almost entirely into the antitrust enterprise.

While this claim is hardly original, what is less frequent in the literature is another remark. This essay will argue that the only way to fully appreciate the contribution of economic ideas to the formative era of antitrust law is to frame the latter within the broader context of the birth and rise of so-called *laissez faire constitutionalism* (LFC). By that term it is meant a major phase in the history of American constitutional law that spanned from the 1880s to 1937 and that was in its turn heavily influenced by the classical paradigm. During those decades the Supreme Court, as well as lower courts, used the due process clauses of the Fifth and Fourteenth Amendments of the US

Constitution, applied substantively, to hold unconstitutional various state and federal laws that abridged the freedom of contract.

LFC is dubbed by many scholars as “Lochner era” or “classical legal thought”. The latter name emphasizes the commonality between the ideas about the individual, natural law, property and contract entertained by LFC jurists and classical economists. All these ideas descended from a common thread dating back to, at least, the mid 18c. The name “*Lochner* era” refers instead to what is the most famous – to many commentators, *infamous* – decision of the period.² Progressive scholars have condemned this, as well as the other decisions in the same vein, as instances of undue judicial activism. Accordingly, they have characterized the *Lochner* era as a time when American judges, motivated by the desire to further the interests of the capitalist class, perverted the original meaning of the due process clauses in order to arbitrarily read in the Constitution a laissez-faire ideology, often caricatured as synonymous with Social Darwinism. However, several law historians have recently questioned the Progressive narrative of LFC. In particular, they have emphasized that, far from being an unprincipled application of the judges’ own class ideology, LFC was a legitimate reading of constitutional principles pertaining to the economic rights of American citizens.³ What matters the most here, emphasis has been given to the circumstance that LFC shared with the classical paradigm the same core views about property and contract.

It is in this revisionist history⁴ that the foundations for the present essay rest. In short, the thesis is that it is impossible to understand the economics of the formative era of antitrust law without a prior understanding of the economics of LFC and of how the latter affected the former. Only following these twin understandings we may thoroughly account for the contribution of economic ideas to the early years of American antitrust. New light on some unsettled questions may then be cast, such as – to mention just the main one – explaining how the very same Court that enthroned LFC with seemingly pro-business decisions like *Allgeyer* (1897), *Lochner* (1905) or *Adair* (1908) could in the same period agree on seemingly anti-business rulings in antitrust cases such as *TMFA* (1897) or *Northern Securities* (1904). Was the *Lochner* era Court either pro- or anti-business? How to account for its inconsistency? Isn’t this proof of an unprincipled Court, applying its own idiosyncratic views of economic relations? In honor of Rufus W. Peckham, the Justice who authored most of these seemingly contradictory decisions, we will call this question “the Peckham’s puzzle”.

The history of economic thought provides helpful material to answer this and other LFC-related puzzles. The key is to identify the contributions that classical economics bestowed to judicial

² *Lochner v New York* 198 US 45 (1905).

³ See Mayer (2008-2009), 217-8

⁴ As noted by Kens 2005, 405, given the popularity of these alternative reconstructions, the term “revisionist” is not even correct anymore, while it surely was three decades ago.

thinking during the *Lochner* era – or, as it would be more correct to say – the ideas that classical economics and classical legal thought happened to share. In Part III of this essay I identify at least three such ideas as enshrined in American constitutional principles. First, the existence and effective working in free markets of an economic mechanism leading market prices to settle at their natural level. As a corollary to this idea, classical economists argued that when natural prices prevail – i.e., always, under condition of complete market freedom – the benefits for society are the greatest (i.e., social welfare is maximized). Second, the notion of competition as the general law of economic affairs in a free society, while monopoly, when not supported by state privilege, is only a temporary phenomenon. Third, the natural law foundations of the ideas of liberty and individualism. It is immediate to recognize the classical origin of all three. This essay claims that formative era antitrust law endorsed these “Smithian” principles – *the three of them, not just the first* – and that this happened because LFC judges, lawyers and legal scholars did that in the first place. In order to prove that, it is necessary to thoroughly reconstruct the evolution of LFC and the role economic ideas played in it. This is the goal of the first two parts of this essay: Part I recasting the traditional accounts of LFC and Part II accounting for LFC’s economic foundations. The concluding section then offers some reflections on why traditional reconstructions have so far missed the point.

PART I: TRADITIONAL INTERPRETATIONS OF LFC

I.A The Progressive view

A unified approach to LFC has dominated historiography until the 1980s. The so-called Progressive interpretation owes its ideological heritage to early 20c Progressive legal thought– that is, to the approach that directly confronted and criticized LFC, or, as is also frequently called, “classical legal thought”⁵. Although there has never been a single authoritative interpretation of Progressivism and no canonical Progressive creed or set of values, a few common traits in the Progressive critique and, later, interpretation of LFC can still be identified. Legal scholars like Charles A. Beard, Oliver W. Holmes (who was also a judge and a Justice), Roscoe Pound and Edward S. Corwin did share some common critiques of classical legal thought. For example, in his 1913 book *Economic Interpretation of the Constitution* Beard shocked his contemporaries by depicting the drafting of

⁵ See e.g. Wiecek 1998. This author carefully distinguishes between a Progressive and a Neo-Progressive interpretation, the watershed between the two being WWII (ibid., 255-263). To our goal, the only value of the distinction would be to clarify that Progressive interpreters co-existed with LFC and fiercely opposed it in the intellectual field, while Neo-Progressives came after LFC had been buried by the New Deal in the late 1930s and thus reasoned only in retrospect.

that sacred document as the outcome of conflict among powerful economic interests. He wrote that the Constitution “was essentially an economic document based upon the concept that the fundamental private rights of property are anterior to government and morally beyond the reach of popular majorities” (Beard 1913, 324). The most important effect of Beard’s work was to set scholars free to subject American constitutionalism to critical review. The earlier Progressives “desanctified the mystique of constitutional debate, making constitutional argument accessible to other outside the hieratic caste of lawyers and judges who treated it as their exclusive preserve” (Wiecek 1998, 257).

Generally speaking, the Progressive interpretation has impressed on law historians the image of a dominant pattern of thought (LFC) and the reaction to it (Progressive thinking). According to this view, starting from the end of the 19c and continuing until the mid-1930s, a group of conservative judges began to aggressively disregard the proper boundaries of their authority in order to search and destroy Progressive social legislation that was inconsistent either with their personal beliefs in laissez-faire economics and Social Darwinism or with the interests of big business that they more or less intentionally served. For sure, the thesis continues, these judges, together with a score of similarly oriented lawyers and jurists, were ideologically driven. They were devout believers in laissez faire, derived from their commitment to classical economics. They were also Social Darwinists, believing that progress was the result of the struggle for survival. Accordingly, they identified as the only function of the state the protection of property and enforcement of contracts. For all the rest, the state should avoid disturbing the beneficent working of the natural order and its outcomes. Beyond ideological orientation, the accusation is also that these same judges were prone to the interests of so-called Corporate America, i.e., of the social class to which they themselves belonged. All of this, Progressive interpreters finally lament, these judges, lawyers and jurists pretended to be ordained and protected by the federal and state constitutions. In reality, their approach was essentially unprincipled and rooted in extra constitutional policy preferences for laissez faire, if not in naked class interests.

A few legal notions are essential to understand LFC and the Progressive critique.⁶ *Substantive due process* is the name of a doctrine that American courts, including the Supreme Court, used from the mid-1880s until the Roosevelt Court-packing crisis of 1937 to determine the constitutionality of regulatory legislation. Under this doctrine, the courts derived a test from the due process clauses of the Fifth and Fourteenth Amendment of the US Constitution⁷ for evaluating the substantive effect

⁶ The following definitions are taken from Hall (ed.) 2005.

⁷ Both Amendments contain a due process clause. The Fifth Amendment is part of the Bill of Rights and recites: “No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall

of economic regulations. In particular, the doctrine was premised on the idea that the Fourteenth Amendment protected an individual's natural rights to "life, liberty and property" by safeguarding her private transactions from undue legislative interference.

The instrument par excellence in the exercise of private property rights was *freedom of contract* (also called *liberty of contract*). This was a private law concept imported into constitutional jurisprudence in the heyday of substantive due process. Liberty of contract meant that parties capable of entering into a contract and giving their consent to its terms ought not to be curbed by the state, save to protect the health, welfare, and morals of the community or to prevent criminal activities. Gilded-age judges incorporated this doctrine into the Constitution by substantively reading the Fifth and Fourteenth Amendment bars upon deprivation of liberty and property without due process. This reading entailed crediting individuals with a constitutional right called "freedom of contract", which, like all other constitutional liberties protected by the Amendments, granted them freedom from government interference. Any individual could therefore invoke the due process clause and ask a court to evaluate the substantive effect of any kind of economic regulation interfering with her contractual freedom.

The third key notion was that of *police power*. An ubiquitous concept in post-Civil War constitutional analysis, this power was also the most elusive for it had no textual basis. Indeed, judges and scholars of the last two centuries have recognized that the concept admits no clear definition. Traditionally, the police power comprises the authority to protect public health, safety, and morals by appropriate laws; to perform their task, these laws may even restrain rights of liberty or property. According to Ernst Freund's classic treatise, these two dimensions singled out the police power from other exercises of state authority. The police power, he wrote, "is the power to restrain common rights of liberty or property" (Freund 1904, 19); its distinguishing attributes are that "it aims directly to secure and promote the public welfare and it does so by restraint or compulsion" (ibid., 3). One of the most challenging task in American constitutional history has been the development of working doctrines delimiting this power. As an implication, the task has often been tantamount to defining the boundaries of judicial review of legislative acts.

It is important to underline that the Progressive interpretation may take different nuances. LFC decisions, and the judges voting on them, have been attacked on the basis of a varying combination

be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation". The first section of Fourteenth Amendment recites: "All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws".

of elements.⁸ These include: *i*) an excessive judicial activism, which led judges to arbitrarily include freedom of contract among the liberties protected by the due process clauses of the Fifth and Fourteenth Amendments and, more generally, to substitute their personal socio-political preferences for those expressed by democratically elected legislators; *ii*) an equally illegitimate interpretation of due process as substantive, rather than merely procedural, again frustrating the majority will expressed in legislation; *iii*) a dull adherence to a formalist pattern of judicial decision-making that privileged form over substance and abstraction over reality; *iv*) a naïve faith in intellectual fads, like laissez faire economics and Social Darwinism, which inevitably led to judicial ratification of a very unequal distribution of private economic power; *v*) a far less naïve willingness to protect the interests of Corporate America, in particular by expressing the same pro-big business and anti-labor attitude that many of these judges had exhibited in their previous occupation as corporate lawyers.

The Progressive indictment has been particularly severe with the Supreme Court. Portrayed as engaged in unprecedented judicial activism, the Court has been accused of having routinely and repeatedly invalidated state economic regulations, thereby overstepping its proper bounds and invading the preserve of the state legislators. Of the five previous variants of the indictment, the last two are those that have been more vehemently raised against the LFC Court. More charitable interpreters have accused the Justices of having unintentionally ratified the existent pattern of private economic power through their naïve belief in individual rights, limited government, neutral legislation, and the like. The idea is that Justices decided the way they did because they still felt the influence of the economic world where they had grown up, namely, the simpler world of pre-Civil War America where large corporations were few and laissez faire had some meaning. Other interpreters have been less gentle to the Court. For instance, Robert McCloskey denounced that the Justices knew perfectly well what they were doing. Their decisions were the willful defense of wealth and power, “an unadorned endorsement of the strong and wealthy at the expense of the weak and poor” (McCloskey 1951, 84). In his ground-breaking essay “The Path of the Law”, Oliver W. Holmes had played a similar tune: “When socialism first began to be talked about, the comfortable classes of the community were a good deal frightened. I suspect that this fear has influenced judicial action both here and in England [...] I think that something similar has led people who no longer hope to control the legislatures to look to the courts as expounders of the Constitutions, and that in some courts new principles have been discovered outside the bodies of those instruments, which may be generalized into acceptance of the economic doctrines which prevailed about fifty years ago” (Holmes 1897 [1997], 999-1000).

⁸ See on this Phillips 1998, 457.

A non-progressive scholar has summarized the indictment in these terms: “It was to protect the privileges of the wealthy and of corporations, [Progressive] scholars concluded, that American judges engrafted upon the Constitution the economic principle of laissez-faire, the admonition that government ought not to interfere with the natural laws that govern economic relations” (Benedict 1985, 295). In this framework, laissez faire had a purely instrumental role. As another non-progressive author put it: “Unelected justices, serving for life, imposed their own laissez-faire ideology, and they did so often, mercurially, and without explicit constitutional justification, inventing out of whole cloth a doctrine of freedom of contract not heretofore contained in the standard meaning of due process of law. The Court used this fictional freedom of contract to protect big business interests at the expense of common workmen and their attempts to secure protective legislation and to unionize” (Franken Paul 2005, 519). Starting from the mid-1980s, revisionist scholarship has seriously questioned the robustness of the Progressive critique.

I.B The Progressives’ bête noire: *Lochner v New York*

The case that has come to epitomize the LFC era is *Lochner v New York* (1905), hence the name “Lochner era” also given to the period. The decision is the most discredited one in Supreme Court history and is commonly ranked as a prime example of judicial malfunctioning. At issue in that case was the New York Bakeshop Act of 1895.⁹ Most bakers at the time were small businesses, located in the cellar of tenement houses. With dirt floors and open sewers, the cellars made for a filthy environment in which to bake bread. The New York legislature had *unanimously* voted the 1895 Act. It contained six substantive provisions, five of which addressed sanitation; these regulations, which clearly aimed at producing unadulterated bread, were not controversial. Only one section was controversial, namely, the one that made it unlawful for bakers to work more than ten hours a day or sixty hours a week. By a narrow 5 to 4 majority, the Supreme Court stroke down the statute as an infringement of contractual freedom as protected by the Fourteenth Amendment. The Court found that the state’s invocation of the police power to protect the health of bakers was unpersuasive, doubting that the measure was “really a health law” and considering it merely a labor law to “regulate the hours of labor between the master and his employees” (*Lochner*, at 64).

This opinion is crucial for our story for several reasons, not the least being that the Justice who authored it, Rufus W. Peckham, had also authored a few years before some of the Court’s earliest and most important antitrust decisions. Writing for the *Lochner* majority, Peckham maintained that:

⁹ See Kens 2005, 408.

