Contemporary Conservatism and Government Regulation

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American conservatives have opposed the growth of government regulation in principle but accommodated that growth in practice. The disjunction has been particularly striking during the recent decade of Republican ascendency (1998–2008). This paper explains the conservative hostility to regulation (Section I), describes and attempts to account for the growth of regulation through Republican as well as Democratic governments (Section II), reviews the record and legacy of the George W. Bush Administration (Section III) with special attention to the financial crisis of 2008 (Section IV), and concludes with suggestions for conservative thought and action in the post-Bush era (Section V).

"Regulation" is a protean and potentially all-encompassing term: essentially every act of government aims to alter some course of events. A functional definition is that regulation is government prescription of terms and conditions of private transactions, usually in the form of rules written and enforced by specialized administrative agencies, in order to achieve some public result.[1] That differentiates regulation from taxing and spending—but taxing and spending programs are replete with detailed specifications of how taxes are to be calculated and funds awarded, which like naked regulations are intended to alter private conduct. And, in the United States, the federal government applies numerous detailed grant conditions, and also "unfunded mandates," to state and local governments. Beyond the functional definition, regulation has at least two political meanings in the American context: government efforts to manage private markets and hence "free enterprise" and "capitalism," and federal government efforts to centralize power and policy-making within the federalist system. Ambiguities at the margin are unimportant in this paper: conservatism's dilemma with the growth of regulation has some unique features but is not fundamentally different from its dilemma with the growth of government *tout court*.

I. Regulation in Conservative Thought

Contemporary American conservatism, taken as a body of political thought and policy analysis rather than a political movement, is strongly disposed against government regulation. This disposition has four sources.

First, regulation generally takes the form of restrictions on private property or markets. Government rules may specify or limit prices, product designs, production methods, the uses of land or other property, the information firms provide to investors or consumers, the forms of financial or operating arrangements among firms, or who may provide goods or services in certain markets. In every case, regulation impinges on property rights and economic freedom. Conservatives place a high value on property rights and economic freedom—they do not regard them as secondary to civil rights and political freedoms. And they admire the entrepreneur and the works of commerce and finance, both as expressions of human freedom and sources of material prosperity. Conservatives will usually acknowledge that some government impositions on property and business activities are appropriate and, if executed well, can vindicate property rights—the classic case is pollution control. But they oppose other purposes, such as restricting market competition, and are generally skeptical of the "public good" rationales for government controls on property and commerce.

Second, regulation is a problematic form of government action—a font of "unintended consequences" and "perverse consequences" even when the formal purposes are accepted as valid. This is because of the narrowness and specificity that are defining attributes of regulation. The government fixes one term of a complex private contract—a price term, a feature of product design, a disclosure statement, a production method—but leaves myriad other terms unregulated, and cannot regulate the extra-contractual behavioral responses of firms and individuals. The unregulated terms and conduct adjust and compensate for the fixed term, reflecting private purposes that are independent of the government's purpose; the result is always to compromise and sometimes to entirely defeat the government's purpose. The minimum wage leads to unemployment among marginal groups; safety-and-efficacy controls on the introduction of new pharmaceuticals retard innovation and worsen rather than improve public health; price controls raise rather than lower prices—or if they lower prices, produce queues; financial regulations suppress corporate risk-taking and drive financial markets to jurisdictions with less onerous controls (e.g., from New York to London).

Regulatory ineffectiveness vindicates the conservative's skepticism about government intervention in private social and commercial arrangements: it demonstrates the market's robustness and adaptability, its superior knowledge of varying local circumstance, and its subtle accommodation of variegated interests. But conservatives are offended by the waste, inefficiency, and social harm that result; affronted by the pretense that government regulators "correct market failures"; and discouraged by the corruption of popular understanding of the sources of social progress and problem solving. Moreover, the pervasiveness of "regulatory failure" leads to the suspicion that regulatory instruments are chosen over other, more effective policies deliberately and for surreptitious reasons. For example, a substantial tax on gasoline would be a highly effective means of encouraging energy conservation—and wildly unpopular for that reason; so Congress instead regulates the average fuel economy of automobile fleets in a highly porous and ineffective manner. Precisely because regulatory edicts are relatively easy to elide, they permit government officials to take credit for ambitious social goals without risking adverse political reaction to the significant costs and social disruptions that a full-throttled pursuit of those goals would entail. And regulations, by targeting specific firms, industries, and economic groups, provide the government with great discretionary power to reward and punish particular groups for reasons having nothing to do with the regulations' formal purposes: regulation facilitates the pursuit of unworthy purposes in the name of worthy purposes. Conservatives think policies should be judged by results, not good intentions—much less bad intentions.

Third, regulation is almost entirely the work of administrative agencies. There are exceptions—the U.S. minimum wage is a legislative enactment—but for the most part regulations are produced by bureaucracies whose power to make law is delegated from the Congress. And the modern regulatory state, in its structure, profusion, and minuteness, is entirely an artifact of the bureaucratic state. It could not have been created by direct legislation, given the numerous constraints the U.S. Constitution places on legislating, and given the inherent cumbersomeness of legislative decision-making. Moreover, the problem of regulatory ineffectiveness—of private adaptation to narrow rules vitiating their intended effects—calls for the close integration of lawmaking and administration. If regulation is to have any hope of success, the issuance of rules needs to be combined on a continuous basis with surveillance, enforcement, interpretation, and amendment. This was achieved first by the hybrid, commission form during the Progressive and New Deal eras (e.g., the Interstate Commerce Commission, Federal Trade Commission, and Securities and Exchange Commission)—a mini-legislature of commissioners made rules by majority vote and also administered an agency that policed and enforced those rules and recommended new and revised rules. Later, beginning in the 1960s, the commission form was displaced by the pure hierarchy (e.g., the National Highway Traffic Safety Administration and Environmental Protection Agency)—the legislative mimicry was abandoned and a single administrator wrote the rules and supervised their enforcement and amendment. That was even more efficient.

American conservatives are limited-government constitutionalists. They are hostile to departures from the structure of government laid down by the U.S. Constitution, and few departures have been more dramatic than administrative lawmaking and the fusion of lawmaking, surveillance, and enforcement. At one level the conservative hostility is legalistic and traditionalist, born of devotion to the rule of law and fear of departures from arrangements that have endured for a long time and produced admirable results. But it is also practical and consequentialist: administrative government has proven to be a powerful innovation for increasing the size, scope, reticulation, and general busy-bodiness of the state. This is not only because of the relative alacrity of administrative action, but also because delegated lawmaking permits elected representatives to diffuse, and where convenient to evade, political accountability for particular policies.[2]

Fourth, regulation has facilitated the growth of government in another way, by taking public spending off-budget. Most of the expenditures occasioned by regulatory policies are realized entirely within the private sector: the costs of complying with the rules of the Environmental Protection Agency, Federal Communications Commission, and Securities and Exchange Commission dwarf the agencies' own budgets.[3] Although regulatory expenditures are public expenditures in the sense of being made for public purposes and required by law, they are free of the usual constraints of public finance—taxation, legislative authorization and appropriation, and budget constraints and controls. In an era of trillion-dollar budget deficits and hundred-billion-dollar spending authorizations, one would be forgiven for wondering whether traditional financial restraints amount to very much anymore. Yet large spending bills and budget deficits are front-page political controversies, while regulatory costs are not. And government expenditures, once authorized and appropriated, are at least subject to budget controls. In recent decades, the growth of regulation has prompted the establishment of cost-constraining procedures that mimic budget procedures: agencies are required to estimate regulatory compliance costs and conduct benefit/cost assessments under the supervision of the Office of Management and Budget. But these procedures are much more abstract and less constraining than budgeting and expenditure controls.[4]

II. Regulation in Political Practice

The conservative critique of regulation has had little durable influence on American politics and government. It has won occasional victories, and it supplied the policy content of the "deregulation movement" running from 1978 (when the Airline Deregulation Act was passed) through 1988 (when the Reagan administration ended). But it has not prevented regulation from growing over time, powerfully and inexorably, and it has not even caused the Republican Party, its natural political home, to be a consistent or forceful opponent of regulatory growth.

