

Constitutional Law - By-Products of the Social Security Decisions

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NOTE

CONSTITUTIONAL LAW—BY-PRODUCTS OF THE SOCIAL SECURITY DECISIONS.—Economists and experts on constitutional law were not surprised at the two unemployment compensation opinions of the United States Supreme Court rendered on May 24, 1937,¹ for it had been expected that both the Alabama unemployment compensation law and Title IX of the Social Security Act would be sustained by a narrow margin. What the economists and constitutional experts were worrying about was not the main outcome, but rather two dangerously possible by-products which lurked inherent in that outcome. It is the object of this present article to point out just how the Supreme Court on May 24 effectively avoided both of these dangers.

NUMBER ONE: UNLIMITED COERCION OF THE STATES

The theory behind Title IX of the Social Security Act was frankly that the several states should be coerced (or bribed, if you prefer a less harsh word) into adopting a certain type of legislation desired by the federal government, to wit unemployment compensation.² To this end, a so-called "excise tax" (of 1% in 1936, 2% in 1937, and 3% in 1928 and thereafter) was levied upon the payrolls of all employers (with certain exceptions) who have eight or more employes. Against this tax an employer is permitted to offset, up to nine-tenths of the amount of the tax, any contributions made by him under a state unemployment benefit law which has received federal approval. Furthermore, if his state contribution is reduced because of favorable employment experience, he can deduct from his federal tax the full amount which, but for this reduction, he would have had to contribute to the state fund.

The object of Title IX was frankly as follows in Senate Report No. 628 on the Bill which became the Social Security Act: "This bill does not set up a Federal unemployment compensation system. What it seeks to do is merely to make it possible for the States to establish unemployment compensation systems and to stimulate them to do so. This objective is carried out through grants-in-aid to the States (in Title III) for the administration of unemployment compensation laws and through the imposition of a uniform pay-roll tax on employers (in Title IX) against which a credit is allowed for contributions made by them to unemployment compensation funds set up pursuant to State law." To similar effect is the House report.

The President's message of January 17, 1935, to Congress had been even more frank, stating: "I have concluded that the most practical proposal is the levy of a uniform Federal pay-roll tax, 90 percent which should be allowed as an offset to employers contributing under a compulsory State unemployment compensation act. The purpose of this is to afford a requirement of a reasonably uniform character for all states cooperating with the Federal Government and to promote and encourage the passage of unemployment compensation laws in the States." Accordingly even those who hoped that Title IX

¹ Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 779. Carmichael v. Southern Coal & Coke Co., (1937) 81 L.ed. 811.

² *Our New Federal-State Cooperation in Unemployment Compensation* (1937) 27 AM. LAB. LEG. REV. 51.

would be sustained, have been very much afraid that its sustention would establish a dangerous precedent under which the Congress could dictate state legislation in any field. For example, suppose that the Congress decided that uniform legislation on the subject of marriage and divorce was desirable. A federal excise tax of \$100 per marriage and \$1000 per divorce could be levied, with complete remission in those states which adopted a certain model statute on marriage and divorce. The adoption of the uniform conditional sales act could be stimulated by a 10 per cent sales tax. The Congress could dictate at will the details of state legislation on any and every subject.

This fear is still very real to two of the dissenting Justices in the *Steward* case. Thus Justice McReynolds says: "By the sanction of this adventure, the door is open for progressive inauguration of others of like kind under which it can hardly be expected that the States will retain genuine independence of action."³

And Justice Butler says: "The provisions in question, if not amounting to coercion in a legal sense, are manifestly designed and intended directly to affect state action in the respects specified. And, if valid as so employed, this 'tax and credit' device may be made effective to enable federal authorities to induce, if not indeed to compel, state enactments for any purpose within the realm of state power and generally to control state administration of state laws."⁴

But the seven other members of the Court seem to feel that Title IX of the Social Security Act presents a special situation. The opinion of the five majority Justices, written by Justice Cardozo, after outlining the widespread and extensive distress caused by unemployment during the recent depression, states:

"The *parens patriae* has many reasons—fiscal and economic as well as social and moral—for planning to mitigate disasters that bring these burdens in their train . . .

