



# Law and the Regulatory State

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To be a conservative—or, as in my case, an empirical, Pax-Americana, rule-of-law, constitutionalist, conservative libertarian—is pretty much by definition to believe that America is “exceptional”—and that it is perpetually in danger of losing that precious characteristic. Exceptionalism is not natural or inborn but must be understood, cherished, maintained, and renewed each generation—and its garden is always perilously unattended.

Like every word describing beliefs, however, “exceptionalism” is a slippery concept. America’s detractors often use the same word pejoratively and derisively. To them, exceptionalism means a parochial and ignorant moral superiority. We are not the first or only society to see itself as exceptional, different, or somehow better than everyone else.

## The Promise

So why *is* America exceptional, in the good sense? Here, I think, economics provides a crucial answer. The ideas that American exceptionalism

propounds have led to the most dramatic improvement in widely shared well-being in human history. That improvement is not just material but includes health, life span, peace, and any measure of human prosperity. Yes, despite the horrors we read about from the world's war zones and some of our own cities, violence remains on a steady decline.

Aesop tells of a hungry wolf who meets and admires a well-fed dog. But when the wolf sees the dog's collar, he says "no thanks" and walks off. Fortunately, we do not face the wolf's conundrum. We do not have to argue for a moral superiority of freedom and ask for material sacrifice. In the United States it is possible to be both well fed and free.

Despite the promises of monarchs, autocrats, dictators, commissars, central planners, socialists, industrial policy makers, progressive nudgers, and assorted dirigistes, it is liberty and rule of law that has led to this enormous progress. To the Chinese argument, say, that their ancient culture demands authoritarianism, a simple reply suffices: you, \$7,000 per capita GDP and filthy air; us, \$52,000 per capita and a clean environment.

I do not think this outcome was intentional. Neither the Founders, nor those who built the British institutions that the Founders improved, had any idea of the material progress their invention would father, or that the United States would rise to lead the world to a seventy-year Pax Americana. Jefferson envisioned a bucolic agrarian society. Washington warned against foreign entanglements. A system designed only to defend individual liberty unintentionally unleashed unimaginable material and international benefits.

Without this economic success, I doubt that anyone would call America exceptional. Imagine that China were seven times as productive per capita as we are, rather than the other way around. Or imagine that great natural experiment, North Korea versus South Korea had the reverse outcome. North Korea also claims to be exceptional. The rest of the world regards it as an exceptional basket case.

Of course, the foundations of this prosperity—in rule of law, security

of property, internal peace—are not ours alone. America was built on British institutions. Other countries have adopted many of our institutions and joined in our prosperity.

In fact, the core of exceptionalist faith contains its own undoing. If American values are indeed universal, if America's exceptional role is to bring these ideas to the world, then when the world does adopt these ideas, America must become somewhat less exceptional.

America is already less *unusual* than it was at its founding and throughout the eras of monarchy, of dictatorship, and of Soviet communism when America's detractors insisted it would be just one more short-lived republic. But the process is far from over. The United States remains the essential exceptional nation.

All the great ideas for the next advances in human well-being are being made here: computers and the Internet, biotech, genetics, the microbiome. Most important, the great ideas are being *implemented* here—the new companies are American.

More darkly, any hope for resolving the world's gathering storm clouds resides in the United States. If we *don't* get our act together and revive our exceptionalism, and pretty darn soon, the consequences are truly terrifying: chaos in the Middle East; more swarms of refugees; Russian and Chinese forcible expansion; nuclear weapons going off here and there; pandemics among people, animals, or crops, which often follow waves of globalization. The troops in the First Iraq War wore T-shirts saying, "Who you gonna call? 001." It's still the only number.

Enough self-congratulation—it's time to move on to the second item of a conservative's faith: that it's all in danger of falling apart. And it is, more than ever.

## The Rule of Law

I locate the core source of America's exceptional nature in our legal system—the nexus of constitutional government, artfully created with

checks and balances, and of the rule of law that guides our affairs. And this is also where I locate the greatest danger at the moment.

Lawyers? Government? You chuckle. That you may laugh just tells us how endangered this precious flower is. Without rule of law, any American character fostering innovation is quickly squashed.

