

The Rule of Law in the Regulatory State

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1. Introduction

The United States' regulatory bureaucracy has vast power. Regulators can ruin your life, and your business, very quickly, and you have very little recourse. That this power is damaging the economy is a commonplace complaint. Less recognized, but perhaps even more important, the burgeoning regulatory state poses a new threat to our political freedom.

What banker dares to speak out against the Fed, or trader against the SEC? What hospital or health insurer dares to speak out against HHS or Obamacare? What business needing environmental approval for a project dares to speak out against the EPA? What drug company dares to challenge the FDA? Our problems are not just national. What real estate developer needing zoning approval dares to speak out against the local zoning board?

The agencies demand political support for themselves first of all. They are like barons in monarchies, and the King's problems are secondary. But they can now demand broader support for their political agendas. And the larger partisan political system is discovering how the newly enhanced power of the regulatory state is ideal for enforcing its own political support.

The big story of the last 800 years of United States and British history, is the slow and painful emergence of our political institutions, broadly summarized as "rule of law," which constrain government power and guarantee our political liberty. The U.S. had rule of law for two centuries before we had democracy, and our democracy sprang from it not the other way around.

This rule of law always has been in danger. But today, the danger is not the tyranny of kings, which motivated the Magna Carta. It is not the tyranny of the majority, which motivated the bill of rights. The threat to freedom and rule of law today comes from the regulatory state. The power of the regulatory state has grown tremendously, and without many of the checks and balances of actual law. We can await ever greater expansion of its political misuse, or we recognize the danger ahead of time and build those checks and balances now.

Yes, part of our current problem is law itself, big vague laws, and politicized and arbitrary prosecutions. But most of "law" is now written and administered by regulatory agencies, not by Congress.

Use of law and regulation to reward supporters and punish enemies is nothing new, of course.

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Franklin Roosevelt understood that New Deal jobs and contracts were a great way to demand political support. His “war on capital²” hounded political opponents. The New Deal may not have been an economic success, and likely prolonged the Great Depression. But it was above all a dramatic political success, enshrining Democratic power for a generation³. Richard Nixon tried to get the IRS to audit his “enemies list.” But the tool is now so much stronger.

A label?

I haven’t yet found a really good word to describe this emerging threat of large discretionary regulation, used as tool of political control.

Many people call it “socialism.” But socialism means government ownership of the means of production. In our brave new world private businesses exist, but they are tightly controlled. Obamacare is a vast bureaucracy controlling a large cartelized private business, which does the governments political and economic bidding. Obamacare is not the Veteran’s Administration, or the British National Health Service. Socialism doesn’t produce nearly as much money.

It’s not “capture.” George Stigler described the process by which regulated businesses “capture” their regulators, using regulations to keep competition out. Stigler’s regulated businesses certainly support their regulators politically. But Stigler’s regulators and business golf together and drink together, and the balance power is strongly in the hands of the businesses. “Capture” doesn’t see billion-dollar criminal cases and settlements. And “capture” does not describe how national political forces use regulatory power to extract political support.

It’s not really “crony capitalism.” That term has a bit more of the needed political flavor than “capture.” Yes, there is a revolving door, connections by which businesses get regulators to do them favors. But what’s missing in both “capture” and “cronyism” is the opposite flow of power, the Devil’s bargain aspect of it from the point of view of the regulated business or individual, the silencing of political opposition by threat of regulation.

We’re headed for an economic system in which many industries have a handful of large, cartelized businesses— think 6 big banks, 5 big health insurance companies, 4 big energy companies, and so on. Sure, they are protected from competition. But the price of protection is that the businesses support the regulator and administration politically, and does their bidding. If the government wants them to hire, or build factory in unprofitable place, they do it. The benefit of cooperation is a good living and a quiet life. The cost of stepping out of line is personal and business ruin, meted out frequently. That’s neither capture nor cronyism.

“Bureaucratic tyranny,” a phrase that George Nash quotes⁴ Herbert Hoover as using is a contender.

² Amity Shlaes, 2008, *The Forgotten Man*, <http://www.amazon.com/Forgotten-Man-History-Great-Depression/dp/0060936428/> offers a good account

³ For example of new scholarship on this point, see Harold Cole and Lee Ohanian, 2004, “New Deal Policies and the Great Depression: A General Equilibrium Analysis”, *Journal of Political Economy* 12, 779-816. <http://www.jstor.org/stable/3555138>

⁴ <http://www.hoover.org/research/herbert-hoovers-life-and-his-crusade-against-collectivism>

Charles Murray, writing recently on the status of the regulatory state⁵ notes many of these issues. He totals 4,450 distinct federal crimes— just the law, not including regulations with criminal penalties, or the vastly greater number with civil penalties. He adds up the 175,000 pages of the Code of Federal Regulations, and the vagueness of the enabling legislation — Congress only decrees that rules are “generally fair and equitable,” “just and reasonable,” prohibits “unfair methods of competition” or “excessive profits.” He notes the absence of judicial rights in administrative courts. He notes the wide scope of regulation and the comparatively tiny — but ruinous to those charged — enforcement:

the “Occupational Safety and Health Administration has authority over more than eight million workplaces. But it can call upon only one inspector for about every 3,700 of those workplaces. The Environmental Protection Agency has authority ... over every piece of property in the nation. It conducted about 18,000 inspections in 2013—a tiny number in proportion to its mandate.