"Every dollar of the new taxes will continue in all likelihood to be used and needed by the nation as long as states are unwilling, whether through timidity or for other motives, to do what can be done at home . . . On the other hand fulfilment of the home duty will be lightened and encouraged by crediting the taxpayer upon his account with the Treasury of the nation to the extent that his contributions under the laws of the locality have simplified or diminished the problem of relief and the probable demand upon the resources of the fisc [*sic*]. Duplicated taxes, or burdens that approach them, are recognized hardships that government, state or national, may properly avoid. . . . If Congress believed that the general welfare would better be promoted by relief through local units than by the system then in vogue, the cooperating localities ought not in all fairness to pay a second time. . . .

"In ruling as we do, we leave many questions open. We do not say that a tax is valid, when imposed by act of Congress, if it is laid upon the condition that a state may escape its operation through the adoption of a statute unrelated in subject matter to activities fairly within the scope of national policy and power. No

³ Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 779, 799.

⁴ Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 779, 803.

such question is before us. In the tender of this credit Congress does not intrude upon fields foreign to its function. The purpose of its intervention, as we have shown, is to safeguard its own treasury and as an incident to that protection to place the states upon a footing of equal opportunity. Drains upon its own resources are to be checked; obstructions to the freedom of the states are to be leveled. It is one thing to impose a tax dependent upon the conduct of the taxpayers, or of the state in which they live, where the conduct to be stimulated or discouraged is unrelated to the fiscal need subserved by the tax in its normal operation, or to any other end legitimately national . . . It is quite another thing to say that a tax will be abated upon the doing of an act that will satisfy the fiscal need, the tax and the alternative being approximate equivalents. In such circumstances, if in no others, inducement or persuasion does not go beyond the bounds of power."⁵

And two of the four dissenters expressly accept this reasoning of the majority, dissenting only as to the constitutionality of two of the criteria established by Title IX for state unemployment benefit laws.⁶ So that we have a seven to two assertion that the principles of this decision can not be extended by analogy to other types of legislation; and it is certain that the two, being opposed to the principle in its entirety, will even more strenuously oppose its extension.

It is probable that, if this ground for differentiating Title IX of the Social Security Act from all other seemingly similar possible attempts of the Congress to dictate state legislation had not occurred to the Supreme Court, a majority would have felt constrained to hold Title IX unconstitutional for fear of establishing a precedent which would forever destroy the independence of the states. But fortunately (or unfortunately, depending on one's point of view) the way out had been suggested over a year ago by two members of the Wisconsin bar, William E. Brown and H. W. Story, in an article in which they said:

" . . . it is necessary to show that Titles III and IX are not essentially a scheme to regulate unemployment compensation with the tax simply incidental thereto, but that they constitute a true revenue measure, and that none of their features are inconsistent with that characteristic. Specifically, it is necessary to establish that the appropriation and the offset and the criteria, all of which concededly are component part of a single scheme, are not arbitrarily inserted in the measure, but are all reasonably related to the proper purpose of the measure as a tax, especially in the sense that they do not render the measure regulatory or coercive of the states in a matter within the exclusive realm of the states.

"An offset, or credit, for payments to funds under state unemployment compensation plans does, in the nature of things, bear a reasonable relation to the purpose and to the levying and collection of an excise tax on payrolls. At the time the Act was passed, state unemployment compensation plans had been and were being inaugurated, which, in the first place, were deriving their funds from payrolls, and in the second place, were calculated to have the

⁵ Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 779, 788 *et seq.*

⁶ Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 779, 799.