Rule of law means the rights of the accused to know charges against them, to see evidence, to confront witnesses; the right of free speech and especially unwelcome political speech; the separation of prosecution and judges; grand juries to weigh evidence and grant warrants for searches; the right to property and courts that will defend what that right means (fracking developed in the United States pretty much because property rights include subsoil minerals, which are retained by the government in most other countries); the delicate constitutional checks and balances that keep majorities from running amok and delay awful ideas until enthusiasm passes; a free press that can expose corruption; and so on, *ad infinitum*.

Even democracy only lives on top of rule of law. We are a republic, not a democracy, and for good reasons. Democracy is fundamentally a check on tyranny, not a good way to run day-to-day public affairs. Democracy without rule of law produces neither prosperity nor freedom. Even countries like Venezuela and Russia go through the motions of elections, but you can't get a building permit there without connections or speak out against the government without losing your job. On the other hand, rule of law without democracy can function for a time and tends to produce democracy. America lived for 150 years under rule of law while still a monarchy.

And without rule of law, democracy is soon subverted. Those in government are always tempted to use the government's power to silence opposition and cement their hold on power, and ruin the economy in the process. *That's* the danger we face. If speaking out for a candidate, arguing a policy question such as climate change, or working on

behalf of a losing party earns you the tender attentions of the Securities and Exchange Commission (SEC), Internal Revenue Service (IRS), Environmental Protection Agency (EPA), Consumer Financial Protection Bureau (CFPB), National Labor Relations Board (NLRB), and increasingly the Department of Justice (DOJ) and the Federal Bureau of Investigation (FBI), it does not matter who votes.

## Erosion of Rule of Law

The erosion of rule of law is all around us. I see it most clearly in the explosion of the administrative, regulatory state. Most of the “laws” we face are not, in fact, laws, written by a legislature and signed by an executive, as we are taught in school. They are regulations, promulgated by agencies. This system made sense, initially. For example, it does not make sense for Congress to write the criteria for maintaining an airliner. But now it has spiraled out of control. The Affordable Care Act (Obamacare) and the Dodd-Frank Act (banking regulation) are poster children. Their enabling acts go on for thousands of pages. The subsidiary regulations go on for tens of thousands. The letters and statements of interpretation and guidance, now essentially laws of their own, go on for more.

Were these even rules that one could read and comply with, the situation wouldn't be so bad. But the real problem is that the rules are so vague and complex that nobody knows what they really mean. Companies can't just read a set of written rules. They must ask for regulator approval, which can take years and yields arbitrary results. Hence, the “rules” really just mean discretion for the regulators to do what they want—often to coerce the behavior they want out of companies by the threat of an arbitrary adverse decision. Anyone can be found guilty at any time—if a regulator chooses to single someone out, as an EPA administrator once said, for “crucifixion.”

Richard Epstein calls the system “government by waiver.” The law and regulations are impossible to comply with. So business after business asks for waivers, which are granted, mostly. But you’d be out of your head to object too loudly to the actions of an agency or the administration it serves if you want a waiver.

On top of laws, rules, and judicial interpretations, now agencies write “guidance” letters to state their interpretation of a rule, and these letters become law themselves.

As with laws, agencies promulgating new regulations are supposed to follow a procedure. They are supposed to respect and implement Congress’s authorizing legislation, incorporate public comment, perform serious cost-benefit analysis, and so forth. But even these weak constraints are less and less binding.

Obamacare subsidies, the Federal Trade Commission’s regulation of the Internet, the EPA’s assault on carbon and coal, the obstruction of the Keystone XL pipeline, the Department of Education’s war on private colleges, the Federal Deposit Insurance Corporation’s withdrawal of bank access from payday lenders and pot farmers: all of these step far outside the established procedural limits. (My point is not about the merits of any of these examples, which may be fine regulations. My point is the lack of rule-of-law process in how they were promulgated.)