Murray advocates civil disobedience with insurance for the few zebras who get caught by the regulators.

But by and large Murray deplors merely the silliness of and economic inefficiency of the regulatory state. This misses, I think, the greatest danger, that to our political freedom. Just who gets that visit from the EPA can have a powerful silencing effect.

And it also misses, I think, an explanation for how we got here. Regulators and politicians aren’t nitwits. The libertarian argument that regulation is so dumb — which it surely is — misses the point that it is enacted by really smart people. The fact that the regulatory state is an ideal tool for the entrenchment of political power was surely not missed by its architects.

Likewise, Alex Tabarrok and Tyler Cowen make a good case⁶ that most of the economic rationale for regulation has disappeared along with information. Uber stars are far more effective than the Taxi Commission. But the demand for protection and the desire to trade economic protection for political support will remain unchanged. “Protect the consumer” is as much a distracting argument in the Uber vs. Taxi debate as it was when the medieval guilds advanced it.

Rule of Law: the Devil in the Details

“Rule of law” and “regulation” are dangerous Big Vague Words. The rule of law is so morally powerful that the worst tyrants go through the motions. Stalin bothered with show trials. Putin put Pussy Riot on trial, and then they were “legally” convicted of and jailed for the crime of “hooliganism.” Even Henry the Eighth had trials before chopping heads. Is this not rule of law?

No, of course, but it’s worth reminding ourselves why not as we think about bureaucracies.

“Rule of law” ultimately is a set of restrictions to keep the state from using its awesome power of coercion to force your political support. If you oppose Castro, you go to prison. If you opposed

⁵ <http://www.wsj.com/articles/regulation-run-amokand-how-to-fight-back-1431099256>

⁶ <http://www.cato-unbound.org/2015/04/06/alex-tabarrok-tyler-cowen/end-asymmetric-information>

Herbert Hoover, could you still run a business? Sure. If you oppose President Obama, or the future President Hillary Clinton can you do so? If you oppose the policies of one of their regulatory agencies, now powers unto themselves, or speak out against the leaders of those agencies, can you do so? If you support candidates with unpopular positions, can you still get the regulatory approvals you need? It's not so clear. That is our danger.

"Rule of law" is not just about the existence of written laws, and the superficial mechanics of trials, judges, lawyers, and sentences. Rule of law lies deep in the details of how those institutions work. Do you have the right to counsel, the right to question witnesses, the right to discovery, the right to appeal, and so forth. Like laws, what matters about regulation, both in its economic efficiency and in its insulation from politics, is not its presence but its character and operation.

Regulators write rules too. They fine you, close down your business, send you to jail, or merely harass you with endless requests, based on apparently written rules. We need criteria to think about whether "rule of law" applies to this regulatory process. Here are some suggestions.

- Rule vs. Discretion?
- Simple/precise or vague/complex?
- Knowable rules vs. ex-post prosecutions?
- Permission or rule book?
- Plain text or fixers?
- Enforced commonly or arbitrarily?
- Right to discovery and challenge decisions.
- Right to appeal.
- Insulation from political process.
- Speed vs. delay.
- Consultation, consent of the governed.

- Rule vs. Discretion?

This is really a central distinction. Does the regulation, in operation, function as a clear rule? Or is it simply an excuse for the regulator to impose his or her will on the regulated firm or person? Sometimes discretion is explicit. Sometimes discretion comes in the application of a rule book thousands of pages long with multiple contradictory and vague rules.

- Simple/precise or vague/complex?

Regulations can be simple and precise — even if silly. "Any structure must be set back six feet from the property line" is simple and precise. Or the regulation can be long, vague and complex. "The firm shall not engage in abusive practices."

Many regulations go on for hundreds of pages. Long, vague, and complex is a central ingredient which gives the appearance of rules but amounts to discretion.

- Knowable rules vs. ex-post prosecutions?

Is the rule book knowable ex ante? Or is it, in application, simply a device for ex-post prosecutions. Insider trading rules are, at present, a good example of the latter. The definition of “insider” varies over time, and there is really little hope for a firm to read a coherent rule book to know what is and is not allowed. Much better to stay on good terms with the regulator.

- Permission or rule book?

In one kind of regulation, there is a rule book. If you follow the rule book, you’re ok. You go ahead and do what you want to do. In much regulation, however, you have to ask for permission from the regulator, and that permission includes a lot of discretion. Environmental review is a good example.

- Plain text or fixers?

Can a normal person read the plain text of the rule, and understand what action is allowed or not? Or is the rule so complex that specialists are required to understand the rule, and the regulatory agency’s current interpretation of the rule? In particular, are specialists with internal agency contacts necessary, or specialists who used to work at the agency?