“The general right to make a contract in relation to his business is part of the liberty of the individual protected by the Fourteenth Amendment of the Federal Constitution”. Although he conceded that a state could impose “reasonable conditions” on the enjoyment of both liberty and property and further agreed that the state could inspect bakeries and enact measures to improve workplace conditions, Peckham was unconvinced that baking was an unhealthy trade and could see no relationship between hours of work and the health of bakers. Consequently, he declared that: “It is impossible for us to shut our eyes to the fact that many of the laws of this character, while passed under what is claimed to be the police power for the purpose of protecting the public health or welfare, are, in reality, passed from other motives. [...] It seems to us that the real object and purpose were merely to regulate the hours of labor between the master and his employés (all being men *sui juris*), in a private business, not dangerous in any degree to morals or in any real and substantial degree, to the health of the employés. Under such circumstances the freedom of master and employé to contract with each other in relation to their employment, and in defining the same, cannot be prohibited or interfered with, without violating the Federal Constitution” (ibid.)

Called to draw the line between the individual right to contractual freedom protected by the Fourteenth Amendment and the state right to prohibit contracts deemed harmful to the “safety, health, morals and general welfare of the public” (ibid., at 53),¹⁰ Peckham’s answer was clear. His words rejected the state’s paternalistic argument that it had a right to protect certain classes of workers, including bakers, from their own imprudence in laboring beyond a healthful limit. The statute was not a legitimate exercise of policy power. As individuals in full possession of their rights, bakers were perfectly capable of looking out for their own interests by bargaining on equal grounds with employers. Thus, statutes like that under scrutiny were “mere meddlesome interferences with the rights of the individual” (ibid., at 61), possibly in the effort to promote one class interest over another.¹¹

Progressive scholars treat *Lochner* as an archetypical example of the corruption of judicial power for two reasons.¹² First, it is argued that in ruling against the New York statute because it violated liberty of contract as protected by the Fourteenth Amendment’s due process clause, the *Lochner* majority was reading into the Constitution a prohibition on legislative power that could not be found in the text of the Constitution and was not supported by any previous interpretation of either the words or the intent of the Framers – in short, the majority’s protection of a constitutional “right” to make contracts was a fraudulent interpretation of the Constitution, an example of judges *making*

¹⁰ “It is a question of which of two powers or rights shall prevail – the power of the State to legislate or the right of the individual to liberty of person and freedom of contract” (*Lochner*, at 57).

¹¹ On the role of judicial hostility against special privilege, or class legislation, see below, III.C.

¹² See Gillman 1993, 3.

law rather than *interpreting* it. Second, in expressing the view that the New York legislation was not substantially related to legitimate concerns about public health and safety, the Court was assaulting the doctrine of separation of powers by substituting its own conception of good and effective policy-making in the matter of bakers' physical well-being for that of the legislature. The upshot of the Progressive analysis is that the *Lochner* majority simply made up a constitutional "right" as a cover for an illegitimate, unrestrained act of judicial legislation. The basic ingredients for this "make up" were, as always, laissez faire and Social Darwinism.

A third critique of *Lochner* is that it was an expression of a purely formalist conception of judicial decision-making. Indeed, few decisions are charged with legal formalism as often as *Lochner*. However, it is important to emphasize that the formalist side of the decision, if any at all, lay not in the outcome, but rather in the motivation (Schauer 1988, 511). It is Peckham's alleged denial of the existence of any choice – moral, social, political, even economic – that the Court could legitimately make in assessing the New York statute that may be charged with "formalism". While expressing a very specific point of view about the moral, social, political and economic aspects of the issue – in particular, that the employer and the employee were bargaining equals – the Court majority denied it had any choice at all. The decision was deemed compulsory: individuals *sui juris* had to enjoy their utmost liberty of contract, without legislative impediments, and this liberty included by definition that of contracting for labor conditions. As Schauer (*ibid.*, 512) put it, the Court viewed contracting for labor without any legislative impediment as synonymous with liberty, any opinion to the contrary amounting to a violation of legal categories – indeed of the meaning itself of the word "liberty". Those who charge *Lochner* with formalism thus deny Peckham's candor when he declared that the decision was a matter of line-drawing: "It is a question of which of two powers or rights shall prevail – the power of the State to legislate or the right of the individual to liberty of person and freedom of contract" (*Lochner*, at 57). Focusing just on differences in kind, not in degree, legal formalism did not allow such line-drawing exercises in any meaningful sense.

Until about 25 years ago, all major discussions of the LFC era centered on the Progressive interpretation of *Lochner*. They took for granted that the case illustrated the potential harm when activist judges turn away from constitutional norms and become more interested in making rather than interpreting law. So, for instance, the following characterization of *Lochner* and the ensuing jurisprudence can be read in Paul Kens's *Judicial Power and Reform Politics*: "The *Lochner* decision was, and remains, important because it signaled the Court's adoption of [...] laissez-faire social Darwinism, at a time when attachment to that philosophy was waning" (Kens 1990, 4-5). Or take Bernard Schwartz's *A History of the Supreme Court*: "The [Fuller] Court decisions reflected the Spencerean laissez faire that had become dominant in the society as a whole at the time.

However, the Court also helped to mold the society and economy in the Spencerean image. It furnished the legal tools to further the period's galloping industrialism and ensure that public power would give free play to the unrestrained capitalism of the era. [...] the Court apparently believed in everything we now find it impossible to believe in: the danger of any governmental interference with the economy, the danger of subjecting corporate power to public control, the danger of any restriction upon the rights of private property, the danger of disrupting the social and economic status quo" (Schwartz 1993, 174-5). Remarkably, this established reading of *Lochner* dated back to the case itself.

I.C The mother of all dissents

In what arguably represents the most famous dissenting opinion ever, Justice Oliver W. Holmes provided fuel for the next generations of interpreters. In little more than 600 words Holmes made a series of points, each of which would have a big impact on constitutional debate. First, he declared that the decision was based "upon an economic theory", one that "a large part of the country does not entertain" (*Lochner*, at 75). Second, he argued that, regardless of what any single judge could think of that theory, or of any theory at all, the majority in the country had the right to see its opinion embodied in a law regardless of its being in conformity with the judge's view. Third, he noted that the Supreme Court had recognized in the past the right of a state to regulate the economy and violate the liberty of contract: under this respect, the New York statute regulating bakers' working hours was hardly unprecedented. Fourth, and crucially, he explained that the majority opinion contrary to the statute was founded on "a shibboleth", that is, on Herbert Spencer's so-called law of equal freedom: "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" (*ibid.*).¹³ However, as Holmes famously put it in his typical style: "The Fourteenth Amendment does not enact Mr. Herbert Spencer's *Social Statics*" (*ibid.*). Indeed, "a constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the State or of *laissez faire*. It is made for people of fundamentally differing views, and the accident of our finding certain opinions natural and familiar or novel and even shocking ought not to conclude our judgment upon the question whether statutes embodying them conflict with the Constitution of the United States. General propositions do not decide concrete cases. The decision will depend on a judgment or intuition more subtle than any articulate major premise." (*ibid.*, 75-6).

¹³ "Every man has freedom to do all that he wills, provided he infringes not the equal freedom of any other man" (Spencer 1851, Ch.6, §1, original emphasis).

Finally, Holmes made a concession whose meaning will become clear in the rest of this essay. After having reiterated his view of the necessity to conform to the dominant opinion (“I think that the word liberty in the Fourteenth Amendment is perverted when it is held to prevent the natural outcome of a dominant opinion”), he qualified that statement by adding: “unless it can be said that a rational and fair man necessarily would admit that the statute proposed would infringe fundamental principles as they have been understood by the traditions of our people and our law” (ibid., 76). Hence, though this was not so in that specific case (“It does not need research to show that no such sweeping condemnation can be passed upon the statute before us”), the possibility was left for the Court to invalidate a statute that flagrantly clashed with custom and common sense,¹⁴ regardless of its being expression of the amplest majority of the public opinion. The difference between Holmes’s initial statement on majority rule and his final one is substantial, with the first seemingly a blanket permission for the majority to have its way, and the second placing a serious limitation on majority will. As typical of Holmes (see below), it was in the end a matter of line drawing. While supporters of Spencer’s theory would admit no exception whatsoever to the principle of equal freedom, he thought that no such absolute statement could ever be made (“General propositions do not decide concrete cases”) and that, while many – perhaps most – regulations could survive judicial scrutiny as legitimate expressions of legislative majorities, a threshold of constitutionality existed somewhere that a state could not trespass.

The first four of Holmes’s points provided material for the Progressive narrative in terms of laissez faire doctrinarism and Social Darwinism as the prime movers of the *Lochner* Court. In particular, Spencer’s first book, the very 1851 *Social Statics* mentioned by Holmes, seemed to embody almost verbatim the Court’s philosophy.¹⁵ Spencer deemed it necessary for the proper functioning of any economic system that individuals be allowed to pursue and realize their own private interests unimpeded by the state. Hence the state had to be precluded from intervening in the economy except to enforce contractual terms. State regulation of the economy was not only undesirable, but also unnecessary because freedom of contract itself ensured that all individuals enjoyed an equality of bargaining rights. Laissez faire thus promoted bargaining equality: the free market reflected an equal order of things where every individual was equally at liberty to transact and compete. Yet, Spencer made clear that this equality of right to compete in the market place did not mean equality of outcomes. Owing to natural inequalities of talent, initiative and skills some will compete more successfully than others. Winners will flourish, while losers will flounder. Hence laissez faire, in Spencer’s view, was also coupled with natural selection.

¹⁴ The “fundamental principles as they have been understood by the traditions of our people and our law” that Holmes had in mind were in all likelihood the rules of the common law.

¹⁵ Here I follow Duxbury’s summary of Spencer’s book (Duxbury 1995, 27-30).

The Progressive narrative views Social Darwinism as the main creed not only of American businessmen, but also of many judges and politicians (see Hofstadter 1944). Accordingly, the conception of laissez faire that emerged in late 19c courts had a distinctly Spencerian bent, which, in turn, explained why the Supreme Court attempted to write Social Darwinism in the Constitution. The point is that, while the actual impact of Spencer's thought in American social science has been subjected to increasing criticism,¹⁶ the Progressive interpretation of LFC may survive even a downgrading of Social Darwinist influence. Indeed, the Justices' negative attitude towards (selected instances of) paternalism may act as a surrogate of a more explicit endorsement of Social Darwinism (Soifer 1987, 252-3). Only a feeble boundary divided the late 19c American image of "the great race of life, premised somehow on the notion of an equal start" – an image that naturally abhorred of paternalist interferences by the state – and the more ruthless view of the Spencerian struggle for economic survival. When read through the lens of the Justices' anti-paternalism, the losers of the socio-economic struggle had only themselves to blame, exactly like the victims of natural selection. They may not have been properly Spencerian, but to Progressive eyes LFC Justices acted nonetheless to selectively dismiss paternalist legislation and, through this, "constitutionalize what was seen as scientific and necessary" (ibid., 279).

Thus, at least on the Social Darwinist (or anti-paternalist) side, Holmes's critique of the *Lochner* majority seems well taken. However, a more thorough interpretation of his words may reveal interesting angles not adequately emphasized by Progressive authors and that open the door to a significantly different narrative. As noted by Ellen Franken Paul, Holmes was not referring to a mere "economic theory" but, more correctly, to a "political economy". By the latter term it is meant, as typical in the 18c and 19c, "a discussion of economic principles" followed upon or integrated with "a discussion of the nature of man, how governments were formed and what ends they served, and how they could or, more often, could not intervene in the economy to promote prosperity" (Franken Paul 2005, 525).¹⁷ This can be seen from Holmes's characterization of the position antithetical to laissez faire as "paternalism and the organic relation of the citizen to the State". Here he was plainly referring to a "political economy" antagonistic to individualism, i.e., one that views the person as a part of a greater whole and where the state must harmonize individual interests in order to avoid conflict and ensure the overarching interest of the whole, the state itself.

¹⁶ The best synthesis of these critiques being intellectual historian David Hollinger's quip that "Social Darwinism can now claim a dubious honor: that it has been shown not to have existed in more places than any other movement in the history of social theory" (quoted by Soifer 1987, 252). Soifer also provides some classic references to the debate.

¹⁷ According to Joseph Schumpeter's definition, a system of political economy is "an exposition of a comprehensive set of economic policies" that are advocated "on the strength of certain unifying normative principles" (Schumpeter 1954 [1994], 38). Or "an economics that includes an adequate analysis of government action and of the mechanisms and prevailing philosophies of political life" (ibid., 22).

So the laissez faire ideology Holmes accused the Court of having embraced – Spencer’s “shibboleth” – was more than an economic theory. Indeed, as another revisionist scholar noted (Benedict 1985, 305), it was probably not by chance that Holmes did not refer to Adam Smith, as it might probably seem more natural to indict laissez faire as an economic theory (though see below, III.B), but to a social philosopher like Spencer. Moreover, we now know that of all the members of the Court Holmes was the one with more affinity with Social Darwinist ideas.¹⁸ Hence, the indictment against his colleagues for using the Fourteenth Amendment to “enact Spencer” should probably not be meant as specifically condemning natural selection ideas when applied in the social realm but as a broader, though less specific, refusal to read in the Constitution a whole system of thought or worldview – a “political economy” in Frank Paul’s sense.

Even interpreted in this broader sense, the essence of Holmes’s indictment stands. The Constitution was neutral with respect to political economy, embracing neither organicism nor laissez faire; thus, argued Holmes, majorities should be allowed to enact their own theories into law unless clearly barred by the Constitution beyond the doubt of any reasonable man (Frank Paul 2005, 527). We come here at a crucial juncture. Holmes’s dissent proved crucial to establish the Progressive interpretation. Indeed, its author is depicted as one of the few heroic opponents in the Court against the rising tide of LFC. Social Darwinism and laissez faire were the latter’s building blocks – as Holmes had said; unfortunately, their constitutional foundations were feeble – as Holmes again had said; hence it was easy to conclude – as Holmes had at least implied – that their influence in Court’s decisions was due to the judges’ idiosyncratic preferences, if not to their sheer class interests, an interest that big business counsels could easily arouse with their briefs.