The basic rights that citizens are supposed to have in the face of the law are also vanishing in the regulatory state. The agency is prosecutor, judge, jury, appeals court, executioner, and recipient of fine money all rolled into one. One does not have conventional rights to see evidence and calculations, discover information, and challenge witnesses. Agencies change their interpretation of the law and come after their victims *ex post facto*.

Retroactive decisions are common, never mind the constitutional prohibition on bills of attainder. When the DOJ and CFPB went after auto lenders, based on a statistical analysis of last names of people

who had received auto loans, the computer program was obviously not announced ahead of time, so businesses had no idea whether or not they were following the law. The CFPB went after PHH, a mortgage lender, issuing a novel interpretation of the law, charging PHH ex post facto with violation of that new interpretation, and increasing its own administrative judge's \$6 million fine to \$109 million.

The expansion of the regulatory state, along with the disappearance of rule of law in its operation, is already having its economic impact. The long-term growth rate of the US economy has been cut in half, a decrease driven largely by anemic investment.

I fear even more the political impact. The point of rule of law is to keep government from using law for political purposes. As we lose rule of law in the regulatory state, its politicization is inevitable. Recall Lois Lerner of the IRS and her treatment of conservative groups. Recall Governor Scott Walker's persecution by Wisconsin's attorney general using vague campaign finance laws.

The drive toward criminalizing regulatory witch hunts and going after the executives means one thing: those executives had better make sure their organizations stay in line. ITT Technical Institute got closed down as part of the Obama administration's war on for-profit education. Laureate International Universities, the for-profit college that coincidentally paid Bill Clinton \$17.6 million for being "honorary chancellor," did not. The SEC is piling onto an ambitious state-attorneys-general drive to sue Exxon, under securities law, for insufficient piety over climate change. Big "settlements" with banks are leading to millions of dollars being channeled to left-wing and Democratic Party political-advocacy groups.

The classic analysis of regulation says it leads to capture: the industry captures the regulator, they get cozy, and regulation ends up being used to stifle competition in the industry. Capture is now going the other way. Health insurers, banks, and energy companies are slowly being

captured by the politicized regulators. Yes, they still get protection, but they must do the regulators' and administrations' political bidding. And a constant stream of CEO show trials and criminal investigations keeps them in line—with calls for more. Just imagine what they could do with lists of donors to out-of-power party political action committees and nonprofits.

Campaign finance law is precisely about regulating speech and the government taking control over who can support whom in an election. Corporations will be forced to disclose contributions. Unions will not.

The key attribute that makes America exceptional—and prosperous—is that *candidates and their supporters can afford to lose elections*. Grumble, sit back, regroup, and try again next time. They won't lose their jobs or their businesses. They won't suddenly encounter trouble getting permits and approvals. They won't have alphabet soup agencies at their doors with investigations and fines. They won't have prosecutions of their political associations. We are losing that attribute.

In many countries, people can't afford to lose elections. Those in power do not give it up easily. Those out of power are reduced to violence. American exceptionalism does not mean that all the bad things that happen elsewhere in the world cannot happen here.

Perhaps I am guilty of nostalgia, but I sense that, once upon a time, those in American public life believed that their first duty was to keep alive the beautiful structure of American government, and the policy passion of the day came second and within that constraint.

We are suffering now a devotion to outcome, to winning the battle of the moment at any cost. Legislation that passes by one vote? Fine. Regulations written far past enabling authority? Go for it. Executive order in place of law or regulation? Do it. Just write a letter of interpretation to tell them what to do. Shove it down their throats. But when policies are adopted without at least grudging consensus that the battle was fairly won, you can't afford to lose an election.

Since the Nixon impeachment, and with the spread of campaign finance law and regulation, we are seeing a greater and greater “criminalization of politics.” It’s part of the trend toward using any tool to win. And it is more and more dangerous to lose an election, so those in power will fight by any means to hang on.

Our public life depends on voluntary cooperation. Administrations follow the law, even when they don’t really have to. They defer to court and Supreme Court decisions that they could ignore. The president does have a pen and a phone—and the number at DOJ and FBI and IRS. The rule of law depends on him not using it. We do not ask the question too insistently, “So, what are you going to do about it?” We are losing that respect for the system.