As a private pilot, I often bristle at the FAA’s mindless bureaucracy and the plain silliness of much of their regulation. But to their credit, there is a strong culture that the plain text of the rule counts, and each pilot should read the rules and know what they mean. That is a system much harder to misuse. Financial, banking, environmental, health care, and housing regulation stand on the opposite end of the spectrum.

- Enforced commonly or arbitrarily?

Regulations that are seldom enforced, but then used occasionally to impose enormous penalties are clearly more open to political abuse. If Americans commit three felonies a day⁷ in “conspiracy,” internet use, endangered species, wetlands, or employment and immigration regulations (just to start), but one in a hundred thousand is ever prosecuted, just who gets prosecuted is obviously ripe for abuse.

- Right to discovery, see evidence, and challenge decisions.

Do you have the right to know how a regulatory agency decided your case? Step by step, what assumptions, calculations, or interpretations did it use? Often not, and even in high profile cases.

For example, the Wall Street Journal’s coverage⁸ of Met Life’s “systemic” designation reports

The feds ..still refuse to say exactly which [threats] make MetLife a systemic risk or what specific changes the company could make to avoid presenting such a risk.

and continues

⁷ Harvey Silverglate 2011, *Three Felonies A Day: How the Feds Target the Innocent*

⁸ <http://www.wsj.com/articles/metlife-takes-on-jack-lew-1434669950>

...MetLife says that..the government's decision is based on mere speculation and "undisclosed evidentiary material."

Since the case is still being decided, the point here is not the correctness or not of these charges. But the charges are a clear example of the kind of regulation that can go wrong

(In fact, the miracle of the MetLife case is that the company had the chutzpah to sue. They are taking a big bet that FSOC doesn't believe in revenge.)

- Right to appeal.

And not just to the same agency that makes the decision! In law, the right to appeal is central. In regulation, the right to appeal is often only to appeal to the same agency that made the decision. The Chevron doctrine severely limits your ability to appeal regulatory decisions (and the regulations themselves) to any outside entity. As an example, continuing the above MetLife coverage,

The ... stability council "lacks any separation in its legislative, investigative, prosecutorial, and adjudicative functions." That combined with MetLife's inability to see the full record on which the decision was based made it "impossible" to get a fair hearing.

As in law, secret evidence, secret decisions, secret testimony; and legislature, prosecutor, judge, jury, and executioner all rolled in to one are classic ingredients for subverting rule of law. And, eventually, for using the machinery of law to silence political opposition.

- Insulation from political process.

There are many structures in place to try to ensure the "independence" of independent agencies. There is also a tension that we live in a democracy, so independent agencies can't be too independent if they have great discretionary power.

These important structures try to limit explicit party politics' use of the regulatory state. They are less successful at limiting the bureaucracy's use of its regulatory power to prop up its own separate fiefdom. They are also less successful at limiting unwitting political cooperation. When vast majorities of the bureaucracy belong to one political party, when government employee unions funnel unwitting contributions to candidates of that party, and when strong ideological currents link decisions across agencies, explicit cooperation is less necessary.

And, though it was ever thus, the enormous expansion of the size, power, and discretion of the regulatory state makes the insulation structures more important, just as they are falling apart.

- Speed vs. delay.

The regulatory process can take years, and a canny regulator need not explicitly rule against a political foe. Delay is enough. Lois Lerner herself didn't deny applications. She just endlessly delayed them. The FDA similarly sits on applications, sometimes for decades.

A central element of a new Magna Carta for regulatory agencies should be a right to speedy decision. If a decision is not rendered in say, 6 months, it is approved.

- Consultation, consent of the governed.

The process by which rules are written needs to be reformed. Congress writes empowering legislation, usually vague and expansive. The agencies undertake their own process for rule writing. They usually invite comment from interested parties, but are typically free to ignore it when they wish. We are as supplicants before the King, asking for his benevolent treatment.

And that was before the current transformation. As exemplified by the EPA's decision to brand carbon dioxide a pollutant (coverage here⁹), to extend the definition of "navigable waters" to pretty much every puddle, HHS' many reinterpretations of the ACA, and the Education Department's "Dear Colleague" letters, even the barely-constrained rule-making process now proceeds beyond its previous mild legal and consultative constraints.

A structure with more formal representation, and more formal rights to draft the rules that govern us, is more in keeping with the parliamentary lessons of the Rule of Law tradition.

2. A Tour

Do we really have reason to be afraid? Let's take a tour.

These cases are drawn mostly from media coverage, which allows me a quick and current high-level tour. Each case, and many more that are unreported, and a serious investigation to the structure of our massive regulatory state, could easily be drawn out to book length.

My point is not so much a current scandal. My case is that the structure that has emerged is ripe for the Faustian political bargain to emerge, that the trend of using regulation to quash political freedom is in place and will only increase.

As we tour our current regulatory state of affairs, then, think of how well the current regime represents "rule of law," how well it respects your freedom to speak, your freedom to object, your freedom to oppose the regulator and regulatory regime. Think how insulated it is against the strong temptations of our increasingly polarized, winner-take-all, partisan political system to use regulatory power as a means of enshrining political power.