Writing for the Court after WWII, Progressive Justice Felix Frankfurter sealed the iconic status of Holmes’s dissent in a famous passage. During the *Lochner* era, he declared, “Adam Smith was treated as though his generalizations had been imparted to him on Sinai, and not as a thinker who addressed himself to the elimination of restrictions which had become fetters upon initiative and enterprise in his day. Basic human rights expressed by the constitutional conception of ‘liberty’ were equated with theories of laissez faire. The result was that economic views of confined validity were treated by lawyers and judges as though the Framers had enshrined them in the Constitution. This misapplication of the notions of the classic economists and resulting disregard of the perduring reach of the Constitution led to Mr. Justice Holmes’ famous protest in the *Lochner* case against measuring the Fourteenth Amendment by Mr. Herbert Spencer’s *Social Statics*. [...] The attitude which regarded any legislative encroachment upon the existing economic order as infected with

¹⁸ And even for him it was a very limited one: see Hovenkamp 1988, 418. On Holmes’s relation with Social Darwinism, also see Novick 1989, 140-1.

unconstitutionality led to disrespect for legislative attempts to strengthen the wage-earner's bargaining power" (*AFL v. American Sash & Door Co.*, 335 U.S. 538, 1949, at 543).

As the rest of this essay will show, both Holmes's *Lochner* dissent and the Progressive interpretation that stemmed from it overlooked the deepest motivations underlying Peckham's opinion and, more generally, LFC jurisprudence. While it was true that these motivations rested upon a specific approach to economic relations, the latter was much broader and sophisticated than the mere acknowledgment of the laissez faire principle. The whole edifice of classical political economy supported and motivated LFC. What matters the most, this edifice was largely the same as that of classical liberalism. Far from being unprincipled doctrines devoid of constitutional basis, they both lay at the foundations of the American Constitution.

PART II: THE ECONOMIC FOUNDATIONS OF LFC

II.A Two notions of laissez faire

The traditional view of laissez faire equates it with *freedom to compete*, or *freedom to trade*. Individuals should be free of pursuing any kind of market activity without government interference. The roots of this interpretation are in economic theory. The market is viewed as an atomistic and fluid structure, made of prevalently small businesses – a universe of “small dealers and worthy men”,¹⁹ whose independence and possibility to compete, absent any external interference, is guaranteed by the market mechanism itself. No market position is permanent, everything is fluid and subject to change under competitive pressure. Competition, both actual and potential, is the key economic force by which the market self-polices itself, guaranteeing the freedom to trade. Under competitive conditions, any market power is only temporary: whenever a business obtains, by either luck or merit, a supra-competitive profit, free entry creates the conditions for bringing the profit back to the competitive level. Hence, laissez faire guarantees an atomistic market structure of diffused property, while at the same time rewarding with temporary extra gains those who deserve them. The state may only disturb this mechanism by hindering free entry and potential competition; this happens first and foremost when the state creates a privilege, that is, wealth that only certain individuals, designated by government acts, can acquire.

This characterization of laissez faire emphasizes horizontal competition and, of course, gets into troubles whenever competitive forces cease to work. This may happen because of state-created

¹⁹ To borrow the famous expression from Justice Peckham's opinion in *United States v Trans-Missouri Freight Association*, 166 U.S. 290 (1897), at 323.

privileges or because the market itself determines a situation where a business becomes so powerful that competition, actual and potential, may not effectively work against it anymore. The latter is what happened in the American economy after the Civil War.

An alternative, also very common view of *laissez faire* still focuses on the idea that individuals should be completely free to pursue their economic activities, but emphasizes *contract*, rather than competition. *Laissez faire* then means *freedom of contract*, that is, the possibility for any grown-up individual to bargain without any external constraint, first and foremost impediments arising from the state. This notion follows directly from the legal protection of property rights and of the value of property itself. Since value is determined on the market and materializes through contractual activity (i.e., exchanges), property is truly protected only when the individual is free to enter any kind of contract he deems proper to reap the value of his property.²⁰

Contracting is a vertical activity. Hence, depicting *laissez faire* as freedom of contract means to emphasize vertical competition. This was the kind of competition classical economists stressed the most: the competition between a buyer and a seller, each trying to get the most from the bargain. Still, the notion of *laissez faire* as contractual liberty transcends economic theory and draws its attractiveness from higher values, such as the protection of individual autonomy, personal freedom and the ownership over the fruits of one's own labor. As I argue below, it is because they emphasized these same values that classical economists attached so great an importance to vertical buyer-seller relations and, therefore, to freedom of contract. The state should not interfere with individual decisions as to how to perform market transactions. The only limit to contractual liberty is the maxim *sic utere tuo ut alienum non laedas*, or Herbert Spencer's law of equal freedom (see above, note 13).

Liberty of contract was the specific kind of freedom emphasized by the *Lochner* majority. Hence, this was the notion of *laissez faire* *Lochner* era courts embraced. Two corollaries follow from it. First, that contractual freedom should remain undisputed even in those cases where it causes, or favors, increasing concentration of market power. The extreme instance is that of a cartel: if participants freely determine to form or join it, the law should protect their right to do so as a legitimate expression of their liberty. Monopoly and concentration may thus arise as spontaneous outcomes of contractual freedom and should themselves enjoy constitutional protection against state interference.

However a second corollary qualifies the first. It often happens that contracts, freely entered by economic agents, coerce someone else's liberty of contract. For example, a cartel may coerce the contractual freedom of non-participant businesses, or the buyer's freedom to purchase the good

²⁰ The idea was already in Mill 1848 [1909], II.ii.3.

from alternative sources. More generally, we know that competition exists in any buyer/seller relation: freedom of contract guarantees the parties the possibility to build that vertical relation as they like, but it also authorizes each party to inflict economic damage to the other by reaping the biggest share of the value arising from their relation. The point is that every competitive activity, including contracting, inflicts damage upon someone else. Horizontally speaking, if a customer buys my service, she is not buying yours, so your freedom to contract with her is somehow affected by my own contractual activity. Vertically speaking, though every contract is by definition mutually beneficial, if I manage to have customers pay dear for my service, I am grabbing the largest share of the gain and, at the same time, reducing my customers' liberty to contract with some other provider (at least as long as my contract with them expires). Broadly speaking, every contract coerces someone somehow.

II.B Competition as privilege to injure

Oliver W. Holmes was the first legal thinker to see that the existence of a competitive regime was fundamentally incompatible with a notion of absolute property rights, including absolute freedom of contract.²¹ A conflict existed between competition and property. Already in his *magnus opus*, the 1881 treatise *The Common Law*, Holmes had singled out competition as the primary example of the law allowing someone to injure some else's property, even intentionally, with impunity. Competitive injury was peculiar in that it enjoyed immunity from liability. Such immunity showed that the notion that the law protected property from any kind of harm had no universal validity. An individual had a right to "establish himself in business where he foresees that the effect of his competition will be to diminish the custom of another shop-keeper, perhaps to the ruin of him" (Holmes 1881, 144-5). The law permitted competitive injury to property on grounds of public policy, that is, on the belief that competition be socially beneficial – a belief descending from classical economics and, more generally, classical liberalism.²²

²¹ Here I follow Horwitz 1992, 128-142.

²² For example, J.S. Mill had already noted in *On Liberty* that "In many cases, an individual, in pursuing a legitimate object, necessarily and therefore legitimately causes pain or loss to others, or intercepts a good which they had a reasonable hope of obtaining. [...] Whoever succeeds in an overcrowded profession, or in a competitive examination; whoever is preferred to another in any contest for an object which both desire, reaps benefit from the loss of others, from their wasted exertion and their disappointment. But it is, by common admission, better for the general interest of mankind, that persons should pursue their objects undeterred by this sort of consequences. In other words, society admits no right, either legal or moral, in the disappointed competitors to immunity from this kind of suffering; and feels called on to interfere, only when means of success have been employed which it is contrary to the general interest to permit – namely, fraud or treachery, and force" (Mill 1859 [2001], 86-7).

In his 1894 paper “Privilege, Malice, and Intent”, Holmes posited the existence of a fundamental contradiction in the law between property and competition. The issue of competitive injury had become central to his reflection for two reasons. First, because increasing business concentration had put at center stage the issue of how to distinguish legitimate from illegitimate competition. Competition between large combinations or cartels destroyed the harmony between the natural rights view of property and social welfare. In the new economic regime it was apparent that competition was *not* necessarily beneficial to all market participants and that, therefore, absolute freedom of contract meant coercing someone else’s freedom. Natural rights – or their common law proxy, customs – began to lose their legitimating power in the realm of economic relations. The second reason urging Holmes to focus on competitive injury had to do with the labor market.. The struggle between labor and capital raised the issue of whether that struggle should be governed by the same rules pertaining to business competition – in short, of whether labor organizations should be treated like business combinations.

In the 1894 paper Holmes repeated the public policy reasons justifying the privilege granted to firms to use competition to injure their rivals’ property. This privilege to injure did not descend from mere logical deduction about absolute rights – i.e., it was not an issue of kind – but rather from a comparison between two conflicting rights, the right to property and the right to compete. Hence, it was a matter of degree, of two rights that “run against one another, and a line has to be drawn” (Holmes 1894, 6). The conflict between property and competition required that a balancing test replace formalist reasoning. According to Horwitz (1992, 131), this was the first time a fully articulated balancing test between these two rights entered American legal theory. While this issue will go beyond the limits of this essay, we may note here that the 20c triumph of balancing tests in various fields of law, including antitrust law, would mark the end of natural rights theory and objective standards and the rise of the rule of reason and of cost/benefit analysis.

Back to the 1890s Holmes, where should the boundaries of legitimate economic struggle lie? Without a conception of bright-line boundaries based on absolute rights, or at least customary norms, it was impossible to construct any objective standard to distinguish between legitimate and illegitimate forms of competition. The solution only came in his last major theoretical essay, the 1897 “Path of the Law”, where he offered the first clear articulation of would-be legal positivism. Holmes message was truly path-breaking. As he famously wrote, no basis in reason existed for deciding which of two contradictory legal doctrines was correct. Law was just prophecy, the prophecy of what courts will do. Further than that, he even more famously declared that: “The language of judicial decision is mainly the language of logic. And the logical method and form flatter that longing for certainty and for repose which is in every human mind. But certainty

generally is illusion, and repose is not the destiny of man. Behind the logical form lies a judgment as to the relative worth and importance of competing legislative grounds, often an inarticulate and unconscious judgment, it is true, and yet the very root and nerve of the whole proceeding. You can give any conclusion a logical form” (Holmes 1897 [1997], 998). Logic was just the outcome of a “longing for certainty and for repose”. Thus he called it a fallacy “the notion that the only force at work in the development of the law is logic.”²³

If law was not logic, but experience, what was the latter’s source. Once again, the 1897 answer was brand new. The source of experience could not be found, as usual, in the past; now policy should prevail over history: “I look forward to a time when the part played by history in the explanation of dogma shall be very small, and instead of ingenious research we shall spend our energy on a study of the ends sought to be attained and the reasons for desiring them. As a step toward that ideal it seems to me that every lawyer ought to seek an understanding of economics” (ibid., 1005). Knowledge of policy reasons required a study of social sciences different from history: “For the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics” (ibid., 1001). If the source of experience was policy, rather custom or history, it had to be admitted that policy always reflected a trade-off, of the same kind studied by economists: “In the present state of political economy, indeed, we come again upon history on a larger scale, but there we are called on to consider and weigh the ends of legislation, the means of attaining them, and the cost. We learn that for everything we have to give up something else, and we are taught to set the advantage we gain against the other advantage we lose, and to know what we are doing when we elect.” (ibid., 1005).

For the first time a prominent legal thinker renounced the belief that law be independent of politics and separate from social reality. On the contrary, he explicitly declared that law depended upon a comparison of the costs and the benefits of available alternatives. In the hands of future Progressive scholars, it would be just a short step to turn law into an instrument of social engineering. To our aims, suffices to note that the 1897 essay explains why Holmes, in his activity as a judge and Justice, always privileged judicial self-restraint. If no immanent rationality existed in common or customary law, if law was merely politics, a battle ground where social interests clashed, then it was only fair, in his view, to leave the final word to legislators. The legislature, rather than the court, was the proper place where competing interests may be weighed one against

²³ Already in 1891 he had written: “One of the reasons why judges do not like to discuss questions of policy, or to put a decision in terms upon their views as law-makers, is that the moment you leave the path of merely logical deduction you lose the illusion of certainty which makes legal reasoning seem like mathematics. But the certainty is only an illusion, nevertheless” (Holmes 1891, 7).

the others. This, rather than an ideological hostility against laissez faire or Spencerian philosophy, was the real rationale behind Holmes's *Lochner* dissent.

II.C Laissez faire's third characterization

In a third characterization laissez faire still meant either freedom to trade or freedom to contract, or both, yet in the new American economy of big business and huge fixed costs the outcome of such freedoms was not anymore a fluid and atomistic market structure. Now laissez faire brought concentration and entrenchment of economic power. The market mechanism, while still free to work, could not anymore exercise its beneficial effects in terms of dispersion of power and welfare maximization. On the contrary, by letting businesses free to compete a laissez faire system enabled market forces to generate concentration. With high fixed costs, Americans were soon to discover, market power was the natural product of competitive markets; the inevitable outcome of laissez faire was monopoly, i.e., the demise of competition itself. Privilege now had another source beyond state grants: it was an endogenous source whose roots rested in the market mechanism itself. Broadly speaking, this was the Progressive economists view of laissez faire. That is, the idea that under the new industrial conditions laissez faire favored the consolidation of power and a raising inequality. Eventually, the Progressives argued, the utmost liberty to compete played *against* individual freedom. Far from promoting social welfare and personal autonomy, laissez faire hampered them (see McCann 2012, 223).

The rise of big business put at centre stage a new issue, the relation between business size and competition. Size meant scale economies and increasing returns, in themselves positive phenomena that however led to either monopolization or combination in its various forms (trusts, cartels, mergers, etc.). American economists had therefore to reconcile their traditional view of competition with the consolidation trend triggered by socially beneficial industrial processes. Railroads provided the earliest example of how difficult this reconciliation might be. The cheapest possible transportation could only be achieved by those railroads capable of fully exploiting their scale economies, but, as several authors recognized, this entailed a tendency to monopoly that was incompatible with classical competition. In his 1885 book *Railroad Transportation*, economist Arthur T. Hadley applied the teachings of the railroad industry to the economy in general. Hadley observed that in any industry characterized by relevant sunk costs the classical idea that capital could be easily withdrawn from unprofitable uses and re-invested in more profitable ones was meaningless. Ever more industries looked like railroads, i.e., they were characterized by "a large

permanent investment, which can be used for one narrowly defined purpose, and for no other. The capital, once invested, must remain. It is worth little for any other purpose” (Hadley 1885, 40).