effect over a long period of time of greatly reducing distress due to unemployment and consequently the burden of emergency unemployment relief currently being borne by the Federal Government. The first of these facts bears a reasonable relation to the subject of tax, namely, payrolls; the second bears a reasonable relation to the object of the tax, namely, to raise revenues, a substantial portion of which are, or may be, used for emergency unemployment relief. Putting the two together, Congress decided that, in the first place, it is fair to relieve a subject of the burden of double taxation, and that, in the second place, by so doing, the passage of state unemployment compensation plans would be actually induced, with the effect of reducing the necessity for federal revenues in approximately the same amounts as the 'offset.' On both counts, therefore, the particular offset chosen is reasonably related to the tax as such."⁷

This Brown-Story article perhaps furnished the inspiration for Justice Cardozo's opinion in the *Steward* case. But be that as it may, there is little danger that the *Steward* case will constitute a precedent for an extension of the technique of Title IX of the Social Security Act to the stimulation of any form of state legislation which does not bear a direct relation to the protection of the federal treasury. So danger number one is eliminated.

DANGER NUMBER TWO: DISCOURAGEMENT OF EMPLOYER RESERVES

In an earlier article by the present author in this magazine⁸ the distinction was drawn between unemployment compensation laws of the pooled-fund type (as exemplified by the statutes of New York and Alabama) and laws of the employer-reserve type (as exemplified by the statutes of Indiana, Kentucky, Nebraska, Oregon, South Dakota, Vermont and Wisconsin); and it was there pointed out that laws of the pooled-fund type are quite definitely socially subversive. Proponents of the socially defensible employer-reserve type of unemployment compensation legislation⁹ had two serious alternative fears of the Alabama case, both fears being based on the possibility that the Court might omit to distinguish between the above two types of law. Such an omission, in event the Alabama statute were held invalid, would convey the impression that laws of the employer-reserve type would be invalid too. Whereas, if the Alabama statute were held valid, it would give the pooled-fund type of law an undeserved boost at the expense of the employer-reserve type.

The first horn of this dilemma was eliminated by the sustension of the Alabama law. The other horn was eliminated by the fact that the dissenting opinion of Justices Sutherland, Van Devanter and Butler was almost entirely devoted to praise of the Wisconsin act. Justice Stone, speaking for the majority of five, after a lengthy argument

⁷ *Constitutionality of the Unemployment Compensation Features of the Federal Social Security Act* (1936) 11 NOTRE DAME LAWY. 245, 262, 263.

⁸ Note (1937) 21 MARQ. LAW REV. 138.

⁹ On the actual operation of the Wisconsin law to stabilize employment, see Elizabeth Brandeis, *Unemployment Compensation in Action—A Progress Report from Wisconsin* (1937) 27 AM. LAB. LEG. REV. 61. On page 53 of the same issue there is an excellent comparative analysis of all the state laws.

to establish the principle that the relief of unemployment is a public concern, concluded with: "The end being legitimate, the means is for the legislature to choose."¹⁰

A bit further on, the majority in dismissing the attempt of the respondents to distinguish the two types of unemployment compensation law, uses language which makes evident that they regard the employer-reserve type of law as *a fortiori* valid; the opinion stating in this connection:

"Appellees' contention that the statute is arbitrary, is so far as it fails to distinguish between the employer with a low unemployment experience and the employer with a high unemployment experience, rests upon the misconception that there must be such a relationship between the subject of the tax (the exercise of the right to employ) and the evil to be met by the appropriation of the proceeds (unemployment) . . .

"But, as the state is free to distribute the burden of a tax without regard to the particular purpose for which it is to be used, there is no warrant in the Constitution for setting the tax aside because a court thinks that it could have drawn a better statute or could have distributed the burden more wisely. Those are functions reserved for the legislature."¹¹

Thus the majority placed themselves squarely on record that unemployment compensation legislation generically is constitutional. And one of the majority had already paid a tribute to Wisconsin's law in the other case, saying: "Before Congress acted, unemployment compensation insurance was still, for the most part, a project and no more. Wisconsin was the pioneer. Her statute was adopted in 1931."¹² And three of the four dissenters in the case now under discussion, in an opinion written by Justice Sutherland, had the following to say:

"The statute lays a payroll tax upon employers, the proceeds of which go into a common fund to be distributed for the relief of such ex-employees, coming within the provisions of the statute, as shall have lost their employment in any of a designated variety of industries within the state . . .