Banks

Start with finance. Finance is, of course, where the money is.

The Dodd-Frank act is 2,300 pages of legislation, in which "systemic" is never defined, making a "systemic" designation nearly impossible to fight. The act has given rise to tens of thousands of pages of subsidiary regulation, much still to be written. The Volker rule alone — do not fund

⁹ <http://www.wsj.com/articles/barack-obama-re-founding-father-1433373010>

proprietary trading with insured deposits — runs now to nearly 1,000 pages. To call this Talmudic is to insult the clarity and concision of the Talmud.¹⁰

The result is immense discretion, both by accident and by design. There is no way one can just read the regulations and know which activities are allowed. Each big bank now has dozens to hundreds of regulators permanently embedded at that bank. The regulators must give their ok on every major decision of the banks.

The “stress tests” are a good case in point. Seeing, I suspect, the futility of much Dodd-Frank regulation, and with the apparent success of the Spring 2009 stress tests in the rear view mirror, such tests have become a cornerstone of the Federal Reserve’s regulatory efforts. But what worked once does not necessarily work again if carved in stone.

In “stress tests,” Federal Reserve staff make up various scenarios, and apply their own computer models and the banks’ computer models to see how the banks fare. However, the Fed does not announce a set scenario ahead of time. They Fed staffers make up new scenarios each time. They understand that if banks know ahead of time what the scenario is and the standards are, then the clever MBAs at the banks will make sure the banks all pass. And billions of dollars hang on the results of this game.

Now, the Fed staffers playing this game, at least those that I have talked to, are honest and a-political. For now. But how long can that last? How long can the Fed resist the temptation to punish banks who have stepped out of line with a stress test designed to exploit their weakness? Is it any wonder that few big banks are speaking out against the whole regime? They understand that being an “enemy” is not the way to win approvals.

And the stress-test staff are getting handsome offers already to come work for the banks, to help the banks to pass the Fed’s stress tests. Ben Bernanke himself is now working for Citadel.

If this sounds like the cozy world of “capture,” however, remember the litany of criminal prosecutions and multibillion-dollar settlements. These are instigated by the Attorney General and Department of Justice, with much closer ties to the Administration, but they revolve around violations of securities regulations. Is it a coincidence that S&P, who embarrassed the Administration by downgrading U.S. debt, faced a \$1.4 billion dollar settlement for ratings shenanigans, while Moody’s, which gave the same ratings, did not? Pay up, shut up, and stay out of trouble is the order of the day.

The Wall Street Journal nicely characterized today’s Wall Street, quoting¹¹ John J. Mack, Morgan Stanley’s ex-chairman “Your No.1 client is the government,” which embeds “About 50 full-time government regulators.”

¹⁰ Two recent excellent OpEds summarized this state of affairs on the anniversary of the Dodd-Frank act: Phil Gramm, *Wall Street Journal* July 23 2008, “Dodd-Frank’s Nasty Double Whammy,” <http://www.wsj.com/articles/dodd-franks-nasty-double-whammy-1437692851>, and Jeb Hensarling, *Wall Street Journal* July 19 2015 “After Five Years, Dodd-Frank is a Failure,” <http://www.wsj.com/articles/after-five-years-dodd-frank-is-a-failure-1437342607>

¹¹ <http://www.wsj.com/articles/SB10001424127887324324404579044503704364242>

CFPB

Another example: The Consumer Financial Protection Bureau and Department of Justice charged Ally Bank with discrimination in auto lending, and extracted a nearly \$100 million settlement¹². Ally provides money to auto lenders. Lenders negotiate interest rates. Nobody is allowed to collect data on borrowers' race. So Justice ran statistical analysis on last names and zip codes — Bayesian Improved Surname Geocoding — to decide that minorities are being charged more than they should, essentially encoding ethnic jokes into law.

Why did Ally pay? Sure, they might survive in court. But nobody wants to be branded a racist. And DOJ and CFPB have many more cards up their sleeves. CFPB now can disapprove any retail financial arrangement it deems “abusive,” and put Ally out of business.

Note in this case, there was no charge or evidence of discriminatory practice or intent. The case was purely that DOJ and CFPB didn't like the statistics of the outcome.

More importantly, was this a knowable regulation, or a bill of attainder? Did CFPB and Justice make available the Bayesian Improved Surname Geocoding program on their website, and tell financial institutions “please download the BISG program, make sure you run loans through it, and that they come out with the right statistics?” Obviously not. This was an unknowable regulation. Ally had no way to make sure it was lending to the right last names.

Ominously, in Wall Street Journal coverage,

Larger settlements may be on the horizon. J.P. Morgan.. warned in a recent filing that it is discussing the issue of possible “statistical disparities” in auto lending with Justice. With more than \$50 billion in auto loans on Morgan's balance sheet at the end of last year, real or imaginary disparities wouldn't have to be that large to generate a fat settlement.