Beyond the slow readjustment of bad investments, two further problems affected those industries. The adoption of new technologies and sheer scale effects lowered the production cost below current market price, generating supra-competitive profits and attracting new capital. As a consequence, excess capacity and overproduction were frequent phenomena in industries characterized by huge fixed investments and increasing returns. But contrary to what classical economists maintained, in those very industries capital was hardly fluid: as a matter of fact, it was very difficult to withdraw or redirect it. Hence, overproduction was a semi-permanent phenomenon in heavily-capitalized sectors of the economy. A long debate then arose among American economists about the nature and permanence of the overproduction caused by irreversible investments in fixed capital – what Herbert Hovenkamp has called “the great fixed-cost controversy” (Hovenkamp 1991, 311). Some authors remained faithful to the classical thesis that, thanks to the competitive mechanism, general gluts or resource misallocations were impossible. Others believed that the presence of enormous sunk costs undermined the classical mechanism: under the conditions of modern capitalism, overproduction emerged as an endogenous and chronic tendency of the market.

Economists in the latter group also shared a second, even more serious concern. Speaking of the railroads’ experience, but again only as an instance of a more general issue, Hadley noted: “In order to attract new capital into the business, [railway] rates must be high enough to pay not merely operating expenses, but fixed charges on both old and new capital. But, when capital is once invested, it can afford to make rates hardly above the level of operating expenses rather than lose a given piece of business” (Hadley 1886, 223). In modern terms: the price needed to attract new investment in industries characterized by massive sunk costs was higher than the price that forced existing firms to withdraw old investment. In Hadley’s brilliant synthesis: “the rate at which it pays [for capital] to come in is very much higher than the rate at which it pays to go out” (ibid.).

A downward pressure on price was of course unavoidable, given persistent overproduction. Yet, the loss to be suffered by stopping production and exiting the market would be so large that firms preferred to fight until the end and keep producing as long as price exceeded average *variable* cost, and maybe even below that. The point was that such a low price would eventually drive such firms into bankruptcy. Contrary to what classical economists thought, the entry/exit mechanism in these industries stabilized neither the market price nor the return on investment around their normal level. No “normal” limit to competition existed in the presence of large sunk costs. Forced to compete by cutting prices, firms were inevitably destined to ruin.

Many American economists shared Hadley's opinion, arguing that competition was ruinous in industries with huge fixed costs. Cornell University economist Jeremiah Jenks was exemplary in this regard. In his classic work on *The Trust Problem*, he wrote: "The circumstances and skill of the different competitors may be so nearly equal that competition will eventuate, not in the elimination of some few while the majority are still making profits, but rather in a depression of the entire business, so that only the very few most skilful or best situated will be making any profit at all, while the others still struggling along may be losing money for a long period before they finally yield. Indeed, the result may well be that for a considerable length of time all will be running at a loss" (Jenks 1900, 19).

The implication of this reasoning by Hadley, Jenks and others was that industries with massive fixed costs would naturally gravitate away from competitive conditions. Competition often led to the survival of only one firm, i.e., to monopoly, and thus to the end of competition itself. Monopoly could be either the spontaneous outcome of ruinous competition or the deliberate goal of a firm's strategy addressed at preserving its invested capital by waging a price war against its rivals – so-called *cutthroat competition*. In either case, a significant reduction in the number of competitors, or, possibly, a monopoly, would follow. Another prominent American economist, Richard T. Ely, concluded that competition in the presence of large fixed costs was self-destructing and *inevitably* led to monopoly (Ely 1888, 121). In a similar vein, Jenks stated that: "Under a system of free competition industrial efficiency tends toward monopoly. The business genius whose industrial efficiency is greatest tends to overcome his rivals, and to take over a continually increasing proportion of the business, until he becomes a monopolist" (Jenks 1912, 349). The twin notions of *ruinous* or *cutthroat competition* and *inevitable monopoly* became a mantra for late nineteenth-century American economists. Unlike the classical model, monopoly had another possible source beyond state interference, a source depending on the strict logic of competition paired with the existence of giant fixed costs. Worse than that, this alternative source entailed that monopoly was not only possible, but actually inevitable. As the most famous American economist of the time, John Bates Clark, put it: "Easy and tolerant competition is the antithesis of monopoly; the cut-throat process is the father of it" (Clark 1886, 120).

A dilemma then arose as to what the law should do. Fighting this privilege meant to interfere with the market mechanism, but letting it go undisturbed meant favoring the eventual demise of that very mechanism. Still worse, any business endowed with monopoly power – any business enjoying economic privilege – had the power to interfere, one way or the other, with the contractual freedom of other businesses. This power, intrinsic as we said above to any contract, was ever more relevant when the contracts themselves were the expression of a powerful economic position. Hence, even

those who identified laissez faire with freedom of contract had at least to recognize that in a world of rising concentration and business power the true issue was how to guarantee the freedom *from* contract. By the latter term it was meant the opportunity for every market participant to pursue his economic activity without being coerced, either vertically or horizontally, by the business activity, i.e., the contracts, of his powerful rivals. A small firm's freedom to compete was inevitably coerced by its rivals' market power and by the restraints they could enforce. Hence, in the absence of free entry and other equilibrating market forces, state intervention could be invoked to preserve this freedom, and with it the possibility itself of competition to survive. Remarkably, this plea did not exclusively, or necessarily, come from Progressive quarters. Even some conservative supporters of freedom of contract might endorse it.

Freedom *from* contract thus became a catchword for everyone requiring that some obstacles be put to unbridled competition; this as the only way to effectively protect the universal enjoyment of freedom *of* contract, as well as the persistence of competitive conditions in the marketplace. Little surprise that from these ranks also came the voices in favor of antitrust law and of its strict enforcement. The coercion of the law was invoked to block those particular business contracts or practices that could be used by powerful firms to coerce their rivals' economic freedom. Similarly, it is not surprising that antitrust law sounded anathema to the most traditional interpreters of laissez faire as either freedom to compete or freedom of contract. As we will argue in the third part of this essay, freedom from contract provides a possible key to solve the Peckham's puzzle and, more generally, to reconcile LFC with the evolution of economic ideas.

PART III: THE CLASSICAL PARADIGM AND THE AMERICAN CONSTITUTION

III.A The classical price mechanism

Progressive scholars of the LFC era usually neglect the multiple meanings of the notion of laissez faire. As a consequence, they offer a biased and incomplete reading of the *Lochner* Court's motivations and, more generally, of what really drove many post-Civil War judges. It is claimed here that these flaws are due first and foremost to their lack of knowledge of the history of economic thought. These scholars fail to recognize the multifaceted contributions classical economics gave to the development of LFC; these cannot be reduced to the notion of laissez faire, let alone a uniform one.

At least five major ideas by classical economists had a massive influence upon LFC scholarship and jurisprudence. Three of them were purely analytical and therefore belonged to classical *economics* proper; the other two were intellectually broader, had a clear “philosophical” or “political” import and were not the economists’ exclusive: hence they pertained to classical *political economy*.²⁴ The three analytical ideas were the classical price mechanism, the vertical/horizontal dimensions of competition and the privilege-based view of monopoly; the two “political” principles were, first, that competition should be taken as the organizing principle of a prosperous society and, second, that liberal societies should be erected upon the sanctity of the individual and his property rights. Historians of economic thought know well that it would be impossible to understand classical authors such as, say, Adam Smith or John Stuart Mill without taking into account (among many others) these five ingredients. In the same vein, my analysis will show that only combining them we may reach a proper understanding of the influence economic ideas had upon LFC and, from there, upon the formative era of antitrust law.

The classical price mechanism and vertical/horizontal competition were in a sense two sides of the same coin. In classical economics competition was a *behavior*, not a state. It meant the actions and reactions of individuals in the marketplace. These actions were first and foremost identified by the *vertical* intercourse between sellers and buyers: the mantra of “selling dear and buying cheap” captured the essence of market activity.²⁵ The vertical dimension of market relationship, emphasizing exchange and the trading partners, was central to classical analysis. It had an obvious counterpart in the legal notion of contract and contracting parties. A contract was conceived as a pro-tempore juridical crystallization of the seller/buyer bargaining activity.

The analytical function of competition within the classical model was to bring market price to its normal, or natural, level, eliminating both excess profits and unsatisfied wants (McNulty 1967, 396). The natural price – also called “the price of free competition” (Smith 1776 [1904], I.vii.27) – was a reference point for the theorist as well as for the market participants. It was, as Adam Smith said, “the central price, to which the prices of all commodities are continually gravitating. Different accidents may sometimes keep them suspended a good deal above it, and sometimes force them down even somewhat below it. But whatever may be the obstacles which hinder them from settling in this center of repose and continuance, they are constantly tending towards it” (ibid., I.vii.15).

In short, for Smith and the other classical economists competition was a *process* leading to certain predicted results – a price-determining force that operated within the market, but did not coincide with it. In particular, competition was *not* conceived of as a market situation or state, like

²⁴ For the distinction between economic theory and political economy, see above, I.C.

²⁵ On the classical notion of competition see McNulty 1967; 1968; Blaug 1997, Ch.6; Salvadori & Signorino 2013; 2014. The expression “buy cheap and sell dear” is e.g. in Smith (1776 [1904], IV.2.30).

in the modern neoclassical approach. As a consequence, the classical solution of the basic allocation problem was independent of the market structure, i.e., of specific assumptions about, say, the number and size of firms. In the modern sense of the term, it would perhaps more correct to say that classical economists did not deal with “competition”, but just with the *price mechanism* (Peterson 1957, 69). In order for this mechanism to work, the only analytical requirement was that buyers and sellers be endowed with the utmost freedom during their vertical intercourse, i.e., be free to act and react. Legally speaking, that they should be guaranteed complete liberty to enter, exit and mold contractual relations.

The centrality of the vertical dimension of market activity also affected the classical analysis of *horizontal* competition, i.e., the competition among sellers or among buyers that was the other necessary component of the price mechanism. Horizontally speaking, the essence of, say, sellers’ competition was to undersell rivals and lead customers to patronize one’s own product. Setting and cutting prices were the main competitive weapons in this respect.²⁶ The analytical task of horizontal competition was to prevent either the seller or the buyer to exploit their vertical counterparts by coercing them into lopsided exchanges. Competition ensured that whenever the seller increased the price, the buyer always had the opportunity to quit the relation and buy at a lower price from another seller. The underlying assumption was that in a competitive market – a “system of natural liberty”, as Smith called it (1776 [1904], IV.ix.51) – such an alternative seller always existed or, at least, was always ready to enter the market if profitable opportunities arose. To prevent entry and preserve its vertical relations the original seller had necessarily to limit, or avoid, the price increase. The converse held in the case of buyers bidding too low. Freedom of entry was therefore the only “structural” feature of the market that classical economists invoked – though a crucial one to ensure the convergence of the price mechanism to the natural level.

It is not often recognized that the concept of competition, vertical and horizontal,²⁷ entered economics as a behavior consisting of a series of deliberate actions, like undercutting or bidding up

²⁶ The two dimensions of competition, horizontal and vertical, were clearly defined by Karl Marx: “The competition by which the price of a commodity is determined is threefold. The same commodity is offered for sale by various sellers. Whoever sells commodities of the same quality most cheaply, is sure to drive the other sellers from the field and to secure the greatest market for himself. The sellers therefore fight among themselves for the sales, for the market. Each one of them wishes to sell, and to sell as much as possible, and if possible to sell alone, to the exclusion of all other sellers. Each one sells cheaper than the other. Thus there takes place a competition among the sellers which forces down the price of the commodities offered by them. But there is also a competition among the buyers; this upon its side causes the price of the proffered commodities to rise. Finally, there is competition between the buyers and the sellers: these wish to purchase as cheaply as possible, those to sell as dearly as possible. The result of this competition between buyers and sellers will depend upon the relations between the two above-mentioned camps of competitors – i.e., upon whether the competition in the army of sellers is stronger. Industry leads two great armies into the field against each other, and each of these again is engaged in a battle among its own troops in its own ranks. The army among whose troops there is less fighting, carries off the victory over the opposing host” (Marx 1847 [1933], 21).

²⁷ A third aspect of competition pertains to the activities by which firms learn what and how to produce (see e.g. Machovec 1995, Ch.2). It is far from clear that this “internal” side of competitive behavior was as important for classical economists as the vertical and horizontal ones.

prices, entering a new market, etc., that later neoclassical economists – for whom competition was a state, rather than a process – would often consider as manifestations of market power, i.e., antithetical to competition and themselves “monopolistic”. Classical economists would never consider price-taking as the quintessential competitive behavior. Indeed, monopoly itself had an entirely different meaning and explanation for them: it was basically synonymous with *privilege*, usually state-granted privilege. But before analyzing this third analytical component of classical economics, their monopoly theory, let’s move to the first “political” idea.

III.B Competition as a principle of social organization

For Smith and his successors competition was not just an analytical force overseeing the functioning of the price mechanism. It goes to Smith’s perennial credit to have been the first to elevate competition to the status of a general organizing principle of society. This way of conceiving of competition marked a real breakthrough with respect to previous traditions.²⁸ In a famous passage, he claimed that: “Every individual is continually exerting himself to find out the most advantageous employment for whatever capital he can command. It is his own advantage, indeed, and not that of the society, which he has in view. But the study of his own advantage naturally, or rather necessarily, leads him to prefer that employment which is most advantageous to the society” (Smith 1776 [1904], IV.ii.4). Thus, the individual pursuit of self interest served the best interests of society as a whole: self-interest and social interest were partners rather than enemies.

The principle had an immediate policy implication, namely, that the operation of self-interest had to be facilitated rather than hampered by government. If the allocation of resources generated by self-interest promoted the greatest increase in national wealth, then any government measure that interfered with this allocation would necessarily harm economic growth. Far from being society’s savior from the negative effects of self-interest, the state was an obstacle hindering the full deployment of a socially beneficial force (Medema 2009, 22). In Smith’s own words: “every system which endeavours, either by extraordinary encouragements to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it, or, by extraordinary restraints, force from a particular species of industry some share of the capital which would otherwise be employed in it, is in reality subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and

²⁸ See McNulty (1967, 396-7) and Medema (2009, Ch.1) whom I follow here.

labour” (Smith 1776 [1904], IV.ix.50). Competition thus became the *sine qua non* of economic policy reasoning.