Of course an intellectual critique is not a political program. The ideas described in the previous section are academic and reactionary—the application of conservative principles and microeconomic precepts to the experience of government regulation since roughly the New Deal. One finds them in pure form mainly in law reviews, economics journals, and think-tank publications and conferences, from whence they are deployed in real-time policy debates mainly by conservative editorial pages, opinion magazines, pundits, and politicians. But they are neither exclusively conservative nor all of conservatism. That regulation is frequently counterproductive—suppressing market competition, inflating prices, retarding innovation—is a concern shared by many economists and other scholars who are liberals (in the American sense of the term) when it comes to other policy issues such as taxation, health care, and social insurance. At the same time, many American conservatives today are primarily concerned with issues of morals, culture, personal conduct, and marriage and family, and are relatively indifferent to issues of the size, scope, and methods of government. Indeed, many of them—"big-government conservatives"—see government as an important ally in promoting better social norms and private behaviors, through regulation as well as taxing and spending. And many modern conservatives—"neoconservatives"—are primarily concerned with maintaining a robust role for the United States in international politics, and may or may not have conservative views of any sort in domestic policy; their patron saints, Daniel Patrick Moynihan and Henry M. Jackson, were forthright liberals on the domestic stage. Anti-regulation conservatives vie with many other agendas and constituencies, both within the conservative movement and the wider Republican Party. Worse, they are not consistently allied with any powerful interest group within the movement or Party; business firms and trade associations are often opposed to new regulation but often make piece with it or find it positively advantageous (on which more below)—and the growth of regulation has left business increasingly compromised and unreliable as a force for reform.

These circumstances are obscured by the continuing prestige of Reaganism—which was the contemporary conservative movement's greatest success in practical politics, and which did have a strong intellectual core that included adamant resistance to the growth of regulation and bureaucracy. But America has long since regressed to normal politics. American political parties are not ideological parties. They exist to win elections on behalf of certain political constituencies and their characteristic political values, not to advance broad philosophic principles such as limited government—much less to oppose techniques of government, such as regulation, which could be useful to the electoral tasks at hand. And the conservative movement, in its activist rather than intellectual embodiments, must sink or swim in this intensely practical environment, and has become increasingly integrated with Republican Party interests since its ascendency in the Reagan era. The context of normal politics, rather than that of Reagan exceptionalism, provides a better basis for assessing the state of conservatism and regulation today.

Regulatory Persistence: Theory and History

There are three general explanations for the political durability of regulation despite its ineffectiveness or positive harmfulness. The most famous is the "public choice" explanation: regulatory programs, while parading in the rhetoric of the public interest, in fact favor narrow interest groups at the expense of the general public, and survive because the interest groups have higher incentives and lower costs for political organizing than the passive general public.[5] The second is the "public misperception" explanation: the general public is not merely inattentive to regulatory policies but, when it is paying attention, mistakenly thinks that such things as trade restrictions, price controls, and farm subsidies are effective and beneficial.[6] The third is the "natural progress" explanation: the benefits that regulatory programs purport to promote (safer products, cleaner air, lower prices, etc.) are provided by private markets, independently of regulation, to an increasing degree over time, and this secular progress masks the ineffectiveness or harmfulness of regulatory programs and makes them difficult to oppose or reform.[7] These arguments are powerful, well-supported, and mutually reinforcing. They help explain why Republican politicians and conservative activists have not made greater use of the conservative intellectual critique of regulation. For an elaboration of the conservative predicament, let us review the record of regulatory growth.

The political history of U.S. regulatory policy exhibits two central features. First, although the Republican Party has been much more rhetorically attuned than the Democratic Party to conservative arguments about regulation, economic interventionism, and the role of the state, in practice there has been no strong partisan correlation of political party to regulatory policy apart from the New Deal. The Democratic Party, from its founding by Andrew Jackson down to the present day, has stood for the common man and the value of social equality. The Republican Party, from its founding by Abraham Lincoln down to the present day, has stood for business and commerce and the value of individual freedom. These sweeping generalizations gloss over many important features of the parties' evolving political platforms and electoral bases, but they serve to suggest why neither party has been consistent, about government regulation or economic interventionism generally, in response to changing political problems and opportunities. Jackson's Democratic Party was founded in opposition to centralized government economic power in the form of the Second Bank of the United States. Lincoln's Republican Party was strongly protectionist and pro-tariff, and his administration collaborated energetically with commercial interests to achieve rapid internal development—both for its own sake and to crush the agrarian South in the Civil War and win freedom for the slaves.

A century later, the Democratic Party had become identified as the party of regulatory activism primarily because of the New Deal, with its signal innovation of the expertise-based, law-writing regulatory agency (such as the Securities and Exchange Commission) and the Supreme Court's eventual acquiescence in that innovation. But the Eisenhower administration famously made peace with the New Deal, and, since 1960, the record has been thoroughly mixed. John F. Kennedy was a strong supporter of labor regulation but was the first president to propose weakening the Interstate Commerce Commission. Richard Nixon loathed the federal bureaucracy but instituted economy-wide wage-and-price controls, created the Environmental Protection Agency (EPA) by executive order, signed into law the statutes creating the Occupational Safety and Health Administration (OSHA) and the Consumer Product Safety Administration (CPSC), pursued aggressive antitrust policies (including prosecution of the television networks for political rather than economic reasons), and instituted racial "affirmative action" requirements in federal contracting. Jimmy Carter was a determined regulator of energy markets but deregulated the airline industry and beefed up the procedures that Nixon had initiated for White House oversight of agency rulemaking. A month before leaving office, Carter signed (over the unanimous opposition of his cabinet) the Paperwork Reduction Act, which established the institutional framework for Ronald Reagan's even stronger procedures for supervising regulatory policies under a cost/benefit standard; these procedures were continued, in somewhat milder form, by George H. W. Bush, Bill Clinton, and George W. Bush, and will undoubtedly be continued by Barack Obama.

The second feature, really a qualification of the first, is that there has been a significant difference—significant especially in a discussion of conservatism—between Republicans and Democrats in their *posture* toward regulation. Democrats, as representatives of the common man (eventually including workers and "the poor") and proponents of greater social equality, have generally been committed advocates of new regulatory and other policies to correct perceived social and economic abuses and injustices. Republicans, as representatives of business and proponents of individual freedom, have generally been opposed to new regulation and other intervention (the only exception since Lincoln in the presidential lineage is Theodore Roosevelt in full flush). But the Republicans have also been practical politicians, obliged to accommodate themselves to circumstances as they found them—including not only prevailing popular sentiments but their inheritance of government programs and the influential constituencies that have inevitably grown up around them. The secular pattern is Democratic policy activism as the motive force behind regulatory growth, followed by Republican acquiescence.

It is more than a detail to note that the constituencies favoring the regulatory status quo have often included staunchly Republican business groups, who had opposed the programs at the outset but then learned to live with them and even to love them. The Interstate Commerce Commission (ICC), established in 1887, was the product of a populist, agrarian, social equality movement against the railroad barons in the big Eastern cities. But in operation the ICC promptly became a price-fixing cartel, and thereafter the railroads worked to sustain it, strengthen its enforcement powers, and, following the development of the automobile, to extend its reach to those cartel-busting upstarts, the truckers and bus lines. No serious Republican, or Democrat, proposed to upset the regulatory status quo until the late twentieth century, by which time the railroads had lost most of their capacity to charge monopoly prices even in concert, and many had been driven in or close to bankruptcy by ICC policies. In general, regulatory programs apply in the first instance to business firms, and it is business firms that invest in mastering their details, forging compromises and working arrangements with their agency staffs and officials, and learning to operate in their lacunae. The firms thereby acquire an interest against the uncertainties that reform or abolition would entail, even when those changes would be highly beneficial to the market system and economic freedom. As students of regulation know, this tendency applies to "social regulation"—regulation addressed to health, safety, and environmental issues—as well as to economic regulation of the cartelizing kind.