While the Obamacare (King v. Burwell) and gay marriage decisions soaked up the airtime in the summer of 2015, the Court's upholding¹³ of statistical discrimination and disparate impact stands as the greatest affront to liberty. Without even alleging discriminatory intent, without following any established procedure, the Justice Department can chew numbers as it feels, and based on statistical analysis brand you a racist and drag you to court.

SEC

The SEC's regulation of insider trading is a fine example of discretion run amok. There is no legal definition of insider trading. Other than corporate insiders (who have legal fiduciary

¹²<http://www.wsj.com/articles/washingtons-latest-bank-heist-1428362436>; http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0010.pdf; <http://dealbook.nytimes.com/2013/12/20/ally-in-98-million-settlement-on-bias-in-auto-loans/>; See also followup WSJ coverage on the conundrum of how to distribute settlement money <http://www.wsj.com/articles/do-two-half-victims-make-a-whole-case-1428966741>.

¹³ Texas department of housing v. Inclusive communities project, http://www.supremecourt.gov/opinions/14pdf/13-1371_m64o.pdf

responsibilities not to trade on information) there is little economic rationale for this witch hunt. The game is characterized by big suits with big settlements and novel theories.

And thus, big discretion. The SEC can ruin anyone it wants to. If you're running a hedge fund and the SEC accuses you of insider trading, it grabs your computers and shuts down your business. Sure, 5 years from now you might win in court, but your customers left and the fund shut down the day they took the computers away. And appeal is only to the SEC itself.

Robosigning

During the financial crisis, many banks didn't fill out all the forms correctly when foreclosing on houses. The charge was entirely about process — there was no charge that anyone was evicted who was paying his or her mortgages. From the Federal Reserve's own press releases¹⁴ we learn that the Fed found them guilty of "unsafe and unsound processes and practices." The Fed was

acting in conjunction with a comprehensive settlement agreed in principle between the five banking organizations, the state Attorneys General, and the Department of Justice ... The Settlement Agreement requires these organizations to provide \$25 billion in payments and other designated types of monetary assistance and remediation to residential mortgage borrowers.

The Fed, a supposedly non-political independent agency devoted to bank safety and monetary policy, acted with the Administration, to transfer \$25 billion dollars from bank shareholders to mortgage borrowers (not the victims of robo-signing, other borrowers) and "nonprofit housing counseling organizations."

It's a small example, but a concrete one.

Regulation in general is transitioning from widespread application of rules to sporadic but very large enforcement actions, frequently involving threat of criminal prosecution and ending in large settlements. Documenting this trend, the Wall Street Journal¹⁵ noted the spread of Department of Justice Attorneys to regulatory agencies. For example, the EPA "described a strategy of pursuing larger, more complicated enforcement cases, albeit fewer in number." Similarly,

Larry Parkinson, another former federal prosecutor who runs FERC's [Federal Energy Regulatory Commission] investigations, described it as an outgrowth of shifting resources to more serious matters—like market manipulation—and away from more traditional violations. In 2008, for example, a majority of the agency's penalties were against firms that violated requirements that natural-gas shippers maintain title to the gas.

¹⁴ <http://federalreserve.gov/newsevents/press/enforcement/20120209a.htm>; <http://federalreserve.gov/newsevents/press/enforcement/20120213a.htm>;
More of my discussion at <http://johnhcochrane.blogspot.com/2012/02/fed-independence-2025.html>

¹⁵ <http://www.wsj.com/articles/SB21243517353677433384204580564650048326296>

“Market Manipulation” is of course a lot more nebulous and discretionary than natural-gas title checks.

The ACA, AKA Obamacare

The ACA is 2,700 pages, and the subsidiary regulation is so convoluted that there is an active debate on the page count of its actual regulations. Justice Scalia invoked the eighth amendment against cruel and unusual punishment as protection against actually reading it.

The Heritage foundation counted 1,327 waivers¹⁶. Clearly, someone needing a discretionary waiver shouldn't be a big critic of HHS or the law.

The cartelization of health insurance and health care under the ACA is almost a textbook case of corporatism. The big hospitals doctors, and insurers get a protected small cartel. In return for political support for the ACA, HHS, state exchanges, and so on. And, the ACA itself being an intensely partisan question, that support already leaks into major party politics.

Writing on the consolidation of health insurance into two or three big companies, the Wall Street Journal quotes¹⁷ Aetna CEO Mark Bertolini that the federal regulators “happen to be, for most of us now, our largest customer,” adding

“So there is a relationship you need to figure out there if you're going to have a sustained positive relationship with your biggest customer. And we can all take our own political point of view of whether it's right or wrong, but in the end-analysis, they're paying us a lot of money and they have a right to give us some insight into how they think we should run our business.”

The Journal opined that “such domestication is part of ObamaCare's goal of political control,” echoing my fear.