"An example will make this clear. Let us suppose that A, an employer of a thousand men, has retained all of his employees. B, an employer of a thousand men, has discharged half of his employees. The tax is upon the payroll of each. A, who has not discharged a single workman, is taxed upon his payroll twice as much as B, although the operation of B's establishment has contributed enormously to the evil of unemployment while that of A has contributed nothing at all. It thus results that the employer who has kept all his men at work pays twice as much toward the relief of the employees discharged by B as B himself pays. Moreover, when we consider the large number and the many kinds of industries, their differing characteristics and the varied circumstances by which their operations are conditioned, the gross unfairness of this unequal burden of the tax becomes plain beyond peradventure . . .

" . . . the Alabama act seeks to impose the character of 'a

¹⁰ Carmichael v. Southern Coal & Coke Co., (1937) 81 L.ed. 811, 821.

¹¹ Carmichael v. Southern Coal & Coke Co., (1937) 81 L.ed. 811, 823, 825.

¹² Charles C. Steward Mach. Co. v. Davis, (1937) 81 L.ed. 799, 788.

single employer' upon a large number of employers severally engaged in entirely dissimilar industries . . .

"Other states have not found it impossible to adjust their unemployment laws to meet the constitutional difficulties thus presented by the Alabama act. The pioneer among these states is Wisconsin. That state provides . . . that while the proceeds of the tax shall be paid into a common fund, an account shall be kept with each individual employer, to which account his payments are to be credited and against which only the amounts paid to his former employees are to be charged. . . . When his tax contributions have reached a certain percentage of his payroll, the amount of his tax is reduced, and when they reach 10%, the tax is discontinued as long as that percentage remains. The result is that each employer bears his own burdens, and not those of his competitor or of other employers. The difference between the Wisconsin and the Alabama acts is thus succinctly stated by the Social Security Board in its Informational Service Circular No. 5, issued November, 1936, pp. 8-9:

"(1) The plan for individual employer accounts provides for employer-reserve accounts in the State fund. Each employer's contributions are credited to his separate account, and benefits are paid from his account only to his former employees. If he is able to build up a specified reserve in his account, his contribution rate is reduced.'

"Such is the Wisconsin plan; while under the Alabama statute—

"(2) The pooled-fund plan provides for a pooling of all contributions in a single undivided fund from which benefits are paid to eligible employees, irrespective of their former employers.'

"Which of these plans is more advantageous from a purely economic standpoint does not present a judicial question. But from the constitutional point of view, in so far as it involves the ground upon which I think the Alabama act should be condemned, I entertain no doubt that the Wisconsin plan is so fair, reasonable and just as to make plain its constitutional validity; and that the Alabama statute . . . is so arbitrary as to result in a denial both of due process and equal protection of the laws."¹³

The only member of the Court whose approval of laws of the employer-reserve type is in doubt is Justice McReynolds, who dissented without opinion. Thus if proponents of the pooled-fund type of law now say, as they are quite likely to say: "We now know that the pooled fund type of law is constitutional. We know nothing about the constitutionality of laws of the employer-reserve type. Probably that type, would be unconstitutional. At least the Supreme Court hasn't yet passed upon laws of that type. So let's play safe, and adopt the pooled fund type," the answer is that the Alabama law just barely squeaked by, by a vote of five to four, whereas it is evident from the majority and minority opinions in the *Carmichael* case that, if it had been the Wisconsin Act which was before the Court, it would have been sustained eight to one, if not unanimously.

ROGER SHERMAN HOAR.

¹³ *Carmichael v. Southern Coal & Coke Co.*, (1937) 81 L.ed. 811, 826, 827.