Thus it is not surprising that the first successful stroke of economic deregulation, the abolition of the Civil Aeronautics Board (CAB) by a 1978 statute, was accomplished by liberal Democrats Edward M. Kennedy and Jimmy Carter—over the concerted opposition of the airline industry. Both proponents and opponents believed that the CAB was running an effective cartel and that deregulation would result in more competition and lower prices for consumers. Neither side realized at the time, what later became clear, that the cartel rents had been going mostly to unionized employees—pilots, flight attendants, and maintenance workers—rather than to owners and executives. If that had been known, the usual bipartisan alliance for the regulatory status quo might have head, and the CAB might still be with us today.

Although business acquiescence contributes to Republican acquiescence, the phenomenon runs deeper. Typically, a regulatory program is hotly controversial at the time of proposal, legislative debate, and enactment, but thereafter becomes a fact of life, a feature of the governmental landscape, a reality that citizens and politicians of all stripes have accommodated to and that would be costly to try to dislodge. It becomes institutionally entrenched in the government and in the wider society, and also legally entrenched as successive administrative actions and statutory revisions are interpreted by the courts and give rise to a body of precedent. Republicans, when they find themselves in power, are cautious about challenging this edifice—because they have accommodated themselves to it philosophically, because they are temperamentally conservative, or because they have other priorities. Richard Nixon, the Republican regulatory champ prior to George W. Bush, regarded many of his administration's regulatory initiatives as obnoxious nonsense (excepting environmental protection, where he was a sincere proponent of moderate regulation). But his overriding priorities were to bring the Vietnam War to an honorable conclusion and to forge a new strategic alliance with China (and, eventually, to save himself from the Watergate scandal); these required time and space and the maintenance of legislative coalitions. Eisenhower's refusal to lead a counter-revolution against the New Deal regulatory agencies was condemned by the then-nascent conservative intellectual movement, but very few business executives or Republican politicians would have had the heart for it, and Eisenhower was probably right in thinking that the general public, still enamored of FDR, would have opposed it.

Ronald Reagan is the great exception, and an instructive exception. A movement conservative, he had been, in the years before his presidency, a crusading newspaper columnist who often inveighed, knowledgeably and in detail, against government regulations. In office, he made "regulatory relief" one of four cornerstones of his economic program (along with tax reduction, fiscal restraint, and stable money). His first, flamboyant act in office was to abolish petroleum price controls by executive order, and he promptly established much stricter White House procedures for reviewing agency rulemaking proposals and requiring agencies to reconsider existing rules. He presided over a sea change in antitrust enforcement and doctrine and the abolition of the Civil Aeronautics Board and the Interstate Commerce Commission, and he relished preaching the virtues of individual and commercial freedom and deadening sins of regulation. Apart from antitrust, however, the results were mostly temporary rather than lasting. Many inherited rules were modified or rescinded—perhaps the most consequential being the Federal Communication Commission's abolition of the Fairness Doctrine in 1987—and the rate of regulatory growth declined markedly during his first term. But Reagan made no effort to abolish or substantially reform any of the agencies that issued those regulations—the fates of the CAB and ICC were sealed before he arrived, and his initial ambitions to reform the EPA were abandoned following a major scandal involving the Superfund program in 1983. He ended up acquiescing in several major rules, such as the automobile airbag requirement, that he had once strongly opposed, and by the end of his second term regulatory growth had resumed.[8]

Similarly, the other successful movement-conservative politician of recent vintage, Newt Gingrich, challenged regulation only at the margins and not at the core. His "Contract with America," which propelled the Republicans to their dramatic congressional victory in 1994, was mainly concerned with tax and fiscal policy and crime, welfare, and cultural issues (e.g., teenage pregnancy). It contained a few proposals to apply economy-wide regulations to the Congress itself, and to tighten congressional oversight of agency rulemaking, but few of them were enacted and those that were had no discernable effect.

Conservative Politicians Otherwise Engaged

The record, then, is that even the most strong-minded conservative politicians are disinclined to challenge regulation at the fundamental level that their intellectual and academic allies would favor. For example, the economic cases for abolishing OSHA and the Federal Communications Commission (FCC) are very strong, and in the case of the FCC would produce enormous, widely shared economic benefits, mainly through de-zoning the electromagnetic spectrum and vesting its allocation to private property and markets.[9] But no Republican president or congressional leader would even consider advancing either idea. These are not isolated examples. Conservative policy scholars would abolish many programs of economic regulation and restructure many programs of health, safety, and environmental regulation, and their proposals are altogether absent from serious political debate. This is in contrast to tax, entitlement, and health-care policy, where Republican leaders routinely advance ambitious conservative reform proposals. The distance between the intellectual and practical wings of the conservative movement is greater in regulatory policy than in any other area of economic policy.

I can offer two explanations for this state of affairs. First, conservative and Republican politicians are usually more temperamentally conservative—cautious, reactionary, wary of disturbing the status quo for abstract reasons—than are their liberal and Democratic counterparts. After all, the liberal politician who champions an ambitious new regulatory venture is confronting a status quo at least as entrenched and long-established as the subsequent status quo precipitated by the program itself. Liberals seem to be by nature more activist and confrontational than conservatives—perhaps more discontented and irascible, certainly more willing to overturn apple carts. A conservative temperament may lead one to a conservative political program as a philosophic matter but trump that program as a practical matter.

Second, for the political office holder, mobilizing support for deregulation is systematically more problematic than mobilizing (a) support for regulatory creation or (b) support for alternative projects that conservatives favor. The passage of a major regulatory statute is usually preceded by years or decades of preparatory work outside the government itself: publicizing, organizing, petitioning, and public-consciousness-raising concerning the injustices or abuses to be remedied. When the moment of legislating arrives, it often takes the form of a single stroke for social betterment—the legislator votes for clean air or fair railroad rates, leaving the hard work of allocating costs and benefits to be done piecemeal by an administrative agency. Deregulation is different. The costs and benefits have been parceled out, the derivative economic adjustments have been accomplished, the compromises made and the coalitions formed—and, critically, *the regulatory agency exists for purposes of enforcing the coalition*, rewarding those who remain in the fold and punishing those who attempt to defect. At the moment of regulatory creation, the putative beneficiaries are identified and organized while the losers are usually less so; once the program gets organized, the beneficiaries of deregulation are mostly diffuse and inattentive, while the putative losers are a team with a coach.

Finally, regulatory programs feature high complexity and narrow focus—so undoing them lacks political leverage and popular resonance as compared to competing conservative projects such as reducing taxes, reforming entitlement or welfare programs, or defeating communism or terrorism. It is not surprising that ambitious politicians who do combine conservative philosophy with activist temperament devote themselves to projects which, however controversial, can be easily explained and promise benefits that are large and palpable. The income tax, for all of its complexity, is less mysterious than the regulations (or even some individual regulations) of the FCC. The basic structure of the income tax and proposals to change it can be explained in straightforward dollar-and-cents terms; it directly touches and is familiar to vast numbers of people and its influence extends to the entire economy.