United Health¹⁸ wanted to join the California exchange Covered California. Many areas of California have only one or two insurers now, so competition and choice are clearly needed. But participation in the exchange needs prior regulatory approval, and United Health was denied. Why? The LA Times wrote

Peter Lee, executive director of Covered California, said established insurers shouldn't be free to come in right away. Those insurers, he said, should not be allowed to undercut rivals who stepped up at the start and made significant investments to sign up 1.2 million Californians during the first open enrollment.

and quoting Lee further,

¹⁶ <https://www.askheritage.org/how-about-a-national-obamacare-waiver/>

¹⁷ <http://www.wsj.com/articles/obamacares-oligopoly-wave-1434755295>

¹⁸ <http://www.latimes.com/business/la-fi-obamacare-unitedhealth-20150116-story.html>

We think the health plans that helped make California a national model should not be in essence undercut by plans that sat on the sidelines.

You can't ask for a clearer example of a regulator, using discretionary power to cartelize his industry, protect incumbent profits, and punish a business for failure to support political objectives. He said nothing about United Health's ability to serve California customers, or to abide by any regulation.

Again in California, reported by the Wall Street Journal¹⁹, the Daughters of Charity Health system wanted to sell six insolvent hospitals to Prime, which agreed to take on their debt and a \$300 million pension liabilities. Under state law, Attorney General Kamala Harris must approve nonprofit hospital sales or acquisitions, with only a vague guideline that such transactions must be "in the public interest." But only four of Prime's 15 California hospitals are unionized, so the Service Employees International Union was against the merger. Ms. Harris torpedoed the merger, despite a positive report from her own staff.

Was the event a political cave to unions, as represented by the Journal? Perhaps; perhaps not. What matters here is that it certainly could be, as the Attorney General has enormous discretionary power to approve or disapprove hospital mergers. Hospitals are well advised to stay on her good side.

FDA

Henry Miller at Hoover tells the sad tale of the Aquadvantage salmon, submitted for review in 1996 and still under review²⁰:

...Consider what they [FDA] have inflicted on a genetically engineered Atlantic salmon, which differs from its wild cohorts only by reaching maturity about 40 percent faster, as the result of the addition to its genome of a growth hormone gene from the Chinook salmon...

It took FDA more than a decade just to decide how they would regulate the AquAdvantage salmon. Characteristically, they decided on the most onerous pathway, regulating the new construct in genetically engineered animals as though it were a veterinary drug, similar to a flea medicine or pain reliever. After several years of deliberation, regulators concluded as early as 2012 that the AquAdvantage Atlantic salmon has no detectable differences and that it "is as safe as food from conventional Atlantic salmon." ...

When the FDA completed its Environmental Assessment in April 2012 and was ready to publish it—the last necessary hurdle before approving the salmon for marketing—the White House mysteriously intervened. The review process vanished from sight until December of that year, when the FDA was finally permitted to publish the EA (the unsurprising verdict: "no significant impact"), which should then have gone out for a brief period of public comment prior to approval.

¹⁹ <http://www.wsj.com/articles/when-unions-trump-hospitals-1426721146>

²⁰ <http://www.hoover.org/research/fda-department-stagnation>

The reason for the delay in the FDA's publishing the needed Environmental Assessment was exposed by science writer Jon Entine. He related that the White House interference "came after discussions [in the spring of 2012] between Health and Human Services Secretary Kathleen Sebelius' office and officials linked to Valerie Jarrett at the Executive Office [of the President], who were debating the political implications of approving the [genetically modified] salmon. Genetically modified plants and animals are controversial among the president's political base, which was thought critical to his reelection efforts during a low point in the president's popularity."

Needless to say, 20 years of delay makes a project pretty unprofitable.

This is a good example, because the FDA regulations prescribe a precise science-based process for evaluating a food. There are time limits for rendering decisions, which the FDA ignores. But strong political forces don't like GM foods, science be damned.

EPA

A clean environment is important. Pollution is a clear externality. We can also regard it as a Nash equilibrium. Each competitor in an industry is happy to pay the extra money to produce cleanly if all his or her competitors do so.

But the modern EPA violates just about every one of my suggested bullet points for preserving rule of law in the regulatory bureaucracy, and is ripe for political misuse. Discretion vs. rules, the potential for endless delay, the need for ex-ante permission, and a politicized and partisan bureaucracy are just the beginning.

In the Pebble Mine controversy²¹, EPA issued a preemptive veto of a project before a request for review was submitted, and was found colluding with mining opponents. Note, I'm not opining on whether the mine was a good or bad idea. Merely that the process in view is clearly one that could be misused for political purposes, and that mine owners already must know not to speak ill of the EPA or administration with such sway over the EPA.

The Keystone pipeline stands as the example par excellence of regulatory delay and politicization. Perhaps next to the EPA's decision to take on carbon as a pollutant.

Already, anyone opposed to a project for other reasons — like, it will block my view — can use environmental review to stop it. Delay is as good as denial in any commercial project.