Smith’s recipe to achieve social prosperity was straightforward: cancel “[a]ll systems either or preference or restraint”, discharge the sovereign “from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society”, and just let “the obvious and simple *system of natural liberty* [establish] itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men” (ibid., IV.ix.51; emphasis added). Thus, the classical recipe transcended the analytical dimension and took a political, and possibly ethical, content. The principal concern of classical political economy was neither price theory nor trade policy, but rather the identification of the ideal economic regime that would maximize general prosperity and individual liberty (Hovenkamp 1988, 396). *Laissez faire*, if for convenience we retain the term, thus became a principle for governing society. For instance the determination of prices via the competitive mechanism, where each trader was only actuated by his own self-interest, replaced, on strictly welfare grounds, any politically oriented legislative administration of prices.

As remarked by historian of economics Steven Medema, Smith was himself no doctrinaire advocate of *laissez faire*. His “system of natural liberty” – i.e., competition – was just “a regulating mechanism [...] a coordinating force that would keep self-interest from becoming totally destructive” (Medema 2009, 24). He believed that “self-interest, properly channeled, tended to engender positive results, rather than negative ones, and that government interference with its operation in the economic sphere would generally lead to inferior results” (ibid., 25). Still, he did not argue that private action was optimal in the modern efficiency sense, nor that it was *always* superior to government intervention. Moreover, and crucially for our reconstruction of classical thought, he knew all too well that markets themselves could neither exist nor function without the legal-institutional framework supplied by the government and the law.

Smith was well aware of the need for laws establishing rights of property and mutual trust, and he discussed these thoroughly in his 1762-63 *Lectures on Jurisprudence*. Yet, we should never forget that what lay behind the scenes in establishing the natural rights of property was his well-known impartial spectator thesis – a principle he had developed in the 1759 *Theory of Moral Sentiments*.²⁹

²⁹ “Smith’s device of the impartial spectator is deployed to establish the existence of an objective perspective which can be learned and then used to temper one’s own tendency toward selfish, antisocial behavior. Initially introduced in the guise of an actual spectator whom we do not want to offend, Smith argues that with experience the rulings of this

In particular, it was the impartial spectator – “the judge within” (*TMS*, III.3.1) – who led individuals to come to an agreement to exchange goods rather than attempt to rob each other that (Young 1986, 372). The natural price then was a “consensus price” that individuals and the impartial spectator viewed as fair in the sense of not causing injury to any party (*ibid.*, 375).

Significantly for what we will say below about the Scottish Enlightenment roots of LFC, Smith did *not* support a Lockean labor theory of property, but rather a spectator-based one. While he wrote that labor was the only regulator of exchange value, this was just because labor happened to be the feature the parties and the impartial spectator would ultimately agree upon as the basis for a fair exchange – fair in the sense of commutative justice (i.e., an exchange harming neither party). Here, according to Smithian scholar Jeffrey Young, lay the deepest reason for Smith’s thesis that from the standpoint of social efficiency market price should be left free to fluctuate towards natural price, without any interference by legislation (*ibid.*, 375-6).

It follows that Smith’s natural price was a consensus price establishing both commutative justice and social efficiency. In other words, the impartial spectator principle informed both the origin and the normative significance of the natural price – as a just price that satisfied commutative justice and as an efficient price that promoted the “opulence of the community” (*ibid.*, 377). According to Young, the gist of (what in modern terms we would call) Smith’s welfare economics lay in his realization that positive economics alone could not yield normative conclusions. To say that the competitive market was efficient or equitable was to employ a value principle that no positive theory could provide. Smith’s value judgments were grounded in the sympathetic response of the impartial spectator – a notion that pervaded his moral theory and jurisprudence as well as his economic analysis (*ibid.*, 382). As it turns out, and despite the fact that they reached similar conclusions, a gulf separated Smith’s methodology from modern welfare economics. The *laissez faire* ideology American 19c judges allegedly drew from Adam Smith rested on moral grounds much more than on economic ones.

In conclusion, competition had two meanings in classical economics. It was both an economic force, playing a specific – indeed, an essential – role in the market mechanism, and a political principle of social organization, possibly resting upon strong moral foundations. Classical economists were perfectly aware of the notion’s dual character and of the interdependence between the two meanings. Analytical competition was necessary to prove that the competition principle had scientific foundations; in its turn, political competition demonstrated that classical theory was not just an empty edifice, but had a practical content. As John Stuart Mill famously wrote, “only

spectator will be internalized. At this point the spectator becomes a metaphor for the individual’s social conscience, ‘the man within the breast’” (Young 1986, 366). According to Samuel Fleischacker (2013), the ingenious notion of impartial spectator characterized Smith’s moral realism.

through the principle of competition has political economy any pretension to the character of a science. So far as rents, profits, wages, prices are determined by competition, laws may be assigned for them. Assume competition to be their exclusive regulator, and principles of broad generality and scientific precision may be laid down, according to which they will be regulated” (Mill 1848 [1909], II.iv.2).³⁰

It was still Mill who claimed that *laissez faire* was, as a practical principle, the general rule for the administration of a nation’s economic affairs, while state interferences were the exception: “The ground of the practical principle of non-interference must here be, that most persons take a juster and more intelligent view of their own interest, and of the means of promoting it, than can either be prescribed to them by a general enactment of the legislature, or pointed out in the particular case by a public functionary. The maxim is unquestionably sound as a general rule; but there is no difficulty in perceiving *some very large and conspicuous exceptions to it*” (ibid., V.xi.29, added emphasis). The gist of LFC jurisprudence, and of the political struggles surrounding it, lay in finding a criterion to identify these very exceptions. Substantive due process, freedom of contract and a restricted view of the police power were the building blocks for such a criterion provided by the law; *laissez faire*, competition and the notion of monopoly as privilege were the main contributions coming from economics. Crucially, both streams mirrored the Constitution’s classical liberal foundations.

III.C Two questions about classical *laissez faire*: monopoly

Recognizing the political content of the classical faith in *laissez faire* raises two different questions. Notwithstanding Smith’s own prestige, one may wonder how his “system of natural liberty” could rise to the status of the fundamental regulatory principle for all socio-economic relations. It is easy to suspect that the “system” itself was just a component, though a decisive one, of a more complex set of ideas, a set that placed the individual and his rights – including the right to pursue one’s own self-interest – at center stage. Secondly, one may ask what would happen when Smithian competition could not exercise its full force – namely, when monopoly existed. Answering the former question brings to light the other “political” ingredient of classical *laissez faire*; solving the latter provides the third, and final, analytical element.

Let’s start from monopoly. According to George Stigler, classical economists followed the Smithian tradition of substantially neglecting the issue: “The [...] tradition was to pay no attention to the formal theory of monopoly” (Stigler, 1982, 1). A more refined version of Stigler’s dismissal

³⁰ Note however that in the rest of that chapter Mill chastised his fellow economists for their excessive reliance on the explanatory force of competition, to the detriment of another powerful force, custom.

underlines that, given the long-run character of their economics and given their neglect of entry barriers, classical economists could do nothing but devote little attention to monopoly. Two features did characterize their approach.

First, monopoly was to them a short-term phenomenon that the forces of competition, if left free to work their magic without government interference, quickly eliminated. Free entry ensured that any supra-competitive profit would immediately attract new capital and bring profit back to its natural, competitive level. This idea long outlasted classical economics proper. Illinois economist Julian M. Sturtevant would make the point as late as 1886: “There will never be wanting those who will be eager to produce a commodity at a price equal to the cost of production” (Sturtevant 1886, 59). Easy and quick entry of newcomers would thus automatically discipline any firm (or group of firms) that attempted to charge monopoly prices. Faith in potential competition would not diminish, at least for a while, in marginalist authors. For the American leader of the new approach, John Bates Clark, it was an absolutely crucial element of the market mechanism: “The competitor who is not now in the field, but who will enter it at once if prices are unduly raised, is the protector of the purchasing public against extortion. [...] The competition that is now latent, but is ready to spring into activity if very high prices are exacted, is even now efficient in preventing high prices.” (Clark 1900, 407). In short, classical economists believed that monopoly could never be a natural, i.e., spontaneous, outcome of the market mechanism. Its origin and persistence could only be artificial – this being the second key element in the classical approach.

This interpretation, the so-called *non-persistence argument*, is widely acknowledged. It fits nicely with the above-mentioned idea that classical competition was not a theory about price/cost relationships, as it came to be in neoclassical economics, nor a theory about the struggle for survival, as the Social Darwinists believed. Rather, as Herbert Hovenkamp put it, “competition was a belief about the role of individual self-determination in directing the allocation of resources; it was a theory about the limits of state power to give privileges to one person or class at the expense of others” (Hovenkamp 1989, 1021). Monopoly was artificial because it was synonymous with special privilege, i.e., with legislation deciding the allocation of resources denying equality of opportunity to all individuals.³¹ It meant market dominance achieved through governmental activity that artificially impeded free competition. This explains why classical economists had little to say, analytically speaking, about monopoly. When they wrote about monopoly, it was mainly to attack exclusive privileges granted by the government. Competition meant to them vertical and horizontal rivalry, but above all it meant freedom from constraints, such as the exclusive privileges so

³¹ Also see Siegel 1984.

common in the old Mercantilist period (ibid., 1025). Monopoly was first and foremost a political problem, rather than a theoretical one.

When still a judge at the New York Court of Appeals, Rufus Peckham offered a remarkable analysis of the term “virtual monopoly”. Dissenting in *People v Budd* from the court’s decision to uphold a price regulation enacted by the New York state,³² he denied that any such regulation was really necessary against monopolies. He explained that “the term has heretofore been used as indicative of *some special privilege or franchise granted to the individual by the sovereign* which results in such virtual monopoly, and the right of such regulation exists by reason of such grant” (*Budd*, at 65, added emphasis). Thus, any “virtual monopoly” rested upon the state’s infringement of the liberty of others to compete on an equal footing with the putative monopolist. The reason for neglecting other sources of monopoly rested in his distinction between *de jure* and *de facto* monopoly: “In the one case the monopoly exists by reason of the action of the government, and no other citizen can come in and devote his capital and energy to such use. In the other the monopoly exists only as long as other citizens choose to keep out of the business, and just as soon as it is seen that the least degree over the ordinary profit can be realized by an investment in elevator property just that moment capital will flow into that channel, and probably away from some industry where the average rate of profit has ceased to be made. Thus in one case the result cannot be avoided or in any way altered excepting by the action of the sovereign, while *in the other case it may be altered by the action of the ordinary laws of trade*” (ibid., emphasis added). No regulation was required then, because the free play of market forces – “the ordinary laws of trade” – was more than enough to destroy *de facto* monopolies.

While the non-persistence argument and the artificial nature of monopoly did capture the gist of the classical approach, it is important to underline that depicting Adam Smith as an author who paid no *analytical* attention to the problem of monopoly would nonetheless be a mischaracterization. A recent essay by Neri Salvadori and Rodolfo Signorino convincingly argues that, far from denying a role to entry barriers, Smith had a fairly well developed taxonomy of them – from natural barriers, such as “a singularity of soil and situation”, to legal ones, such as “exclusive privileges of corporations, statutes of apprenticeship, and all those laws which restrain, in particular employments, the competition to a smaller number than might otherwise go into them” (Smith 1776 [1904], I.vii.24 and 28). These barriers – themselves the heritage of a tradition dating back to

³² 117 N.Y. 1 (1889). Peckham’s dissent was originally written for *People ex rel Annan v. Walsh*, 22 N.E. 682 (N.Y. 1889), another case involving the same regulation. However, in that case no majority opinion was written. His opinion was therefore reproduced in a companion case, *Budd*

Scholastic authors³³ – explained why market prices could stay above their relative natural levels for a very long time span, or even forever.

Indeed, in Book I Chapter 7 of the *Wealth of Nations*, Smith explicitly classified the circumstances that made market prices *persistently* higher than the natural level into three broad categories (ibid., I.vii.20): “particular accidents” (industrial or trade secrets), “natural causes” (e.g. the very specific nature of French vineyards) and “particular regulations of police” (the legal monopoly granted to an individual or trading company, the exclusive privileges of corporations, statutes of apprenticeship etc.). Their common element was the artificial exclusion of outsiders from a given market, so much so that incumbents could determine the quantity of a given commodity *in the long run*. Hence, according to Salvadori and Signorino (2014, 4), it is the very text of the *Wealth of Nations* that, to say the least, largely qualifies the thesis of those interpreters who take the non-persistence argument as an excuse for the absence in classical authors of a theory of monopoly prices. Competition meant freedom to trade in the *Wealth of Nations*, while monopoly meant any kind of restriction to that freedom – i.e., a heterogeneous collection of market situations characterized by the existence of some restrictions to freedom of trade and, therefore, by the fact that a single agent, or a combination of agents, could obtain control of the supply of a given commodity (ibid., 5-6).

III.D Millian spillovers and the limits to state interference

While never denying the general desirability of Smith’s system of natural liberty, the position of most classical economists was more nuanced than often believed even with respect to the role of state intervention in the economy. For example, the theme of the boundaries of legitimate government interference upon individual freedom was at the center of John Stuart Mill’s analysis.³⁴ The key notion was that of spillovers, or externality. Every individual had a sort of “inner circle”, within which he should be left totally free to exercise his actions (Mill 1848 [1909], V.xi.4). This space of complete freedom was identified by the non-existence of spillovers, i.e., of external consequences of an individual’s actions. On the contrary, “[w]henver [...] there is a definite damage, or a definite risk of damage, either to an individual or to the public, the case is taken out of the province of liberty, and placed in that of morality or law” (Mill 1859 [2001], 75). In language clearly reminiscent of the *sic utere* principle adhered to by common law judges, Mill argued that: “The liberty of the individual must be thus far limited; he must not make himself a nuisance to other

³³ See De Roover 1951.

³⁴ Here I follow Medema 2009, Ch.2.

people” (ibid., 52). Existence of spillovers, actual or expected, was therefore the sole justification for government limitation of individual freedom.