The idea of rule of law, the reverence for process over outcome, seems to be disappearing. Few college seniors will have any idea what we’re talking about. Even basic civics courses are passé. And we see so much on both sides of the partisan divide that ignores it. Our many foreign policy misadventures have a common theme: forgetting that all societies need rule-of-law foundations, not just the superficial exercise of voting.

Rule of law, then, depends on a culture that respects it, not just the written word. And that culture depends on people to some extent understanding how it works. Like medieval peasants, having lost the recipe, looking up in awe at Roman concrete structures, I fear, our children will wonder just how the architecture of a broken system once worked its marvels. And the Romans lasted a thousand years. Pax Americana seems to be running out of steam at a mere 250.

## **Egalitarianism and the Pursuit of Happiness**

Our government’s purpose is set forth in the Declaration of Independence: to secure “life, liberty, and the pursuit of happiness,” period. Government does not exist to lead us to some grander purpose: the

advancement of the Christian faith or the restoration of the Caliphate; the spread of communism on earth; propounding the greatness of our kultur or the glorious American nation. When John F. Kennedy said, “Ask not what your country can do for you—ask what you can do for your country,” he had it precisely wrong.

Yes, American exceptionalists wish to spread their ideas to the world, but not to subjugate other people to some greater cause, instead merely to allow them to pursue life, liberty, and happiness as those people see it.

A central article of exceptionalist faith is that American institutions are universal. We deny that they are specific to a culture or race. People everywhere want freedom and can learn to use American institutions to get it as quickly as they can learn to use an American iPhone to order American pizza (sorry, Italy!).

Most of all, government does not exist to further the ethnic or religious identity of a people. Throughout the world, governments parcel up the spoils of power along ethnic and religious lines. Each losing ethnic or religious group then needs its own government to defend its simple economic and expressive rights. Multicultural and multiethnic empires have existed before. But by and large they were empires of tolerance, not right, and extracted resources from citizens equally rather than serving them equally.

In the United States, the children of Serbians and Croatians, of Indians and Pakistanis, of Catholics and Protestants and Muslims and Jews, live side by side and intermarry. None imagine that they need a government run by one of their own ethnic group or religion for basics like getting a business permit. The idea that government serves to foster their ethnic or religious identity becomes quickly foreign. Yes, this melting pot ideal has never been perfect, but it holds much more here than in any other country.

But how quaint this melting pot view seems now!

Interestingly, that ideal disappeared first from our foreign policy. For a hundred years, the United States has stood behind ethnic or religious

governments, happily playing one against the other and not once saying, “You know, we have a better idea for managing this, one where you won’t be at each other’s throats for another century or so.”

But that exceptional ideal is now vanishing domestically as well. Our government requires us to fill out forms with fine racial categorizations. The core principle that to be treated fairly by the law you do not need to be represented by a police officer, mayor, member of Congress, senator, or president of your own particular racial, ethnic, or religious identity is not only fading away but its opposite is enshrined in law.

It is true that these measures stemmed from the overturning of the even more egregious violation of American principles in laws governing African Americans, not only in the Jim Crow South but the segregated North as well. But at least we paid lip service to the principle.

A country that believes, and enshrines in law, the principle—opposed to everything in American exceptionalism—that you cannot be treated fairly by a government unless the officials of that government share your exact racial, ethnic, religious, and soon gender identity will fracture.

Similarly, exceptional America does not recognize the concept of “class.” Our disavowal of aristocracy and titles set us distinctly apart from Britain in the nineteenth century. And yet we now use that language all the time—“middle class” or “working class” especially. Economic law, regulation, and policy increasingly treat income as a permanent class designator, as fine and permanent as Indian castes, and treat citizens on that basis every bit as much as monarchic Britain treated peasants differently from nobles. We decry the reduction in mixing in America, yet when housing, food, medicine, and so on are distributed based on income, income becomes a permanent class marker.

Opportunity is a key part of the egalitarian credo. But a society divided up by formal categories of class, race, and income quickly loses that opportunity. As with economic regulation, though, each such division is a client usefully exploited for political advantage. Exceptional America foreswore the opportunistic politics of such divisions.