III. Regulation under George W. Bush

The political dilemmas of achieving conservative regulatory reform have become vastly more acute following the presidency of George W. Bush, which brought a tremendous expansion of federal regulation along with federal spending, deficits, and other interventions. Much of that expansion came in response to a succession of crises—the terrorist attacks of September 11, 2001, the corporate accounting scandals of 2001–2002, the sharp increase in energy prices in 2004–2007, and the financial-market upheavals and severe economic contraction of 2008. Crises invariably spur the growth of government through regulation and other means,[10] and those of the Bush years would have prompted some regulatory growth under any President of either party. But President Bush was more than a bystander or crisis manager. He arrived in Washington with substantial programmatic ambitions of his own, and when crises arose he was disposed by political calculation and personal temperament toward highly aggressive, interventionist responses. A "big government conservative," he was not acquiescent about regulation in the manner of Richard Nixon but assertive in the manner of Theodore Roosevelt.

Administering the Regulatory State

Abnormal regulatory growth did not come in the day-to-day administration of the established regulatory programs, where the Bush record was similar to that of previous Presidents, Republican and Democratic, other than Reagan. At the Environmental Protection Agency and other executive branch agencies, there were many public controversies over individual rules, many internal policy debates between the agencies and the Office of Management and Budget (OMB–the White House agency that enforces government-wide regulatory as well as budget policies), and many posturing charges that the agencies were either going too far or not far enough. Students of "the administrative presidency"—both those who think that the White House is increasingly corseting the bureaucracy with political controls, and those who think that the bureaucracy is increasingly autonomous and able to act independently of the White House—could find ample support for their theses in the Bush record. But regulation continued to grow, steadily and inexorably, with no remarkable departures in pace or substance.[11] The number of new "major rules" (those estimated to cost $100 million or more annually, or designated by OMB as unusually important for other reasons) promulgated by the executive branch and "independent" regulatory agencies, and the costs and benefits of those and lesser rules, were not appreciably different than during the Clinton and Bush 41 Administrations.[12]

Nor did the Administration pursue any major initiatives for regulatory reform or deregulation. Not for lack of opportunities. The Federal Communications Commission, for example, was a prospect for root-and-branch deregulation at least as attractive as the CAB had presented to the Carter Administration. The Bush FCC did some important good deeds, especially in removing regulatory barriers to competition between telecommunications and cable television firms, which prompted a surge of investment and dramatic growth in broadband penetration.[13] But for the most part the commissioners remained content, through eight years of Republican control, to preside over a terribly wasteful, innovation-suppressing process of industry rent-seeking rather than attempting to correct the process at a fundamental level.

One important Administration effort, its "Faith-Based and Community Initiative," did involve significant deregulation of a sort: the elimination of numerous restrictions that had prevented religious organizations from competing for social-service grants and contracts.[14] But the initiative was ambiguous from the broader standpoint of government intervention in private society. Its purpose and effect were to widen the array of institutions that could receive federal grants (funding increases were of course part of the effort). The result was government involvement in religious organizations that had previously been entirely nongovernmental—requiring a new set of rules to ensure that public funds went only to social services and other secular efforts and not to religious instruction, worship, and proselytizing. Although the Obama Administration came to office intent on revising many of the business-oriented rules adopted during the Bush Administration, it promptly announced that it would continue the faith-based initiative in all essentials.[15]

In environmental policy, the Bush Administration did pursue one important tactical reform under the Clean Air Act—an attempt to liberalize the rules under which manufacturing and power plants may be upgraded without triggering costly "New Source Review" requirements. The original Clean Air Act of 1970 imposed much more stringent pollution standards on new plants than existing ones; this created perverse incentives to postpone the retirement and replacement of old, relatively high-polluting plants, and wasteful incentives to maintain production capacity through incremental upgrading of grandfathered plants. A statutory amendment, and succession of regulatory interpretations through several administrations, attempted to police the problem by extending New Source standards to major modifications of existing plants; but this created a new regulatory battleground—over what kinds of maintenance, repair, and renovation should trigger New Source Review—which became increasingly complex and contentious over time. The Bush EPA's effort to permit more substantial renovations without review was arcane but significant: it was a case where command-and-control regulation, focused on industrial inputs rather than environmental outputs, was suppressing the natural progress of technological improvement which would otherwise have yielded greater environmental benefits. But the effort was easy to misrepresent as a weakening of environmental protection,[16] and eventually ran aground on internal tactical disagreements and missteps and a series of court decisions.[17] The effort, lasting nearly eight years, was abandoned in late 2008 and accomplished nothing.

Similarly, President Bush provoked considerable controversy for opposing the Kyoto Protocol on climate change and resisting efforts to regulate carbon dioxide and other greenhouse gas emissions domestically. But this was not the obdurate resistance to political consensus that his partisan opponents and the media portrayed it to be. The Senate had voted 95–0 against the Kyoto Protocol in 1997 during the Clinton Administration, and the notion of fabulously costly new U.S. regulatory measures—taken in the face of continuing unregulated emissions growth in China and India and consequent "economic leakage" to those nations—was no more attractive ten years later. Although Barack Obama, as candidate and President, supported an aggressive "cap-and-trade" program to reduce greenhouse gas emissions, the political and institutional obstacles to the program are immense and thoroughly bipartisan.[18] At the same time, the Bush Administration's legal opposition to EPA regulation of greenhouse gasses under the Clean Air Act (which would excuse the Congress from having to vote on the matter) was countermanded by the Supreme Court.[19] By the end of the second Bush term, the EPA was putting a greenhouse gas regulatory program in place.

Big-Government Conservatism

The big change in regulatory trajectory came not at the quotidian administrative level but rather through proposals for new legislation and, eventually, responses to external shocks. In the first instance, it reflected a calculated change in governing strategy, expressed in Bush's signature political slogan, "compassionate conservatism."

President Bush and his advisers believed that the Republican Party was on the cusp of achieving a long-term governing majority potentially as durable as the Democrats' New Deal majority had been. That majority could be sealed, they believed, by embracing spending and regulatory initiatives that were popular with politically important constituencies but that Republicans had traditionally opposed. More generally, they believed that traditional, limited-government conservatism, with its aversion to policy activism, had lost much of its cachet since the Reagan years and needed to be replaced with something more energetic and attuned to popular sentiments. In this view, a sustainable Republican Party required a modernized conservatism that was less squeamish about the exercise of power.[20]

In his first term, President Bush won passage of two of his leading election-campaign proposals, the "No Child Left Behind" (NCLB) school-reform program and the addition of a pharmaceutical drug benefit to the Medicare medical insurance program for older Americans.[21] Both initiatives were important departures from traditional Republican positions. NCLB nationalized control over important aspects of primary and secondary schooling, long considered the province of local and state government, and expanded the U.S. Department of Education, which the Republicans had proposed to abolish as recently as 1996. The Medicare drug benefit had a Republican antecedent: Ronald Reagan had championed and won a similar measure in 1988. But the Reagan version had been wildly unpopular, primarily because it was financed by new taxes on program recipients, and was repealed in 1989 after Reagan had left office.[22] The Bush version learned from this political catastrophe and was a big-government fiscal innovation: the first enactment of a new government entitlement with no new taxes to pay its costs.

