Government By 'Guidance' Quashes Economic Freedom and Rule of Law

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Freedom is declining in America. The Heritage Foundation-Wall Street Journal Index of Economic Freedom ranks the United States at #12, as does the Fraser Institute's Economic Freedom of the World Index. The U.S. ranking has slipped in recent years according to both studies and now scores significantly below Hong Kong, Singapore, Chile, Canada, Australia, Switzerland, and New Zealand.

According to the Heritage Foundation's description of its Index of Economic Freedom, "In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself." The Heritage Foundation notes that greater economic freedom is associated with "healthier societies, cleaner environments, greater per capita wealth, human development, democracy, and poverty elimination." The Fraser Institute's definition of economic freedom is similar, and it also notes the similar connections between economic freedom and favorable economic outcomes.

Not only is economic freedom the wellspring of prosperity, it is essential to all other individual freedoms. If the government can control your work, spending and property, then it can leverage that power to control all of your actions. A legal right to freedom of speech and assembly, therefore, is worth little without significant economic rights.

How did Americans become significantly dispossessed of their economic freedom? There is much talk in the news these days about Presidential overreach through Executive Orders and Memoranda in areas such as immigration and health care, but unfortunately, Presidential actions are only a small part of the problem – and White House overreach is reversible when a new Administration takes office. At the heart of the matter is the growth of unaccountable law making and law enforcement within administrative agencies, which marks a significant erosion of the rule of law.

The number of agencies that enact, enforce, and adjudicate disputes over their own regulations has grown exponentially over the past century. Agencies such as the Environmental Protection Agency, the Occupational Safety and Health Administration, the National Highway Traffic Safety Administration, the National Labor Relations Board, the Federal Communications Commission, the Federal Trade Commission, the Interstate Commerce Commission, the Consumer Financial Protection Bureau, the Securities Exchange Commission – to name only a small number – are given vast authority by Congress to draft regulations that implement the legislative intent of what are often broad and vague statutes. The agencies set and enforce rules

that apply to businesses and individuals, and also preside over disputes by citizens or firms who object to them.

In principle, Congress could alter regulations it regards as undesirable, but that seldom occurs. In 1996, the Congressional Review Act attempted to encourage Congressional review of agency actions. As of May 2008, however, only 47 joint resolutions of disapproval had been introduced in both houses of Congress, relating to just 28 rules. During the same time period, Federal agencies had promulgated 47,540 rules.[1] And while it is also true that U.S. courts retain authority to hear cases related to agency actions, they are not the primary adjudicators of regulatory disputes, and appeals to the courts are challenging to accomplish.

The new trend in regulation has been the use of "guidance" as a means of avoiding even "informal rulemaking"—the laxest kind of executive lawmaking that requires only public notice, a comment period, and detailed explanations of an agency's decision.[2] Agencies are now free to guide the nation without even these simple procedures, giving only vague guidance about the considerations they will take into account in bringing enforcement actions.

Neither does the new reliance on guidance imply any burden of explanation. A recent decision by the National Labor Relations Board broadened the definition of employers, creating huge new potential liabilities for franchising companies like McDonald's. Upon request for clarification of the logic underlying its decision, the NLRB declined even to share internal memoranda, stating that it was reserving those for prospective litigation.[3]

In many cases, agencies' budgets are also self-determined, as they are able to fund themselves by fees that they determine themselves, rather than as part of the budgetary process. For example, the FCC sets taxes on communications firms to fund its various programs. The "universal service program" alone spends $9 billion a year.

Although we might want to believe that the administrative agencies simply apply scientific study to the pursuit of the greater good, such thinking is naïve. Bureaucrats aren't angels living apart from the constraints of real world politics; they live in Washington where the norm is political posturing and willful abuse of discretionary authority to please those that reward such behavior (politicians, lobbyists, or other influential political actors).

Agencies, not Congress, set the rules for who has to sign up for healthcare and how, who is subject to immigration law enforcement and who is not, whether the internet will be subject to "net neutrality" regulation, the determination of what constitutes pollution, and the determination of which financial institutions will be regulated as "systemically important." Some of these rules are even contrary to the explicit language in the statutes passed by Congress, and yet the ability to contest even those seizures of power has been hobbled by the fact that citizens wishing to complain about such actions lack "standing" in court to complain.