Yet Mill was aware that spillovers were often inevitable: “In many cases, an individual, in pursuing a legitimate object, necessarily and therefore legitimately causes pain or loss to others, or intercepts a good which they had a reasonable hope of obtaining” (ibid., 86). Holmes’s path-breaking notion of competitive injury (see above, II.B) had an obvious antecedent here, in particular the idea that the presence of a spillover was by itself insufficient reason to justify government intervention: “It must by no means be supposed, because damage, or probability of damage, to the interests of others, can alone justify the interference of society, that therefore it always does justify such interference” (ibid.).³⁵ Some spillovers were, so to speak, legitimate. Not surprisingly, Mill believed competitive damages always belonged to this category: no redress for competitive injury should, and did, exist (ibid., 87).

But if the mere existence of a spillover by itself granted no legitimacy to state intervention, the problem of establishing the boundary between legitimate and illegitimate interference remained unsolved. As we noted above, although *laissez faire* should be “the general practice”, no universal solution could exist (Mill 1848 [1909], V.xi.16). It was here, as a matter of line drawing, that Mill introduced his analysis of the pros and cons of interference, based on utilitarian principles and, in particular, on the pragmatic notion of “expediency”. The key, he wrote, was to realize that “it is hardly possible to find any ground of justification common to [all functions of government], except the comprehensive one of general expediency”. Only a “simple and vague” rule existed, namely, that government interference “should never be admitted but when the case of expediency is strong” (ibid., V.i.11).

Note that simple expediency, the prevalence on utilitarian basis of the pros over the cons of state intervention, did not suffice either. It had to be “strong” expediency. Drawing a narrower boundary for government action depended on Mill’s distrust of its actual effectiveness (ibid., V.xi.11), as well as on his fear of majoritarian tyranny (ibid., V.xi.15) and his contempt for “government by mediocrity” (Mill 1859 [2001], 62) None of these three reasons had to do with faith in natural liberty. Indeed, Mill criticized those authors who founded their narrow view of government role upon natural liberty arguments.³⁶ The reason for shifting the boundary more in favor of individual freedom was his pessimism with respect to government action. Hence, Mill exemplifies the case of a classical author whose faith in *laissez faire* did not rest on a priori foundations, like the protection of natural rights (which only held within the “inner circle”), but rather followed from an inductive

³⁵ Also see Mill 1848 [1909], V.xi.5.

³⁶ For example, he was critical of the French *laissez faire* champion Frédéric Bastiat: see Franken Paul 1979, 193-4.

argument, based on a combination of real world experience and utilitarian calculus, policed by the principle of expediency (Franken Paul 1979, 194).

These two examples, Smith's monopoly theory and Mill's spillover effects, suffice to reveal the limits of the naïve characterization of classical economists as whole-hearted supporters of *laissez faire* and, above all, as unsophisticated believers in the power of free competition to destroy any kind of monopoly. But if the classical theory of market *imperfections* granted no absolute analytical support for *laissez faire*, how to account for the close association between the latter and classical thought, as evidenced by the latter's skepticism, to say the least, about government intervention? Only one possibility remains, namely, to trace its roots outside of classical economic *theory*, yet within classical *political economy*. More specifically, it may be demonstrated that the classical economists' faith in *laissez faire* was a direct offspring of the classical liberal principles upon which their political economy was founded.

The question of the proper limits of state action in the economy was the most important one for these economists: it was the core issue of classical political economy. They also knew well that, given the moral and political aspects of the question, the answer could not remain within the sphere of theoretical analysis. *Laissez faire* was the shared answer for most of them, or at least the benchmark against which specific proposals for state intervention need be confronted. However, it is not often recognized, especially by law historians, that classical economists approached the issue by two different angles.³⁷ In doing so, they mirrored the similar distinction that existed within the broader camp of classical liberalism, of which their political economy was just a part.

The natural rights tradition of, say, Adam Smith defended *laissez faire* on different grounds than the utilitarian approach of, say, John Stuart Mill. For the former, hostility against state intervention in the economy rested on the contention that such activity represented a direct violation of the individual's natural rights to liberty and property. For the latter, driven by the principle of greatest utility for the greatest number, state intervention had to be opposed every time its effects would be counterproductive, i.e., the costs would exceed the benefits, utility speaking. As a consequence, while both traditions extolled the virtues of *laissez faire*, supporters of the natural rights were much less likely than utilitarians to find exceptions justifying state interference in the economy. The motive is simple. The former's was an absolutist position, grounded on ethical arguments, while the latter's was a relativist one, always open to the possibility that such interference could be legitimate – indeed, desirable – if the benefits outweighed the costs.

The rise of utilitarianism in Britain led the last generation of classical economists working in that country to admit ever more exceptions to *laissez faire*. This happened every time the cost/benefit

³⁷ See Franken Paul 1979, 4-5.

calculus privileged state solutions over the free-market ones. Progress in economic theory revealed that these cases were more frequent than previously thought. The rise of the marginalist school – which had the cost/benefit calculus at its core – strengthened this pattern, so much so that, by the end of the 19c, British economists would become very skeptical of naked laissez faire and accept state intervention in a larger number of situations. The same did *not* happen in America.

As Section III.G will show, utilitarianism was very poorly received in the US, where the natural rights approach to classical liberalism dominated the intellectual environment until the end of the 19c. Economists partook of this domination, so much so that a good quarter century after the marginalist revolution had transformed economic theory, many American scholars still supported an ethically grounded, largely Smithian, version of classical political economy. Specific historical reasons exist for the persistence of the natural rights tradition in the US, not the least being that the version of classical liberalism the Founding Fathers had enshrined in the American Constitution had been deeply affected – among other intellectual influences – by the philosophy of Common Sense Realism, that is, by the leading current of thought of Scottish Enlightenment. In other words, Adam Smith and the American Constitution happened to share a common understanding of liberalism, one based upon the existence of natural rights of liberty and property and, above all, one where the defense of these rights rested on absolute moral (when not explicitly religious) grounds, rather than on pragmatic, cost/benefit ones.

But if classical liberalism, in its natural rights version, was at the same time the baseline of American constitutional law and the pillar of economists' defense of laissez faire, then we have come a long way in explaining the attractiveness of the latter's ideas upon LFC courts. We may understand why, as Hovenkamp (1988, 440, emphasis added) put it, “[t]he Supreme Court eventually adopted a position [...] permitting state intervention *only where the classical economists themselves would have permitted it*”. It was not really a matter of these judges being captive of an outmoded economic theory, as Holmes argued in his *Lochner* dissent, but rather of their recognizing that a common parenthood existed for the Constitution's fundamental values and classical political economy – in the version still prevailing in post-Civil War America.

III.E Two questions about classical laissez faire: the Scottish influence

In a masterful 1988 paper, “The political economy of substantive due process”, law historian Herbert Hovenkamp has reconstructed the crucial role played by Scottish common sense philosophy as the common foundation for both legal and economic principles in 19c American intellectual

environment. As he effectively put it, it is not that “American classical political economists ‘caused’ substantive due process by developing a set of economic ideas that were then learned by American judges. The evidence does not support such a proposition”. The truth is that “both American political economists and American judges operated in a uniquely American ‘market’ for ideas. Like all market participants, each American maker of ideas selected from available inputs to produce his own original output. [...] The inputs of American classical political economy may even have included the decisions of some judges. They certainly included some jurisprudential propositions, such as those asserting the sanctity of property rights. Also included among the inputs into both American political economy and American law was the set of moral and philosophical ideas called Scottish ‘Common Sense’ Realism” (Hovenkamp 1988, 398).

In 1978 historian Garry Wills questioned the Lockean foundations of early American constitutionalism (Wills 1978). Far from bearing the Lockean imprint, as it is usually claimed, the Declaration of Independence should be viewed as a product of the moral and political philosophy of the Scottish Enlightenment; in particular, Wills argued that Thomas Jefferson’s views on the nature of man and society derived not from Locke, but from the works of Thomas Reid, David Hume, Adam Smith, Lord Kames, Adam Ferguson, and Francis Hutcheson. Indeed, the study of Scottish Enlightenment played a prominent role in American education in the second half of the 18c. Scottish moral philosophy was an integral part of the curricula of most American colleges, and this seems to have been especially true in Jefferson’s Virginia.³⁸ At the College of William and Mary, Scottish William Small taught moral philosophy, rhetoric, and belles-lettres, and it was primarily under Small that Jefferson did his undergraduate work. During that period, Jefferson became acquainted with the works of Hutcheson, that Small expressly taught (*ibid.*, 180). Moreover, Jefferson was also familiar with other Scottish writers, whose works seemingly featured in his library, such as Smith, Reid, Hume and Kames (*ibid.*, 175). As to the latter, Gilbert Chinard noted long ago that Lord Kames was for Jefferson “a master and a guide” and the source of “all his conception of natural rights”, which “neither Locke, nor so far as I know any political thinker” of Locke’s period had defined as Kames and Jefferson defined it (Chinard 1929, 29-30). It seems to have been from Kames in particular that Jefferson derived the un-Lockean moral sense philosophy that arguably underlies the Declaration, with its inclusion of the pursuit of happiness among man's natural rights (Ostrander 1980, 532).

³⁸ According to Daniel Robinson, it was so common for late 18c American faculties to appoint Scottish tutors or those educated in Scotland that by 1820 the Founders’ debt to Scottish moral philosophy was widely acknowledged. The influence of Scottish Enlightenment on American education came especially through Princeton Scottish president, John Witherspoon, himself a signer of the Declaration of Independence. His students included “the future President of the United States, James Madison, as well as nine cabinet officers, twenty-one senators, thirty-nine members of the House of Representatives, a dozen State governors, five of the fifty-five delegates to the 1787 Constitutional Convention, and three Justices of the U.S. Supreme Court” (Robinson 2007, 171).

Regardless of the validity of Wills's claims about Jefferson's Declaration, the influence of Scottish 18c philosophy upon the Framers is now widely recognized. One of the key vehicles for its diffusion was James Wilson (1742-1798) and, through him, philosopher Thomas Reid – Adam Smith's successor in the chair of moral philosophy at Glasgow University and the chief architect of Common Sense Realism.³⁹ Wilson owed international celebrity to a 1774 pamphlet titled *Considerations On the Nature and Extent of the Legislative Authority of the British Parliament*, a work that included the claim that “all men are by Nature equal and free” (quoted by Robinson 2007, 175). He played a big role in the founding period both at the 1787 Constitutional Convention, where he was second only to James Madison in exercising control and rallying consensus, and as an Associate Justice in the first ever Supreme Court.

Wilson's ideas were enormously influential in the founding period. They closely followed Scottish common sense philosophy in general, and Thomas Reid's version in particular. As Oxford law philosopher Daniel Robinson put it, “in Wilson's writing and his thought one is able to locate the rich amalgam of the discipline of law and that Scottish Common Sense Philosophy” (ibid., 174-5). His theory of natural rights, which will have a deep impact upon later constitutional jurisprudence, including LFC, was distinctly un-Lockean. Wilson's rights were “the outward expression of an inner truth available to all who are fit for life under the law. It is the inner truth, part of the very constitution of human nature, that makes government possible. Thus, government is not the source but the product of that exercise of power and judgment available to a being capable of self-government” (Robinson 2010, 297). Not surprisingly, Wilson also rejected David Hume's utilitarian foundations of justice and rights: he countered that in performing one's duty, as well as in understanding what one's duties are or what duties others have to oneself, the calculation of utility was both impracticable and rare. Finally, in his most famous opinion as a Supreme Court Justice,⁴⁰ Wilson attacked William Blackstone's traditional doctrine of sovereignty – in particular, the idea that rights were man-made and took on the character of civil privileges, proffered or denied by way of a legislative authority, with the obvious implication (which later Progressives jurists will promptly draw) that rights were mere legal constructs, grounded in certain social and historical facts. In *Chisholm* Wilson famously declared that sovereignty rested in the man, not in the state, and that the Constitution was simply the means by which American citizens could defend themselves and their natural rights against the implications of Blackstonian doctrine (*Chisholm*, at 455).

Another channel through which Scottish Common Sense philosophy reached American judges was of course that of classical political economy. That judges were actually exposed to it is a no-brainer. General reviews, such as the *North American Review*, the *Yale Review*, or the *Princeton*

³⁹ See Bozeman 1977, Ch.1. On the relation between Scottish Common Sense and Adam Smith, see Comim 2002.

⁴⁰ *Chisholm v. State of Georgia*, 2 U.S. 419 (1793).

Review were common debating forums for both economists and legal scholars, hosting “a wonderfully eclectic mixture of political economy, constitutional law, private law, history, ethics, and even literature” (Hovenkamp 1988, 399). Moreover, on top of classical economists’ agenda featured general policy issues that were also the jurists’ concern. The crucial insight is another one, though. Hovenkamp recognizes that throughout the 19c American political economy was dominated by a moral content that was much less visible in British economists of the same period. The moral ideas that American scholars stuck to were those of Scottish common sense philosophers. As a result, the utilitarian approach, which minimized the role of moral determinants and subordinated natural law and absolute economic rights to a pragmatic assessment of collective welfare, had far less influence on 19c American political economy than it had in Britain (*ibid.*, 403).

As we noted above (see III.B), much of Adam Smith’s economics – including his pivotal property and value theories – derived from his theory of commutative justice and natural rights in the *Theory of Moral Sentiments*. By the mid-19c British utilitarianism had undermined the more typically Smithian feature of classical political economy, namely, its moral content. Not so in the United States, where the tradition of Scottish Common Sense Realism continued to influence not only the philosophical, but also the economic and legal discourse. Both American political economists and jurists subordinated utilitarian solutions to Protestant moral values long after their British counterparts had abandoned such concerns. As a consequence, explained Hovenkamp (*ibid.*, 404), substantive due process was built on the political economy of an unreconstructed Adam Smith. Liberty of contract and other rights recognized under the Fourteenth Amendment were not just economic rights. They were moral and religious rights as well.