Both programs were very costly. No Child Left Behind came in at about $10 billion per year, the Medicare drug benefit at about $40 billion, all of it financed by new borrowing. Both also required the construction of elaborate new regulatory programs. The NCLB statute, although regulating state and local school authorities rather than private industry, was structured very much like the Clean Air Act: it combined extreme regimentation (every primary and secondary student in the nation was to take standardized proficiency tests in reading and math every year), lofty but vague objectives (every school must make "adequate yearly progress" toward "universal proficiency" by 2014), and bureaucratic remedies for failure to meet the objectives ("supplemental education services," "corrective action," "restructuring plans"). It also contained special improved-performance requirements for certain categories of students ("major racial and ethnic subgroups," low-income students, special-needs students, non-college-bound students) and discrete programs or requirements for early literacy, teacher training, technology-in-the-classroom, parent involvement, constitutionally protected prayer, and much else. All of these matters needed to be made operational through Department of Education regulations, and the state and local school authorities' compliance with them monitored and enforced.[23] The Medicare drug program was less centralized than the established Medicare hospital and physician insurance programs—it operated through contracts with private insurance companies, who competed with each other and had some flexibility in their coverage features, which obviated the need for a federal drug formulary.[24] Nevertheless, the program imposed numerous coverage requirements on the private insurers and also provided them with large and complex subsidies, and therefore entailed substantial new regulation. Moreover, the new benefit generated strong political pressures for the introduction of pharmaceutical price controls, just as traditional Medicare had led to de facto price controls on covered hospital and physician services.[25]

Also in his first term, President Bush signed into law the McCain-Feingold Campaign Reform Act of 2002, which introduced sweeping new regulatory controls on campaign finance and political speech. He had not advocated the legislation during his presidential campaign—indeed he had opposed it, and his reversal was a particularly striking departure from limited-government conservatism. As a candidate and during his first year in office, Bush had expressed pointed, specific, well-founded constitutional objections to the bill then working its way through the Congress. But when the bill passed with all of the objectionable provisions intact, he signed it and said he would leave it to the courts to sort out the constitutional issues. He then instructed his Justice Department to advocate its constitutionality in court, which it did with success.[26]

Concurrently with these developments, the Republican leadership of the House of Representatives, following the resignation of Speaker Newt Gingrich at the end of 1998, pursued its own, more parochial majority-enhancement strategy—the use of targeted spending projects ("earmarks") to strengthen Republicans in closely competitive districts. The political strategies from the two ends of Pennsylvania Avenue, in tandem with other developments related below, yielded greater growth in domestic discretionary spending than under Bill Clinton or Lyndon B. Johnson.

Moralism in Politics

President Bush's departures from traditional conservatism were more than a matter of attempting to broaden the Republican political base and popular appeal. He was also a strong moralist—and political moralism translates to an expansive view of the mission of government (this was true, among American presidents, of the two conservative moralists, George W. Bush and Theodore Roosevelt, as well as the two liberal moralists, Woodrow Wilson and Jimmy Carter). Like all contemporary presidents, Bush preached and celebrated private morality from the presidential pulpit, regularly calling attention to exemplary deeds of average citizens. But the point here is a separate one. To an extraordinary degree, his official addresses and statements employed moral language to describe public issues, and moral appeals to advocate political choices, across the full range of domestic and foreign policies from the war on terror to energy conservation.[27] And his moralistic rhetoric was an authentic expression of his conception of political leadership, which was to treat policy issues as matters of right and wrong, good and evil, and ethical imperative. Indications of this mindset were the words he used to summarize his political philosophy—"compassionate conservatism" and "when someone hurts, government must act"; the absurd title of his school-reform program—No Child Left Behind, setting forth a romantic, intrinsically unachievable goal; his striking description of his executive role as "the decider"— much more detached and august than the usual conception of the chief executive who pragmatically navigates and adapts to a succession of events; and his impressive serenity in the face of his administration's increasing unpopularity during his second term.

He was, accordingly, relatively uninterested in institutional abstractions such as limited government and federalism, and impatient with economic calculation, trade-offs, and the balancing of costs and benefits in government policy and private behavior—all of which involve constraints on the pursuit of the good. His two Inaugural addresses and eight State of the Union addresses were profuse, detailed, and frequently eloquent in addressing matters of private and national character (duty, sacrifice, charity, tolerance, faith) and innumerable policies and campaigns he was proposing. At the same time, they said next to nothing about limited government, federalism, subsidiarity, overregulation, or the merits of private enterprise and free markets.[28] In the terminology of Max Weber, Bush was guided by "the ethics of conviction" rather than "the ethics of responsibility."[29] The modern formulation of Weber's position is the maximum that government policies should be judged by practical results (the ethic of responsibility) rather than good intentions (the ethic of conviction). George Bush would probably subscribe to that maxim in the abstract, but in practice he tended strongly to put conviction in the forefront.

This point should not be overstated. All successful politicians are pragmatists; President Bush was not indifferent to the consequences of his decisions, and he championed many economic policies whose benefits rested on material calculus. He was an adamant free trader and the first President to forthrightly champion Social Security reform. In his first term he won major reforms to reduce taxation of capital income[30] and correct abuses in civil litigation.[31] Even his Medicare drug benefit included an important economic reform: establishing a beachhead of private, competitively supplied insurance within the larger Medicare framework of noncompetitive, command-and-control government insurance.[32] And, in the much-debated instance of government funding for medical research involving embryonic stem cells, he established by personal direction a nuanced policy replete with ethical trade-offs.[33]

Yet he was strongly inclined to see presidential leadership and decision-making as matters of ethical categorizing, and this played an important role in his response to crisis. He turned out to be a highly energetic spender in response to developments that involved human suffering, even when these were far removed from any grand strategy to secure a Republican governing majority. Following Hurricane Katrina in August 2005, federal emergency-relief spending exceeded $120 billion, vastly higher than for any previous natural disaster. Foreign aid—one of the least popular categories of federal spending—more than doubled during his Administration, even without accounting for Iraq and Afghanistan.[34] His responses to the crises that punctuated his tenure were similarly extravagant when it came to new regulation.

Crisis and Response

The first crisis was the terrorist attacks of September 11, 2001. The attacks prompted (among a great many other things of course) elaborate new "homeland security" procedures and documentation requirements at airports and other transportation depots, along with tighter regulation of immigration and certain financial transactions. These measures accounted for most of the growth in regulatory-agency budgets during the Bush Administration,[35] and probably for most of the growth in (vastly larger) private compliance and opportunity costs. The programs would certainly have been instituted in some significant degree by any Administration of either party. Death by airplane crash is a matter of special dread to a great many people, and in the aftermath of the horrific 9/11 crashes the public was prepared to support security precautions costing many times (in dollars and inconvenience) what a standard cost/benefit analysis would justify. Nevertheless, the airport passenger boarding procedures—dubbed "security theater" by some observers and specialists—were dramatically over-centralized, rule-bound, intrusive, indiscriminate, and impervious to improvement with accumulated experience.[36] They went well beyond what any other nation had imposed even in the face of similar security risks (as in the case of Israel), and may well have set a new record for regulatory cost-ineffectiveness.

The second crisis was the corporate accounting frauds of 2001 and 2002—the exposure of fraud at Enron Corporation followed by bankruptcy and prosecution in late 2001, the exposure of fraud at WorldCom followed by bankruptcy and prosecution in mid-2002, and, in between and subsequently, substantial earnings restatements by several major corporations, often leading to federal and state legal action. In response, the Bush Administration energetically supported, and Congress promptly enacted, a sweeping expansion of federal authority over corporate governance (previously largely a matter of state law) and accounting—the Sarbanes-Oxley Act. In signing the Act in July 2002, the President said, "This law says to every dishonest corporate leader: you will be exposed and punished; the era of low standards and false profits is over; no boardroom in America is above or beyond the law." Sarbanes-Oxley did indeed penetrate every American boardroom, imposing intricate and costly procedures and audit requirements on corporate management for scant evident benefit, and significantly increasing the regulatory power and discretion of the Securities and Exchange Commission.[37] It also created a new regulatory agency, the Public Company Accounting Oversight Board, which set new standards for bureaucratic autonomy: it was vested with independent power to set and collect taxes, and its leadership was not even appointed or confirmed by the President or Congress. In the course of responding to the accounting frauds, the Justice Department employed criminal prosecution in unprecedented fashion to liquidate in its entirety one of the nation's most distinguished accounting firms, Arthur Anderson, for the document-retention violations of a few employees. The Supreme Court later unanimously reversed the conviction,[38] but by then the firm was irretrievably out of business and its 26,000 U.S. employees had been dismissed.