How did this happen in our republic? After all, America's founders stressed the need for checks and balances to protect freedom from excessive concentrations of government power, and claimed that this was precisely what the U.S. Constitution would achieve, via the separation of powers into the three branches of the federal government, and the separation of authority

between the national government and the state governments. Hamilton and Madison were especially confident that the U.S. Constitution would restrain the power of the Executive Branch of government.

How could they have been so wrong? Notwithstanding the Constitution, and Hamilton's and Madison's exhortations about the importance of the separation of powers and the need to limit power when crafting government, our courts have permitted an increasingly deferential Congress to cede authority to an increasingly assertive Executive. The courts have also diminished their own authority to check the executive agencies by making it difficult for citizens to challenge agency actions in court.

In our recent book, Fragile By Design, Stephen Haber and I consider the example of Congress's willing delegation of power over the regulation of banks and the housing financing giants, Fannie Mae and Freddie Mac, in the years leading up to the recent crisis. We show how Congress delegated to the Federal Reserve Board the power to decide on the adequacy of the "good citizenship" of banks applying to merge during the merger wave of the 1990s and 2000s, and delegated to the Department of Housing and Urban Development the implementation of mortgage purchase mandates for Fannie Mae and Freddie Mac for low-income and inner-city mortgage borrowers. In combination, these delegations were crucial to precipitating the subsidization of mortgage risk by banks and Fannie and Freddie, and the debasement of U.S. mortgage underwriting standards, which contributed so destructively to the financial crisis of 2007-2009.

Congress could have undertaken a different approach to promoting home ownership, with far less adverse consequences for the financial system, and without abdicating its governance responsibilities. It could have offered down-payment matching funds (as in Australia) to make it easier for new home owners to qualify for mortgages – an approach that reduces mortgage risk rather than encouraging it. Or it could have expanded targeted Federal Housing Administration interest rate subsidies for low-income borrowers. But relying on those alternative approaches would have required visible actions with visible budgetary consequences. The political coalition that supported mortgage credit subsidization preferred to support the mortgage risk subsidies in a way that did not explicitly recognize the expansion of government control over the mortgage market, or the budgetary costs of those implicit subsidies.

We need to stop kidding ourselves. Despite what is taught in our schools, we are not governed under the political structure envisioned by our founders. We are ruled by an imperious bureaucracy that creates vague rules, funds itself with fees that is sets at will, and controls the adjudication of disputes when citizens complain about its actions. Perhaps rather than having children study the Constitution and the Federalist Papers, which lull them into a false sense of security about limited government, we should have them read Kafka's The Trial, which better captures how our government operates.

What should be done to reverse course?

Guidance and informal rule making by agencies should be prohibited; formal rule making should be required.

Congress should be required to formally approve all major rules before they become effective – as proposed in the 2013 Regulations from the Executive in Need of Scrutiny Act – rather than merely have the option to disapprove of them, as under the current ineffectual Congressional Review Act of 1996. This will require substantial growth in Congressional staff, but it is necessary for Congress to fulfill its constitutional obligations to make our laws.

Administrative agencies should not set their own budgets; they should be funded as part of a congressionally approved annual budget.

Finally, we must remove adjudication authority over regulatory disputes from administrative agencies and return that authority to the courts. Judicial oversight will only be complete, however, if citizens are given standing in the courts to challenge the constitutionality of rules without having to meet the current standard of demonstrating tangible individual harm.

These fundamental changes would be an excellent start toward restoring a robust legislature, an independent judiciary, and the limited government necessary for preserving freedom and adherence to the rule of law under our Constitution.

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[1] U.S. House of Representatives, 113th Congress (2013-2014), House Report 113-160, Part 1.

[2] For details, see Christopher DeMuth, "Can the Administrative State Be Tamed?" Hoover Institution Program on Regulation and the Rule of Law, December 2014; Richard A. Epstein, "The Role of Guidances in Modern Administrative Procedures," Hoover Institution Program on Regulation and the Rule of Law, December 2014; Philip Hamburger, *Is Administrative Law Unlawful*?, University of Chicago Press, 2014.

[3] See Diana Furchtgott-Roth, "The NLRB Turns Government into Kafka's Nightmare," RealClearMarkets.com, December 23, 2014.

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