The small story²² of Al Armendariz, head of EPA region 6 who proposed "crucifying" some oil companies as an example to the others is instructive. He was caught on tape saying:

²¹http://www.washingtonpost.com/national/health-science/internal-memos-spur-accusations-of-bias-as-epa-moves-to-block-gold-mine/2015/02/15/3ff101c0-b2ba-11e4-854b-a38d13486ba1_story.html; <http://www.wsj.com/articles/the-greens-back-door-at-the-epa-1431645574>

²² <http://www.forbes.com/sites/christopherhelman/2012/04/26/epa-official-not-only-touted-crucifying-oil-companies-he-tried-it/>

The Romans used to conquer little villages in the Mediterranean. They'd go into a little Turkish town somewhere, they'd find the first five guys they saw and they would crucify them. And then you know that town was really easy to manage for the next few years.

...we do have some pretty effective enforcement tools. Compliance can get very high, very, very quickly.

According to the story, Armendariz shut down Range Resources, one of the first fracking companies. Range fought back and eventually a Federal Judge found in its favor. But an agency that operates by "crucifying" a few exemplars, explicitly to impose compliance costs, is ripe to choose just which exemplars will be crucified on political bases.

Internet

The Internet is the central disruptive technology of our time. So far it has been "permissionless" — unlike just about every other activity in the contemporary United States, you do not need prior approval of a regulator to put up a website.

Pressure grew under the reasonable-sounding banner of "net neutrality," though what was at stake was the right of some businesses to pay extra for faster delivery. "Net neutrality" meant outlawing business class. The FCC, a supposedly independent agency, studied the issue and found no reason to regulate the internet.

One fine day in November 2014, FCC commissioner Tom Wheeler must have found horse head in bed. Well, more specifically a surprise public announcement from President Obama that "blindsided officials at the FCC" per WSJ coverage²³.

The result is not just "net neutrality" but to apply full telecommunications regulation circa 1935. In particular, this includes Title II rate regulation, in which the FCC has full power to determine what rates are "reasonable." The FCC announces it will "forbear" to use that power. Along with its right, under the regulation, to impose content restrictions — yes, to tell you what to put on your website — and the "fairness doctrine." But forbearance is discretionary. So, a company thinking of investing money in fiber-optic lines had better invest in good relations with the FCC and the Administration that apparently drives its decisions.

The "independence" of regulatory agencies is one of the key structures impeding widespread use of regulatory power to induce political support. The WSJ coverage of the politics behind the decision describes well how specific businesses' access to the White House drove the result. On the commission, the 3-2 vote with 2 republicans issuing withering dissents speaks of the partisan nature of this regulation.

Alas, the internet is all moving to Washington. Uber hired, straight from the Administration, well known tech wizard, David Pflouffe. Given Uber's troubles with labor law — a California court recently ruling that its contractors are employees — and taxi regulation throughout the U.S., investing in politics is good business for Uber.

²³ <http://www.wsj.com/articles/how-white-house-thwarted-fcc-chief-on-internet-rules-1423097522>

Campaign finance

Campaign finance law and regulation is all about restricting freedom of speech and altering who wins elections. So one should not be surprised about its political use to restrict freedom of speech and alter who wins elections.

Still, the recent trend is more troubling than usual.

Lois Lerner, director of the IRS Exempt Organizations Unit, famously derailed applications for nonprofit status from conservative groups, ahead of the 2012 Presidential election. Her main tactic was endless delay. All you need is for the election to pass.

Scott Walker's troubles are similarly renown. Milwaukee District Attorney John Chisolm filed "John Doe" probes²⁴ against conservative issue advocacy groups, "blanketed conservatives with subpoenas, raided their homes and put the targets under a gag order" that they could not even reveal the fact of the investigation. It came to light, and is now in the courts, but not until well after the election. Walker won anyway, but might not have.

The Administration has been pushing since 2010 to force nonprofits to disclose all donors, as campaigns must disclose contributors. It sounds innocuous: "Disclosures?" Who can be against that? Shouldn't "big money" contributing to politics be public information?

Not when the vast power of the regulatory state can come down on whomever it wants to. Tyrannies always start by making lists. Nixon at least had to compile his own enemies list.

Snowden

The Snowden affair taught us some important lessons about our government. The NSA collected phone call "metadata." Well, it's just who called who and not the content of phone calls (unless you call abroad), you may say.

But even metadata is revealing. Suppose you called three cancer doctors, alcoholics anonymous, and two divorce lawyers. And you want to run for the senate. That kind of information is political dynamite.

The NSA has the content, not just metadata, of any emails that go abroad. The NSA likely has many Hilary Clinton's missing emails. And Jeb Bushes'. Unless neither has ever written an email that rises to the embarrassment level of Mitt Romney's 47% remark, the information to sink either campaign is likely sitting on NSA computers.

That information would never leak out, you say? Snowden proves the opposite. Any piece of information on a government computer is one Snowden, one Lois Lerner, or one Chinese hacker away from a twitter feed.

²⁴For example, <http://www.wsj.com/articles/wisconsin-goes-to-the-supremes-1429744522>

John Oliver's Snowden interview²⁵ contained an interesting revelation. The internet is an amazing thing. What do Americans do with it? They send around pictures of their private parts. And NSA employees regularly pass the pictures around to great hilarity.