## Fixing America

The third article in exceptionalist faith, however, is optimism: that despite the ever-gathering clouds, America will once again face the challenge and reform. There is a reason that lovers of liberty tend to be Chicago Cubs fans. (And, as a member of both tribes, I take hope from one for the other!)

Healing is not something we should take for granted, however. There is no automatic self-correcting force. Every scrape with disaster is a scrape with disaster. It can happen here. Hope is not a strategy.

The recipe is straightforward. Rather than just demand “less regulation” even louder, we need to bring rule-of-law *process and protections* to the regulatory state and revive them in our legal procedures as well. It’s time to pay attention to the *structure* of government rather than to its *outcome*.

Congress should restructure the law surrounding regulation. Stop writing thousand-page bills. Strengthen the Administrative Procedure Act describing how regulations are written and implemented. Require serious, and retrospective, cost-benefit analysis. Put in “shot clocks,” time limits for regulatory decisions. Give people more avenues with which to challenge regulation in a timely manner. Sunset all regulations—they have to be reapproved (including congressional overview) and rewritten *de novo* every ten years.

Good news: people on both sides of the partisan divide recognize this fact. Paul Ryan’s “Better Way” plan contains just this kind of radical restructuring of the regulatory process. It goes so far as to require that Congress must approve new major regulations—a large change in the balance of power back to Congress and away from administration and agencies. The Obama administration tried to strengthen the OIRA (Office of Information and Regulatory Affairs). The effort failed, but it signaled a bipartisan realization that the regulatory state is broken, and it taught some useful lessons.

The court system plays a crucial role. Fix the court system so litigants are not bankrupt and dead by the time they win. The litmus test for new judges should be their willingness to sustain rule-of-law restrictions on the regulatory state, not to re-fight social issues. Let the litmus test be *Wickard v. Filburn*, which declared that a man may not grow wheat in his own yard to make his own bread without a Federal Wheat Marketing Order, not *Roe v. Wade*.

### **A Small Comment on Foreign Policy**

I have focused on economics, but nowhere is the decline of American exceptionalism more evident than in foreign policy. Post–World War II Pax Americana has been the most peaceful and prosperous period in all human history. But its development and success have been one narrow scrape after another, and in any of them things could have gone wrong. In the next one they may.

What country can look at the experience of Ukraine—to which the United States guaranteed territorial integrity in exchange for giving up nuclear weapons—of North Korea, Pakistan, Libya, and Iran and not conclude that getting nuclear weapons and rattling them is a darn good idea?

Teddy Roosevelt said to speak softly and to carry a big stick. America these days speaks loudly, aims at the daily polls, doesn't mean what it says, and announces ahead of time that it won't use its stick. Dwight Eisenhower did not tell Hitler ahead of time how many troops he was going to put in at Normandy and how quickly he would take them out. The answer was that he was going to put in enough to win, period.

The Bush administration gave the project of bringing democracy to the world a bad name, in part by misunderstanding just how much rule of law must underpin democracy and in part by misunderstanding just how much the world still needs the idea and culture of rule of law.

For a messianic, universalist religion, we do precious little missionary work these days.

## Hope

It is common to bemoan the state of American politics. But we should be optimistic. The major parties are blowing up. We are in a once-in-a-generation major realignment and redefinition. Only a big realignment can produce the rule-of-law and free-market coalition that I describe here. Power may shift from the once imperial presidency to an emboldened Congress. Only a time of big change offers big opportunity.

Finally, ideas matter. An exceptional—and functional—America must understand how she is supposed to work. We are a democracy, and if voters don't respond with an elemental understanding of their rights, and with outrage when those rights are violated, as the Founders did, we can't expect miracle politicians to save us.

How can we expect our children to understand the machinery if we don't tell them? The schools and universities don't do that anymore. But other institutions do!

This book is the product of an exceptionally American institution, a reservoir of *ideas defining a free society*. Sometimes that reservoir is an ark, keeping ideas alive in a dark age. Sometimes it is a fountain, ready to bring those ideas to the world when it's ready. But you, I, and the institutions we form—another brilliantly exceptional American habit—are crucial to its renewal.