The third crisis was the sharp and sustained increases in energy prices beginning in 2004. In response, President Bush championed and won a series of new measures to subsidize alternatives to petroleum and regulate energy production and consumption. In his 2006 State of the Union Address, he defined the problem in stern accusatory terms: "America is addicted to oil, which is often imported from unstable parts of the world. The best way to break this addiction is through technology." In that address he proposed a variety of projects for funding research and development on biomass, solar, wind, and hydrogen fuels; a year later, in his 2007 State of the Union, he upped the ante with proposals for goals and timetables and new regulatory requirements for reducing energy use, increasing domestic oil production, and increasing the substitution of ethanol and other alternatives for petroleum. He also proposed substantial expansion of exploration and development of new domestic oil and gas development, but Congress largely rejected these ideas following contentious debate. The major enactment, the Energy Independence and Security Act of 2007, was all regulation: it set ambitious new requirements for increased use of ethanol in gasoline, tightened CAFE fuel economy standards for cars and trucks and efficiency standards for a wide variety of consumer appliances and industrial machinery, and established lighting standards to require the replacement of incandescent light bulbs with fluorescent bulbs. Ethanol subsidies and energy efficiency regulations are renowned among economists for their ineffectiveness and in some cases perversity.[39]

The major theme of the Administration's responses to these crises was action for its own sake—action as a demonstration of concern and responsiveness rather than action derived from an assessment of causes and estimate of policy effectiveness. The risk of airplane terrorism could have been reduced to nigh zero at enormously less cost; security did not require that every grandmother partially undress every time she boarded an airplane. The perpetrators of the accounting frauds were all ruined, not only by criminal prosecution and civil litigation under existing laws but by the bankruptcies of their firms, which also imposed heavy costs on their investors. That was strong deterrence, and it added nothing, and subtracted a great deal, to subject all public corporations to a new layer of national regulation that focused the attention of executives and directors on regulatory compliance rather than economic performance. The new energy regulations and ethanol subsidies promised—at best—trivial reductions in dependence on foreign oil; a stiff tax on energy use would have actually achieved the result the Administration and Congress said they were achieving with regulation and subsidies, but would have been highly unpopular because they would have produced the changes in consumption behavior that the regulations and subsidies did not. And the crises were "teachable moments" that were for the most part neglected—opportunities for public education on the nature of important problems and the federal government's appropriate and productive role in addressing them. For example, the "agency problem" in corporate governance is serious and difficult: executives in large public corporations have many opportunities to exploit investors, and there is a large body of professional and academic thinking on how best to address the problem through policy and other means. The corporate accounting scandals were conspicuous instances of the agency problem; beyond the prosecution of those responsible, they might have been an auspicious occasion for advancing serious reforms, such as removing regulatory barriers to competition for corporate control and to the acquisition of concentrated ownership shares in large corporations.

That a conservative Administration responded as it did to these crises served to dramatize the disappearance of conservative argumentation on regulatory policy. They were harbingers of what was to come in the Administration's final year.

IV. The Financial Crisis of 2008

The fourth crisis was the financial market collapse of 2008. The collapse brought many leading financial institutions to or past the brink of insolvency, transformed an economic recession into a sharp contraction that could properly be called a depression, and prompted a series of highly aggressive government interventions that will shape regulatory policy for decades to come.

The financial collapse had many deep causes, including excessively expansive monetary policies on the part of the Federal Reserve Board, excessive debt (and inadequate savings) on the part of households, and excessive leverage (and inadequate capital) on the part of financial institutions. The critical antecedent was a steep increase in housing prices from 2000 through late-2006 that in retrospect was a bubble—that is, an unsustainable price inflation based on speculation that prices would continue to rise. The housing bubble was accompanied by two developments that greatly magnified the impact of its eventual bursting. First, beginning in the 1990s, mortgage lending standards were substantially relaxed in order to provide mortgage loans to people of low income and poor (or no) credit histories. By 2007, more than 45 percent of U.S. mortgages—25 million loans totaling $1.2 trillion—were “subprime” or “Alt-A” mortgages, involving little documentation of mortgagors’ income or credit-worthiness, little or no down-payment (the traditional requirement had been that the home owner invest at least 20 percent of his own money), and very liberal payment terms. Second, innovations in the design and marketing of financial instruments made it possible to pool and “securitize” mortgages and sell them to investors many times removed from the mortgage bankers that originated them. Secondary mortgage markets had existed for many decades but became vastly larger and more reticulated in the 1990s and 2000s. “Mortgage-backed securities,” which combined “tranches” of numerous individual mortgages of various sizes, interest rates, geographic regions, credit ratings, and other characteristics, came to be an important component of the asset portfolios of many commercial and investment banks and pension funds and were actively traded in international markets. The market for mortgage-backed securities was supported by sophisticated mathematical risk-assessment models, strong ratings by credit-rating agencies, and “credit default swaps” through which institutions effectively insured each other against the risks of defaults on their securities.

These three developments powerfully reinforced each other during the 2000-2006 period of exciting growth in housing prices. Securitization brought substantial new capital into housing finance; the additional capital contributed to lower interest rates that made mortgages more affordable for people of modest means, and it was undemanding capital, relatively indifferent to the riskiness of individual mortgages because of the design and diversification of mortgage-backed securities. At the same time, the experience of rising prices, and the expectation that prices would continue to rise, contributed to the relaxation of lending standards: if a zero-down-payment mortgagor defaulted, the mortgagee (probably the remote owner of a mortgage-backed security of which the mortgage was part) would still be protected by the increasing value of the mortgaged property. These expectations were built into the risk models used by investors and by credit-rating agencies and in the pricing of default insurance; and in fact mortgage delinquency and foreclosure rates were very low as long as housing prices skyrocketed.

The reinforcements worked in the opposite direction when the bubble burst. The ascent of housing prices turned suddenly downward in late 2006 and then fell precipitously through 2007 and 2008—by some measures the national average declined by more than one-third during this period. Suddenly, millions of Americans found themselves with mortgage debts substantially greater than the market values of their homes, and those with little or no equity of their own in their homes had scant incentive to continue making mortgage payments. Delinquencies and foreclosures soared and, with housing prices declining rapidly with no bottom in sight, the mortgage-backed securities in the hands of thousands of remote investors suddenly became “toxic.” Their value was clearly much lower than anyone had supposed, but their real value was so uncertain that the cost of insuring them soared to prohibitive levels and they became unmarketable. That rendered them valueless in the immediate run under then-prevailing mark-to-market accounting rules, which in turn meant that the capital positions of the financial institution that owned them (or insured the values of those owned by others) had been impaired to a substantial but unknown degree.

In the world of old-fashioned mortgage finance, mortgages were limited to borrowers with a demonstrated capacity to service interest and principle payments, borrowers shared at least 20 percent of the risk of loss of value, and lenders possessed specific information about the circumstances of individual mortgages. In that world, the housing bubble would not have grown so large, even in the low-interest-rate, easy credit environment of the early 2000s. And, when it burst, the losses would have fallen on those with the incentives and immediate knowledge needed to make prompt adjustments: as in the bursting of the dot-com stock bubble of 2001, the economic pain would have been acute but contained. In the world of high-tech, low-accountability mortgage finance, the loss in value was rapidly transmitted to the wider economy, including the balance sheets of many major financial institutions, where the process of recovery was seriously impeded by uncertainties over the dimensions of the loss.[40]

In 2007 and 2008, plunging housing values and the unraveling of the mortgage-backed securities market produced a cascade of increasingly serious consequences in wider financial markets and eventually the "real economy." The declines revealed that several estimable investment banks had been operating at very high levels of leverage (the ratio of debt to equity)—too high, in light of what was now being learned about the riskiness of some of their investments. Following the bankruptcy of Lehman Brothers, a leading investment bank, in September 2008, even very-low-risk markets found themselves imperiled. Money market funds (widely used by business firms to raise short-term cash and households to hold safe, on-demand deposits) faced a near bank-run as withdrawals escalated and the ability of firms to sustain operating credit was jeopardized. Interbank overnight markets, a routine part of the bank settlement process, ceased operating for a time as banks became suspicious of leaving cash in other banks for even brief periods. Following the frightening events of September—including the Bush Administration's strenuous but shifting rescue efforts, which unsettled rather than reassured many investors—the stock markets themselves collapsed, falling 25-30 percent on various indexes during the last quarter of the year. As the crisis moved from finance to the real economy of commerce, consumer spending, and Main Street employment, the nation's three once-iconic automobile manufacturers, General Motors, Ford, and Chrysler, appeared close to bankruptcy. Along the way, a few Ponzi-type frauds came unraveled, including the spectacular Madoff fraud which itself involved losses of more than $10 billion.