E-Verify

As part of most immigration deals we are likely to see strong enforcement of the right of employees to work via e-verify. Every single human being who wishes to work in the United States must ask for the ex-ante permission the Federal Government.

Leave aside here the obvious question how the same government that runs the Obamacare website, and, as I write, has had all visa applications to the U.S. shut down for two weeks due to hardware failures, will manage this. Let's focus on the political implications.

This power will naturally expand. First, people without proper immigration documents. But once in place, why only enforce immigration laws? Already there are a long list of laws governing who can work and when and where. People must have the right licenses, the right background checks, union memberships and so on. Are you guilty in the latest SEC which hunt? E-verify can really make sure you never work in finance again, not so much as a bank teller. Or that a conviction for violating the endangered species act keeps you out of the work force.

Every tyranny controls its citizens by controlling their right to work. Do we really want every American who wants employment to have to ask for the ex-ante permission of the Federal Government of Edward Snowden and Lois Lerner?

Transactions

We have lost the right to transact privately in the terror and drug wars. The right to political dissent requires the ability to speak freely and privately; the right to earn a living despite political opposition; and the right to transact in private. All three are vanishing.

You may have reveled in the ending of Stephen King's Shawshank Redemption, in which the hero takes cash out of banks and heads to Mexico. Under today's banking laws, that could no longer happen.

As a recent political example, Dennis Hastert was recently indicted²⁶ for violating the spirit of the \$10,000 limit on bank withdrawals, by withdrawing amounts just shy of the limit. Hastert wanted the money, apparently, to pay blackmail to someone with an embarrassing personal secret.

Hastert is retired. But should aspiring politicians really have no privacy in their personal transactions?

Education

²⁵ https://www.youtube.com/watch?v=XEVlyP4_11M

²⁶ <http://www.washingtonpost.com/news/morning-mix/wp/2015/05/29/jaw-dropping-dennis-hastert-indictment-stirs-deeper-mystery/>

As Daniel Henninger put it²⁷:

...historians of the new system will cite the Education Department's Office for Civil Rights' 2011 "Dear Colleague" letter^[28] on sexual harassment as the watershed event.

This letter—not even a formal regulation—forced creation of quasi-judicial systems of sexual-abuse surveillance on every campus in America. The universities complied for fear of lawsuits from enforcers at the Departments of Education and Justice.

The Justice Department's Special Litigation Section and Housing and Civil Enforcement Section have forced numerous settlements from police departments, school districts, jails and housing agencies. Whatever the merits, the locals know the price of resisting Justice is too high.

National Review's coverage²⁹ of Laura Kipinis' travails is a good example of the political use of this regulation. Professor Kipinis "wrote a column in the Chronicle of Higher Education arguing that college campuses are in a state of 'sexual paranoia.'" She quickly became the subject of a "Title IX inquisition," documented in her essay³⁰ by that name. Though eventually cleared, the point is the use of regulatory power to silence speech.

3. A Magna Carta for the Regulatory State

The power of the regulatory state has increased steadily. And it lacks many of the checks and balances that give us some "rule of law" in the legal system. (A system which has its own troubles.) The clear danger we face is the use of regulation for political control. Each industry gets carved up into a few compliant oligopolies. And the threat of severe penalties, with little of the standard rule-of-law recourse, keeps people and businesses in line and supporting the political organization or party that controls the agencies.

We're not there yet. The Koch Brothers are not on the EPA "crucifixion" list, an investigation of every plant they own, or probes by the DOJ, NLRB, EEOC, OSHA, and so on and so on. They could be. The Hoover institution retains its tax-exempt status despite writings such as this one. A free media still exists, and I can read all my horror stories in the morning Wall Street Journal, and the free (for now) internet.

But we are getting there. What stops it from happening? A tree ripe for picking will be picked.

The easy answers are too easy. "Get rid of regulations" is true, but simplistic like "get rid of laws." What we learned in the 800 years since Magna Carta is that the character of law, and the detailed structures of its operation that matter. Law is good, as it protects citizens from arbitrary power.

²⁷ <http://www.wsj.com/articles/barack-obama-re-founding-father-1433373010>

²⁸ <http://www2.ed.gov/about/offices/list/ocr/letters/colleague-201104.html>

²⁹ <http://www.nationalreview.com/article/419359/Laura-Kipinis%27s-title-ix-show-trials>

³⁰ <https://chronicle.com/article/My-Title-IX-Inquisition/230489/>

It is time for a Magna Carta for the regulatory state. Regulations need to be made in a way that obeys my earlier bullet list. People need the rights to challenge regulators — to see the evidence against them, to challenge decisions, to appeal decisions. Yes, this means in court. Everyone hates lawyers, except when they need one.

People need a right to speedy decision. A “habeas corpus” for regulation would work — if any decision has not been rendered in 6 months, it is automatically in your favor.

A return to economic growth depends on reforming the regulatory state. But the deeper and perhaps more important preservation of our political freedom depends on it even more.