The leading texts of British classical economics had been published quite early in America.⁴¹ While the *Wealth of Nations* was taken up at William and Mary sometime between the mid-1780s and the 1790s, the book was read, debated, and absorbed even earlier: an edition was published in Philadelphia within a few years of the Revolution. An American edition of David Ricardo’s *Principles* was published in 1819. Highly influential was also the entry on “Political Economy” in the *Encyclopædia Britannica* authored by John Ramsey McCulloch, Ricardo’s chief expositor in Britain. Many colleges introduced political economy as a subject in its own right in the late 1810s – early 1820s. In most cases the favored text was another landmark contribution in the classical tradition, Jean Baptiste Say’s *Treatise on Political Economy*. Yet a problem arose, especially in Northern colleges. To gain acceptance there, the pillars of classical economic liberalism, like the inviolability of property and free trade, “had to be disassociated from French political radicalism and garbed in religious piety” (Meardon 2008, 6). This sort of religious test became more stringent

⁴¹ The following historical information are taken from Meardon 2008.

in the 1830s, when evangelical religion asserted itself in the same citadels where political economy was establishing its foothold. Hence, noted historian of economics Stephen Meardon, the new subject required “a text reflecting at least the sensibilities, if not always the objectives, of its teachers and students” (ibid., 7). That text was *Elements of Political Economy* by Reverend Francis Wayland. As it happened, it was a work fully imbued with Scottish Common Sense Realism.⁴²

III.F Wayland, the “American Smith”

Laissez-faire and individualism were important parts of American ideology in the first decades of the 19c. The new Jacksonian majority believed that people should be able to worship, think, and manage their affairs with minimal state interference. That view became the principal economic and moral message of the leading political economist of the period, Francis Wayland (1796-1865). Although he was not an original thinker, Wayland is widely regarded as one of the best mirrors of conservative social thought in pre-Civil War America. Raised a New York Baptist and himself an anti-Jacksonian, he learned Scottish Common Sense Realism through the works of Dugald Stewart and Lord Kames at Congregational Andover Seminary in Massachusetts. As president of Brown University he became one of the leading American proponents of that philosophy in the 1830s and 1840s.

As remarked by David Colander, Wayland’s works are truly representative of economists’ attitude during that period. What these economists mainly did was to philosophize, and economics was part of a broader moral philosophy, one area among others in which they philosophized. Textbook writers and teachers were careful to make it clear to their students that what they did was not exclusively, or even primarily, economics (Colander 2011, @). Indeed, Wayland fancied himself a kind of American facsimile of Adam Smith. Just as Smith had published his *Theory of the Moral Sentiments* and then his *Wealth of Nations*, so Wayland published his *Elements of Moral Science* in 1835 and, two years later, his *Elements of Political Economy*. And just as Smith, Wayland regarded the two books as developing related parts of a single system of social philosophy.

His second treatise made him the foremost teacher of political economy for two generations of pre-Civil War students. No other academic economist of the period had greater personal prestige and no other comparably placed moral philosopher published a political economy textbook. The book superseded Say’s *Treatise* and was only rivaled, after 1848, by Mill’s *Principles*. The latter however was too lengthy to serve as a college text. In that role, Wayland’s volume dominated.

⁴² My presentation of Wayland’s contributions follow Dorfman 1966, vol.II, 758-67; Conkin 1980, 116-23; Hovenkamp 1988, 413-6; 1996, 23-31; Meardon 2008, 7-8.

Especially in the North, the *Elements of Political Economy* remained the standard long after the end of the Jacksonian era. Between 1837 and 1875 the book went through 24 printings in Boston and New York, with three more in London and translations into Hawaiian and Armenian! It was the largest selling textbook in that period, with estimates of cumulative sales of 40,000 in the US by 1867.⁴³ A revised version, recast by Aaron L. Chapin, went through other editions well into the 1880s, still with good sales.

Dubbed “the Ricardo of evangelists” (Cole 1954, 178), Wayland summarized in an appealing way the economic truisms most generally accepted and approved in America. His was an optimistic, innocuous version of classical orthodoxy, with little of the tensions of Ricardo’s original system. By transplanting the classical model in the US and by adapting it to the boundless resources and solid political institutions of the American context, he converted it into a blueprint for national prosperity. At the heart of his political economy lay the moral science he borrowed from Adam Smith and other 18c Scottish philosophers. Both the economic and the moral world were subject to scientific scrutiny, as God-ordained. His approach was apparent since the inception of his 1837 textbook. “Political Economy is the Science of Wealth”, he wrote, “By Science, as the word is here used, we mean a systematic arrangement of the laws which God has established, so far as they have been discovered, of any department of human knowledge. It is obvious, upon the slightest reflection, that the Creator has subjected the accumulation of blessings of this life to some determinant laws. [...] Political Economy, therefore, is a systematic arrangement of the laws by which, under our present constitution, the relations of man, whether individual or social, to the objects of his desire, are governed” (Wayland 1837, 3).

Scottish Common Sense Realism had brought two key ideas to American philosophy. The first was a kind of empiricism that despised speculation and abstraction. Against David Hume’s empirical skepticism, the Scottish Realists gave a pragmatic answer, one that encouraged individualism and self-determination: certain ideas about human understanding were just obvious, or intuitive, but could never be proven. This very argument demonstrated the existence of what they called the “moral sense”, i.e., a rationale for individual self-determination in every aspect of human activity. Here lay their second key idea: moral sense meant that every person had the ability to make moral choices within a set of shared moral rules. Moral science thus emerged as the discipline that used the moral sense to discover these rules, i.e., the principles of ethical conduct.

Scottish Realists believed that these principles, of divine origin, were fixed and absolute: “the moral laws of God, never be varied by the institutions of man any more than the physical laws” (Wayland 1835, 5). Yet, they were also discoverable, like scientific laws. Moral scientists of the

⁴³ See Colander 2011, @.

early 19c could thus claim their discipline was as scientific as the natural sciences. Indeed, Wayland opened his *Elements of Moral Science* by comparing moral law with Newton's laws of physics and the axioms of mathematics, and crediting them with the same scientific status (ibid., 3-4). As a consequence, moral science could help anyone well educated in its principles to make the "right" decision whenever confronted with an ethical problem. This was exactly Adam Smith's point in the *Theory of Moral Sentiments*. Wayland's position on the relationship between moral science and political economy was fundamentally Smith's position – only sixty years later.

The principles of political economy, Wayland observed in the preface to his treatise, "are so closely analogous to those of Moral Philosophy, that almost every question in one, may be argued on grounds belonging to the other" (Wayland 1837, vi). Hence, political economy partook of moral philosophy. One could study all kinds of economic behavior and their consequences – production, exchange, distribution, individual and public consumption – and infer God's design therein. The task of the political economist was the systematic arrangement of those divine laws that pertained to wealth. Conversely, a whole chapter of his moral science volume was devoted to economic issues, in particular the foundations of private property. For Wayland, as for Smith, the individual's right to property, and to the profits earned from it, were grounded first and foremost in moral, rather than economic, principles. Property was a natural right that descended from the moral law and that could be understood by the moral faculty: "The right of property is founded on the will of God as made known to us by *natural conscience*, by *general consequences*, and by *revelation*" (Wayland 1835, 246). Natural conscience upheld a right of individual ownership, as long as one's possession did not injure others. Nothing was more natural, more tied to one's happiness than the desire to own things and to have a secure use and enjoyment of the products of one's labor (ibid., 249-50). Wayland then followed Locke in determining which forms of possession qualified as morally legitimate property. First and foremost, an individual had a legitimate claim to all the products of his own labor and to what he procured by these products through exchange (ibid., 250). These principles, he concluded, were in accordance with the law of God, but they required "an able, learned, upright, and independent judiciary" to uphold them. The rewards would be great. Historical experience showed that: "The more rigidly these principles have been carried into active operation, the greater amount of happiness has been secured to the individual, and the more rapidly do nations advance in civilization" (ibid., 253).

In view of the moral foundations of property rights, it is not surprising that Wayland's *Elements of Political Economy* offered an extended argument for laissez faire, designed to show that self-interest and free trade yielded the optimal allocation of economic resources. Wayland's, like Smith's, was a kind of laissez faire that blended moral and economic elements. Moral science

entailed that legislative interference with the individual's freedom to employ his capital and labor constituted no less than a form of public oppression. Even common property was rejected on moral grounds: by severing the connection between labor and proportionate rewards it threatened both industry and savings (Wayland 1837, 113). Society thus had a powerful incentive to get all productive resources in private hands and, conversely, the duty to provide everyone with the opportunity to gain property. By itself, legislation never conferred rights; it merely confirmed the natural rights that previously existed – a statement the likes of James Wilson would openly endorse.

Having secured property, the next concern for society had to be the efficiency of work, because only efficient labor could assure growing wealth. But except for education and patent protection, Wayland wanted no laws directed at increasing production. Accordingly, he taught that the economic role of government was limited to constructing the arrangements of society as to give free scope to the moral laws devised by God. The recipe was simple: men should be left free to produce what they wanted, to sell their labor and invest their capital, to dispose of their product. The policy implications were also immediate. Americans should reject any kind of special privilege, including protective tariffs and monopolies. Indeed, all legislation granting one party or the other any additional privilege was simply – as he repeatedly said – “impolicy” (Wayland 1837, 119-22). And since competition brought wages to their proper level, combinations among laborers were “not only useless, but”, as he wrote in the fourth edition of his book, “expensive, and unjust” (Wayland 1841 [1870], 303). They were expensive because they exposed capital and labor to long periods of idleness; they are unjust because they deprived the capitalist of his right to employ laborers and the laborer of his right to dispose of his labor to whomsoever and on what terms he pleased. Combinations of workers – the “tyranny of trade unions”, as he called it (ibid., 117) – thus deserved the same condemnation as the tyranny of government or the combinations of capital. These ideas will migrate almost verbatim into LFC jurisprudence.

III.G The rejection of utilitarianism

Not only was Wayland exemplar of American economists' belief in the moral foundations of the Smithian system of natural liberty. He was also the archetype of the less than enthusiastic reception they reserved to British utilitarianism. Even this attitude rested on Scottish Realist basis.

That utilitarian influence in American 19c thought has been negligible until the last decades of the century is well known. Utilitarianism, in its crudest Benthamist form, opposed to natural law and natural rights the principle of utility, or the greatest happiness. Alas, none of Bentham's major

works made a splash on the other side of the ocean. As documented long ago by Paul Palmer, neither the 1776 *Fragment on Government* nor the 1789 *Introduction to the Principles of Morals and Legislation* had many American readers. One of the earliest reference to the former was by Oliver W. Holmes, but that came only in 1873 (Palmer 1941, 857). As to the latter, where Bentham presented a systematic exposition of utilitarianism and famously attacked the theory of natural rights as embodied in the Declaration of Independence and the Bill of Rights, Palmer reports the sad remark by one of the few American Benthamites of the period, Aaron Burr, that no more than four people had read it in the US (ibid.). Even qualitatively, Bentham did not enjoy in America the same kind of fellowship he had in Britain. His disciples there were mere epigones, who worked alone and founded no Utilitarian Club or *Westminster Review* (ibid., 865). Only in the last two or three decades of the 19c a Benthamite cross-current in American juristic and political thought emerged, again with Holmes among its exponents.⁴⁴ In any case, utilitarianism did not become part of the intellectual mainstream in American social sciences until the early 20c, i.e., until the rise of Pragmatism and the Progressive era.

American intellectual environment was not at all favorable to Benthamism. Consider Bentham's rejection of natural rights and natural law. In the *Constitutional Code* (1830), he dismissed any kind of bill of rights as useful only as a check upon non-democratic governments; he also rejected absolute limitations on legislative power as in contradiction to the greatest happiness principle. These ideas did not win many supporters in America. Although Bentham's was, at least originally, an individualist laissez faire doctrine, its inner logic could easily take a collectivist turn (Coates 1950, 357-8). A possible implication of the greatest happiness principle was in fact that legislation should respond to the interests of the wage-earning class, which in an industrial society constituted the "greatest number". Furthermore, the utilitarian theory of sovereignty provided, in parliamentary supremacy, the instrument wherewith such legislation might be shaped: it was by the unrestricted use of the legislative power of the state that Benthamites sought to effect their reforms. Finally, in its effective demand for a more efficient and centralized public administration, Benthamism laid the foundation of the modern administrative state.

Because they clashed with both the Lockean and the Scottish Realist traditions, none of these principles could be accepted by the leading American intellectuals of the late 18c - early 19c. In particular, by willing to subordinate moral concerns to the primary goal of maximizing human satisfaction, utilitarianism was fundamentally opposed to the moral and economic views of Common Sense philosophers. For example, his 1826 *Lectures on the Elements of Political Economy*, one of brightest American supporters of utilitarianism, Thomas Cooper, forcefully

⁴⁴ Note however that Holmes's own views about utilitarianism were less than enthusiastic, as he saw them as conflicting with evolutionism: see Holmes 1873, 584, and Novick 1989, 431-2, fn.23.

claimed that “All rights are the creatures of society; founded on their real or supposed utility, and requiring the force of society to protect them. [...] There is no such thing as law of nature” (Cooper 1826, 52-3). Cooper’s materialistic philosophy differed from the Common Sense approach in its eschewal of supernatural truths and sanctions. Utility, not divine commands, was the great ethical canon, and this functioned through self-interest as the sole criterion of human action (Dorfman 1966, vol.II, 527-8). Cooper substituted the word “utility” for “natural” everywhere: being social, rather than natural, rights were sanctioned for the common good, in the sense of aiding and protecting the accumulation of wealth (ibid., 845). But if rights rested on their utility to society, they might be abrogated whenever they were clearly shown to have an opposite tendency (ibid., 537).

As remarked by Hovenkamp (1988, 415-6), nearly all Americans, liberal and conservative alike, rejected the utilitarian foundations of rights. The individual – so central to American ideology – seemed to count little for utilitarians, because her interests could always be bargained away for the good of society. The failure of utilitarianism in 19c America depended on its being considered not so much a basic economic assumption or technique, but rather a moral worldview directly opposed to Protestant orthodoxy and individualistic creed. As a result, it was unacceptable to most political economists, including Wayland, on religious or ethical grounds, regardless of economic objections. “Twentieth century readers trained in the preference driven ideas of neoclassical economics”, noted Hovenkamp (1996, 13), “find it difficult to appreciate the absolute abhorrence early nineteenth century American political economists and moral philosophers felt for utilitarianism”.⁴⁵ Indeed, Wayland’s moral science textbook may be read as little more than an extended argument against utilitarian ethics, i.e., against the idea that the properness of any action should be based on the net value of its consequences (ibid., 26). The “greater amount of happiness” the protection of property rights would guarantee to individuals⁴⁶ rested on no utilitarian calculus, but on the inescapable harmony among divine benevolence, natural rights, moral law and individual well-being.