The Bush Administration, in the person of Treasury Secretary Henry A. Paulson, and the Federal Reserve System, led by Chairman Ben Bernanke, responded with a series of increasingly forceful interventions. These included several market-wide policies, such as special Fed lending facilities intended to ensure the continuing availability of credit, and the extension of federal deposit insurance and other support to money market funds following the near-run of September 2008. But the dominant approach was case-by-case “bailouts”—the extension of massive loans and investments to troubled firms, and the organization of mergers by which healthy firms acquired troubled firms with government financial assistance. Among the most important of these transactions, undertaken from March 2008 to January 2009, were the following:[41]

- The arrangement and financing of the acquisition of two effectively bankrupt investment banks, Bear Sterns and Merrill Lynch, by two commercial banks, JPMorgan Chase and Bank of America respectively;
- The seizure of the two government-sponsored mortgage corporations, Fannie Mae and Freddie Mac, which were placed in conservatorship and provided with nearly $200 billion in initial government funding (through purchases of debt, preferred stock, and mortgage-backed securities) and prospective additional funding of at least that amount;
- The rescue of the insurance firm American International Group (AIG), whose investment arm had experienced massive losses, with an initial loan of $85 billion which soon swelled to $150 billion.
- The contentious enactment of the Troubled Asset Relief Program (TARP), appropriating $700 billion for the purchase of mortgage-backed securities and other “toxic” assets from financial institutions; followed by the Treasury’s announcement that the funds would instead be used mostly to purchase capital (preferred stock) rather than assets; followed by initial stock purchases from most leading commercial banks (including investment banks Goldman Sachs and Merrill Lynch, which converted to commercial banks in order to be eligible for federal assistance).
- The extension of TARP assistance to two non-financial firms, General Motors and Chrysler.

As a result of these and other measures, in the final year of the Bush Administration the Federal Reserve increased its balance sheet from about $800 billion to more than $2.2 trillion, the Treasury made additional commitments of several hundred billion dollars which were expected to grow to $1 trillion, and the federal government acquired controlling stakes in most of the nation's largest commercial and investment banks, one of its largest insurance companies, and two automobile manufacturers.

The crisis of 2008 provoked intense debate over its policy causes and implications. Campaigning for president in September, Barack Obama opined that the financial collapse was caused by "Republican deregulation," John McCain that the cause was "greed on Wall Street." These were mere political fillips: there had been no deregulation during the Bush Administration of financial markets or anything else, and greed is a constant of human nature and therefore cannot explain an extraordinary event. But a more substantial debate developed among economists and other experts. In general, liberals pointed to sins of regulatory omission and conservatives to sins of commission.

There had indeed been some (thoroughly bipartisan) deregulation of financial markets in previous decades, but efforts to connect those measures to the boom, bust, and collapse of 2002-2008 were unsuccessful. For example, one eminent commentator argued that when commercial banks were permitted to pay interest on deposits (following passage of the Monetary Control Act of 1980) so that they could compete with the rise of money market funds and other nonbank financial institutions, the banks were thereby obliged to seek higher profits to cover the costs of their new interest expenses, which led them to riskier investments.[42] That was an economic fallacy. Costs do not drive the pursuit of profit; put differently, firms attempt to increase their profits regardless of whether their costs are increasing.[43] Another deregulation suspect, offered by a leading economist, was the 1999 repeal of provisions of the Glass-Steagall Act, a New Deal statute that had prohibited commercial banks from affiliating with investment banks, insurance companies, and other nonbank financial firms.[44] But how the corporate integration of commercial banking and other financial forms contributed to the crisis was never explained; the subprime boom, and the growth of complex derivative instruments that spread its risks throughout the financial system, were accomplished almost entirely by contract among independent firms. Nor were any of 2008's most troubled firms integrated in this manner; Lehman Brothers, Bear Sterns, and Merrill

Lynch were stand-alone investment banks, and the government's rescues of the latter two involved merging them into commercial banks.

The other major banking deregulation measures had been the abolition of state usury laws (interest-rate ceilings on consumer loans) and restrictions on branch banking and interstate banking in the late 1970s and 1980s.[45] The repeal of usury laws paved the way for national mass-market credit cards, which led to increased consumer debt and reduced savings. Too much debt and too little savings were overarching components of the financial collapse, but the phenomenon had many causes, from government deficits to tax policies to excessive institutional leverage, far more important than credit cards. The evolution of a "bank" from a single building (solidly red brick or neoclassical) to an extended interstate network of storefronts and ATMs and computer websites made the banking system more efficiently interconnected—which in turn facilitated the spread of subprime mortgage risks throughout the banking system. But no one seriously suggested the re-abolition of interstate and branch banking; that would have been like proposing to curb the risks of influenza pandemics by reregulating the airlines, so as to suppress the reach and efficiency of air transportation.

Regulatory *omissions* were another matter: once the crisis had unfolded, one could identify government failures as well as market failures without which the crisis would not have occurred. Monday morning quarterbacking produced several reform ideas that gained wide assent among conservatives as well as liberals—the regulation of bank capital and leverage ratios should be strengthened and made more sophisticated, the private credit-rating agencies should be subject to greater competition and skepticism.[46] More problematic were the calls for expanded regulation—in particular, the idea that the relatively heavy government supervision of commercial banks (justified by the fact that bank deposits are government-insured and by the banks' role in the execution of monetary policy) should be extended to the less regulated nonbank financial system that had grown up since the late 1970s. In general, the commercial banks had joined the subprime-mortgage and mortgage-backed-security bandwagons with as much alacrity as less regulated institutions such as investment banks, and gotten into as much trouble as a result. And the least regulated institutions—such as money market funds (free of government deposit insurance and the regulation that came with it) and hedge funds (most of which had little or no debt and managed the funds of a limited number of investors)—had been largely innocent of the bandwagons and were victims of the eventual collapse along with everyone else.[47]

There was a serious circularity problem in saying that, because the commercial bank regulators had failed to recognize the excessive riskiness of mortgage-backed securities in time to avert the collapse, therefore regulation should be extended to other sorts of financial institutions. If the bank regulators had been asleep at the switch—perhaps "captured" by the institutions they were supposed to regulate, but in any event no more farsighted than most of the market participants had been—then why expect that they would do better at other institutions? But there was another problem that went far beyond logic or capture. The government had not only been part of the subprime herd—it had been leading the herd. Its sins of policy commission—its positive contributions to the financial collapse—had been immediate, central, powerful, and probably decisive.[48]

The federal government had long promoted homeownership through tax advantages; beginning in the early 1990s those policies had been augmented by concerted efforts to encourage homeownership among people of modest and low income (especially members of minority groups) who could not afford mortgages by traditional standards. Beginning in 1993, regulations under the Community Reinvestment Act required commercial banks to extend mortgage loans to those of lower income by the adoption of flexible underwriting standards; although the number of CRA mortgages was not large, the loosening of lending standards throughout the mortgage market—in particular the introduction of low- and zero-downpayment mortgages—clearly began with this regulatory mandate. Riskier mortgage practices were henceforth insisted upon by government bank examiners who would have questioned them sternly in the past, and once introduced they could not practically be limited to CRA applicants. The Bush Administration, in its efforts to promote "the ownership society," continued and expanded these Clinton-era initiatives through such measures as the American Dream Downpayment Act of 2003, which subsidized mortgage downpayments and closing costs; official endorsement of the zero-downpayment mortgages; and subsidization of high-risk mortgages by the Federal Home Loan Bank System and the Federal Housing Administration. As late as 2006, Congress passed legislation encouraging credit-rating agencies to relax their rating standards for subprime mortgage securities. Bank regulators and officials of the Department of Housing and Urban Development became enthusiastic backers of private sector subprime mortgage specialists such as Countrywide Financial and IndeMac Bank, who were among the first firms to collapse in 2008.