In conclusion, what prevailed in America was a non-utilitarian, and possibly anti-utilitarian, version of classical political economy. Indeed, the typical response of 18c American political economists to utilitarianism was to ignore it (Hovenkamp 1988, 416). For example, the same Wayland who had attacked the utilitarian ethics in his moral science treatise, never mentioned Bentham in his *Elements of Political Economy*. Even the massive, three-volume *Principles of Political Economy* (1837-1840) by the best economist of that generation, Henry Carey, never

⁴⁵ The situation for Bentham’s philosophy was further compromised by the use that the few supporters made of utilitarianism in the great political debates of the early 19c. Opponents to the extension of the franchise and supporters of slavery applied utilitarian principles to counter democratic arguments based on natural rights theory. As a consequence, “a doctrine which in England was on the side of the future was here discredited by its association with the forces of reaction” (Palmer 1941, 869). On Thomas Cooper’s own difficulties to reconcile utilitarianism, libertarianism and a strong anti-majoritarian class bias, see Conkin 1980, 141-52.

⁴⁶ See Wayland 1835, 253.

discussed Bentham. And although Carey did discuss James Mill's economics, he never mentioned his utilitarianism. Again, this was hardly surprising: like most American economists, even Carey "followed the teachings of Scottish Realist Protestant Adam Smith" (Freyer 1994, 51).

Hence, it was not casual that when counsel John Jewett in the landmark *Munn v Illinois* case⁴⁷ attacked the opinion by the Chief Justice of Illinois who had upheld the statute, he directed his fire against the use that opinion had made, within a general laissez faire framework, of the "greatest good of the greatest number" principle. Jewett urged the Supreme Court to reject this utilitarian reading of classical political economy. Utilitarianism, he said, conferred too much power to courts and legislators. It was "subversive of the social and political equality of the citizens" and contrary to natural justice and equity. "There is no outrage upon private property rights which might not be perpetrated under it", Jewett added, "It would justify the absolute appropriation of individual property to the public use, or a division of it among the multitude". In short, utilitarianism struck at the basis of the constitutional protection of private rights originally erected by the Framers as one of the "the broad principles upon which the fabric of civil society rests". Acknowledging the Scottish Realist foundations of American Constitution shows that, though he lost the case, Jewett was pretty right on that point.

For decades after the doctrine's mid-19c rise in Britain, utilitarianism remained outside of the mainstream of both American economics and, what matters more here, jurisprudence. Categorical thinking, typical of classical legal thought, rejected the cost/benefit comparison, typical of utilitarianism. Sharp dichotomies applied to the perennial line-drawing problem judges were called to solve when deciding upon the legitimacy of state interferences. A statute could be either a legitimate or an illegitimate exercise of police power, but it was out of question that its constitutional legitimacy could ever be assessed applying a case-by-case approach, weighing the costs and the benefits caused by the statute itself when applied to the specific circumstances under scrutiny. The rejection of utilitarianism thus represents another point of contact between classical political economy and classical liberalism affecting American jurisprudence. It would only be at the turn of the 20c, when regulation of the economy became more frequent and more invasive, that the necessity would arise of a more nuanced approach, less dependent on sharp categorical distinctions. The line-drawing problem between legitimate and illegitimate exercises of the police power would then require a different, more sophisticated tool-box. It would be only then that utilitarianism – i.e., cost/benefit analysis in its modern marginalist version – would gain ground in American jurisprudence, including antitrust law.

It is rather well known among law historians that the dissenting opinions in *Munn* – as well as the plaintiff counsels' arguments on which they were based – will provide later courts several of the rhetorical devices upon which LFC decisions will be based. Jewett's brief in that case is therefore

⁴⁷ *Munn v Illinois*, 94 US 113 (1876). On Jewett's argument, see Twiss 1942, 86-7.

further proof of a basic historical fact, namely, that the influence of Smith's – and Wayland's – moral theory of laissez faire in late 19c American jurisprudence was very significant. LFC courts will in fact become the strongest defenders of that very version of classical political economy, as they will often perceive interventionist legislations as the biggest threat to individual liberty.

FINALE: POLITICAL ECONOMY, CLASSICAL LIBERALISM AND WHAT PROGRESSIVES FORGOT

This essay has showed that it is ultimately impossible to explain LFC without understanding that classical political economy and political liberalism were not two different sources of inspiration, but just one. The two traditions cannot be separated because, as law historian James May effectively put it, “American classical economic theory was not merely implicitly, but explicitly and centrally, a libertarian philosophy” (May 1989, 26). Political liberalism in 19c America was premised on the inherent right of individuals to maximum freedom consistent with the equal rights of others. It asserted that a political system recognizing such a freedom was optimal for both individuals and society. Significantly, economic autonomy and opportunity always constituted an essential element of that freedom. Classical political economy, in its original Smithian version, duly preserved by Wayland and his contemporaries, characterized economic rights and economic freedom in a way that paralleled, and extended, the general vision of political liberalism (*ibid.*).

To further appreciate the affinity between classical political economy and classical liberalism, think of the three laws that, according to May (*ibid.*, 70-71), played a particularly important role in the former. All of them partook of the spirit of the latter; all of them were deemed “natural”, i.e., grounded in the universal principles of moral law. Classical economists insisted, first of all, that an individual's labor gave that person a natural property right in whatever he or she produced. Wayland stated this loud and clear in 1837; nothing changed in the ultimate version of his textbook, published as late as the 1880s: “The exertion of labor establishes a right of Property in the fruits of labor, and the idea of exclusive possession is a necessary consequence. Personal rights begin with the consciousness of individual being and of individual achievement; and the idea of labor expended in the production underlies directly or indirectly the property-right to anything. Originally the thing produced belongs to him who produced it by an intuitive conception of right, and the act of appropriation is as instinctive as the act of breathing” (Wayland & Chapin 1881, 5). Individual property rights lay at the foundation of the second classical law, namely, the “possibility and the right of Exchange” (*ibid.*). Needless to say, both these laws were not merely “economic”: they were

first and foremost “natural” and, as such, they shared the same character of the universal principles of classical liberalism about life, liberty and property.

Within a natural economic world of unimpeded property and exchange, which by itself generated tremendous individual and social benefits, the disparate interests of single economic agents were coordinated and ultimately harmonized by the third natural law of classical political economy, free competition. American economists before and after the Civil War were unanimous in extolling the virtues of free competition in maximizing social wealth. What mattered the most, though, was that the outcomes of competitive markets were also deemed *just*, i.e., consonant with the dictates of morality, when not directly with God’s will. The very same conditions of freedom invoked by political liberalism were also those that, by allowing the unhindered operation of natural economic laws, generated not only the maximum of material wealth, but also justice and harmony in the whole economy. The eulogy of natural economic harmony could sometimes reach poetical levels – or so it seemed: “capital and labor”, one could read in Wayland and Chapin (1881, 107), “are natural partners, and if not interfered with, will spontaneously seek each other as birds mate in the spring for a happy, fruitful union”. In his *Elements of Political Economy*, the post-Civil War successor to Wayland’s work as the leading American textbook, Arthur Latham Perry (1830–1905) put this more straightforwardly: “When the matter is sifted to the bottom, it is seen that capital is as much interested in the prosperity of labor, as labor is interested in the prosperity of capital. All legitimate interests are in harmony” (Perry 1873, 228).

Realization of this harmonious and ethically desirable world of production and exchange critically depended on the security of economic liberty and property, and the protection and availability of bargaining opportunities: “Individuals would not most vigorously and fully take advantage of efficient specialization with an eye toward later competitive exchange unless they could freely choose their own callings, felt safe from external expropriation of the products of their own labor, and fully expected the opportunities for genuinely free exchange to remain open” (May 1989, 274-5). Wayland proclaimed this in all editions of his popular textbook. He was also adamant about the obvious implication, namely, that any interference with these natural laws would necessarily distort the harmony, bringing at the same time to lower wealth and unethical results. Thus, it turned out that security from interference with natural rights and the operation of the three natural laws formed an essential ingredient of both American political liberalism and the most popular renditions of classical political economy .

Perry explained this quite clearly in his textbook: “The great struggles of mankind in all history past have been around three points as centres: first, freedom of person; second, freedom of opinion; third, freedom of exchange. [...] in consequence of the struggle around the third point, one barrier

after another has been thrown down, one monopoly after another has been conquered, until it is pretty generally acknowledged at present that freedom of exchange is just as sacred as freedom of person and of opinion, and the struggle will certainly never cease until the *liberty of contract* and delivery, subject only to conditions of morals, health, and revenue shall be international and universal.” (Perry 1873, 143, added emphasis). Note the explicit reference to liberty of contract – the central theme of future LFC. Perry’s enthusiasm for free trade descended from a general presumption against any kind of commercial legislation, foreign or domestic, and by the firm belief that the only cure for lack of material progress (including the workers’) came from the elimination of any legislative impediment to the working of the natural rights of property and exchange. Never ever could the solution stem from redistributive, or class, legislation or from other assaults against these natural rights (Meardon 2008, 12-13). Thus, even Perry’s post-Civil War battle cries remained straight at the intersection of classical liberalism and classical political economy.

May also underlines that, founded as they were on the image of social harmony, neither doctrine envisioned a world of ceaseless social warfare or boundless individualist rivalry, like Social Darwinists would do. Theirs was a moral world of maximum freedom for individual activities not hurtful to others. In such a world the state had a legitimate and essential role, namely, to identify and deter those forms of the pursuit of self-interest that exceeded the scope of individual natural freedom, threatening the legitimate interests and basic rights of other individuals. The legal *sic utere* maxim, as well as John Stuart Mill’s “inner circle”, captured this quite well (see above, III.D). Unrestrained individual pursuit of self-interest posed a potential threat to the life, liberty and property of other individuals. Security of these natural rights thus required legal enforcement of the rights of liberty, property, and contract. As long as government and courts acted to perform this duty, “state action would remain the essential facilitator of natural law and not its enemy” (May 1989, 277). Outside this duty, the state should abstain from interference and competition should reign undisturbed.

Constitutional adjudication had therefore a well-defined task to accomplish. Every time the state departed from neutral support of natural rights, it became a source of unethical outcomes and economic decline. Identifying the proper boundaries of government power became the central question for American courts, especially after the Civil War. In affirming and applying the core constitutional principles of economic freedom and liberty of contract, LFC judges did nothing more than ensuring that state action supported, rather than threatened, those natural rights of property and exchange that were fundamental to both classical liberalism and classical political economy. It was thus in the perfect complementarity of these two traditions that the true intellectual, as well as legal, foundations of LFC actually lay.

It is here that we may eventually find a (provisional) solution to the “Peckham’s puzzle”. Both when he struck down a statute regulating working hours and when he condemned a combination of, say, railway companies, Justice Peckham was defending property rights and contractual freedom as required by his classical reading of the American Constitution – the term “classical” to be interpreted as encompassing both classical liberalism and classical political economy. The point is that it was not only *Lochner*, and other LFC decisions, that upheld those principles. Even the answer given by the Court’s majority to early antitrust cases can be read as such. While a complete explanation of this statement would require another essay, it suffices here to remark that in decisions like *TMFA* and *JTA*⁴⁸ Peckham affirmed a sort of liberty *from* contract, that is, the right of any business not to be unduly coerced in its economic activities by the behavior of other businesses. This, note well, not as an early application of neoclassical ideas about market power, but as a late enforcement of a basic principle of classical political economy and classical liberalism, namely, the idea that, even in a world of utmost economic liberty, some forms of business behavior did exist that exceeded the boundaries of natural freedom, threatening the interests and rights of other businesses. In other words, the idea that, for moral as well as economic grounds, a limit existed to lawful competitive injury and that this limit resided in the protection of someone else’s right to compete too. Classical economists and classical liberals alike agreed that state intervention was fully legitimate against these coercive behaviors.

The Progressive interpretation of LFC (see above, I.A) generally ignored the moral roots of 19c American political economy. As a result, its supporters failed to understand the philosophical foundations of the notion of laissez faire embodied by LFC legal doctrines. Far from being constitutionally unprincipled, or grounded in Social Darwinist ideas, or actuated by the personal idiosyncrasies or, worse, class interests of the judges and Justices who made it, LFC jurisprudence found its deepest rationale in the specific notion of laissez faire endorsed by 19c American political scientists, economists and law scholars alike. “Part of the blame for this historical error”, wrote Herbert Hovenkamp, “lies with none other than Justice Holmes, whose most quoted dissent was correct but misleading. He was right when he told the *Lochner* majority that the fourteenth amendment did not ‘enact Mr. Herbert Spencer’s *Social Statics*’. In fact, it enacted Mr. Francis Wayland’s *Elements of Political Economy*” (Hovenkamp 1988, 420).

According to Hovenkamp, Progressive economists like Richard T. Ely did not make the same mistake of later Progressive law historians. They knew well where the roots of laissez faire lay. This explains why their economics also contained a good deal of religious moralizing that would prove unacceptable to the eyes of modern economists, i.e., all those from the 1930s on (*ibid.*, 419). These

⁴⁸ *United States v. Trans-Missouri Freight Association*, 166 U.S. 290 (1897); *United States v. Joint Traffic Association*, 171 U.S. 505 (1898).

Progressive economists understood something that later generations did not. For those writing at the turn of the 20c it was not enough to show that laissez faire was not, or not anymore, the best economic theory. Any successful *economic* critique of LFC doctrines, like substantive due process or liberty of contract, had to come to terms with the prevailing belief that laissez faire was coherent with a morally sound, good Christian approach to economics. “Moral arguments were absolutely essential to Ely’s case. He had the awesome task of showing that laissez faire was not merely bad economics, but bad religion as well” (ibid., 420).

Little surprise, then, that beyond analytically proving that state intervention often made economic markets work better and that forced redistribution of wealth could increase total welfare some Progressive economists were also active regulators of morals, often on explicitly religious grounds. Indeed, one of the reasons behind their enthusiasm about economic regulation was that the distribution of wealth had been reconfigured in their minds as a moral, as well as an economic, problem (Hovenkamp 1996, 35). As a consequence, the moral content of laissez faire distribution had become as questionable as its economic outcomes. Crucial for this reconfiguration was the Progressive characterization of both markets and morals as communitarian, rather than individualistic, institutions. This legitimized state intervention in both (ibid., 37). Antitrust law would turn out to be one of the fields where interventionists most clearly and frequently invoked both kinds of legitimization, economic and ethical.

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