But the real impetus behind the subprime boom was the two giant quasi-governmental mortgage companies, Fannie Mae and Freddie Mac, which together account for more than half of the U.S. mortgage market. Although shareholder owned and nominally private, the firms could (before their seizure and conservatorship in 2008) borrow at near-Treasury rates because of the implicit government guarantee of their debt. And they enjoyed many explicit tax and regulatory advantages as well, such as very low capital standards. All of which made them extraordinarily profitable, and extraordinarily responsive to the Congress in order to maintain their special privileges. Beginning in 1992, Congress assigned Fannie and Freddie the mission of promoting affordable housing by making a friendly secondary mortgage market for people of lower income, enforced by progressively stricter requirements—by 2005, 55 percent of their mortgage purchases were those of "low and moderate income" borrowers and 25 percent were "low or very low income" borrowers. And after 2005, the firms had other reasons for promoting affordable housing—to maintain Congressional support following accounting scandals at both firms (coincident with the wider accounting scandals mentioned earlier). Fannie and Freddie became hyper-aggressive promoters of zero-downpayment, low-or-no documentation, and other means of relaxing mortgage standards. During the most frenzied years of the housing bubble, 2002-2006, they purchased $1.6 trillion in subprime and Alt-A mortgages—eventually purchasing over half of all such mortgages. By the time the housing market began its precipitous fall in 2007, nearly half of U.S. mortgages were subprime or Alt-A.

Here was the sine qua non. Through regulation, targeted subsidies, and aggressive market-making and direct purchasing in the secondary market, the federal government was the decisive factor in the explosive growth in high-risk, subprime mortgages—and it was these instruments of unsupported and unsustainable debt that transformed the housing bust of 2007-2008 into an economy-wide calamity. The deregulated, elaborately specialized and interconnected financial sector that had come into existence by those years accommodated and amplified the government policies zealously and made large profits in doing so. And it made what in retrospect were serious errors of risk assessment and pricing. But it is very difficult to imagine that, in the absence of the government regulation and underwriting, private market institutions would have embraced the subprime mortgage and promoted it with abandon to a central position in national finance. After all, modern financial institutions have a great deal of experience in the provision of consumer credit to individuals of modest means with little, no, or poor credit history, two examples being automobile financing and credit cards. Credit cards are particularly apropos because, like subprime mortgages, their credit is unsecured and their provision is capitalized by securitization in secondary markets and risk models that sometimes work and sometimes blunder. But credit card credit, although very substantial (currently nearly $1 trillion) and widely owned by institutions beyond regulated commercial banks, involves nothing like the degree of risk exposure that emerged in the subprime market in the years proceeding the collapse of 2008. The difference is the lack of overt government promotion and underwriting of risk. Predictions of a credit-card-induced financial disaster have been made many times and continue to this day.[49] It hasn't happened yet. Nor has it happened in any other financial market, no matter how supercharged with derivative instruments and insurance swaps and abstract quantitative models—with the sole exception of the mortgage market following the government's campaign for subprime lending.

Nevertheless, the financial meltdown and government response placed economic conservatives in an extremely difficult position. Regardless of the causes of the collapse, it appeared as a "failure of capitalism." Prominent financial institutions were insolvent, credit markets had ceased to function, the economy was in recession, unemployment was rising, and the government was bailing out banks and other institutions with taxpayers' dollars to keep the problems from getting worse. Those with the biggest megaphones—government officials, legislators, and the media—focused heavily on private-sector mistakes and excesses while ignoring the government's far more egregious mistakes and excesses. So public attention turned to such things as the compensation practices of banks and investment firms, which had handsomely rewarded young traders for packaging and marketing complex securities without regard to the securities' financial performance. Those practices were indeed objectionable and foolish, but they were sideshows to the larger story of the financial collapse.

The Bush Administration's (and Federal Reserve's) policy responses exacerbated the difficulties. In judging these responses, one must give ample allowance for the enormous uncertainties, political pressures, and felt necessities to "do something" that attend an economic crisis as serious and comples as the 2008 financial collapse. But even in this light, the responses included momentous missteps and missed opportunities. There are three simple rules for government response to a financial crisis, with long pedigrees in conservative (and wider) economic thinking and experience. First, provide ample credit—to ensure that insufficient liquidity does not deepen the crisis. Second, provide clear ex ante rules describing when the government will and will not step in to rescue firms from insolvency and withdrawal runs—to ensure that market participants understand the extent of public insurance of market operations against the mishaps of individual firms. Third, provide continuous, unvarnished information as the crisis unfolds—to assist market participants in the difficult task of repricing assets ("finding the bottom") as quickly as possible. The Bush-Fed response followed the first rule admirably, but, when it became clear that the essential problem was not illiquidity but widespread insolvency, violated the second and third rules repeatedly. Treasury and

Fed officials acted more like dealmakers that policymakers—saving Firm A with a massive capital infusion one day, then letting Firm B go bankrupt the next, then arranging for Firm C to be merged into Firm D on specified terms the next, all without any explanation, before the fact or after, of why the government was acting as it was or what it might do in the next case. And the dealmaking mentality extended to the provision of information: not only were the officials publically tight-lipped about the fundamentals of the transactions they had orchestrated and those they passed over, but they instructed the executives of the firms to keep mum as well. In this manner, the usual information mistake in financial crisis management, which is to delay the release of negative information because of distrust of the market, was augmented by the government's new role as de facto equity investor, which led it to delay the release of negative information to protect the value of its investments. The ad hoc, closed-door nature of the government's rescue measures served to increase market uncertainty and delay the revival of financial activity.

Throughout the most intense period of the crisis, September–December 2008, President Bush remained above the fray and left the decision-making to his Treasury secretary and the Fed chairman. Regarding the causes of the crisis and the government's rescue measures, he had little to say except that he wished to avert another Great Depression and looked forward to a return to private-market policies after the crisis was passed. As in the case of the accounting scandals six years earlier, an important moment for political leadership and public education was missed.

Two rescue measures were particularly unfortunate, both because they clouded popular understanding of the crisis and laid the groundwork for continuing government intervention and future crises. First, when the magnitude of the insolvency of Fannie and Freddie became apparent, the firms were placed in conservatorship, not receivership. That meant that the fabulous public bailouts of the firms (probably to exceed $400 billion) were to be a prelude not to liquidation after the mortgage crisis had passed, but rather to their resurrection as publically backed agents of mortgage expansion. Second, shortly after the TARP legislation was passed, Secretary Paulson announced that the $700 billion appropriation was to be used not to purchase the "toxic" assets of banks and other financial institutions, but rather to make direct investments in the firms themselves. That effectively gave the government controlling interest in many of the nation's most important financial institutions. A great dilemma in the management of financial crises is that government bailouts of troubled firms, undertaken to maintain the functioning of wider markets, creates "moral hazard" for the future: the demonstration of government backing in times of crisis undermines both prudent financial management and the effectiveness of safety-and-soundness regulation. Purchasing "toxic" assets at prices sufficient to revive the capital positions of the distressed firms would have created serious moral hazard for the future. But purchasing control of the firms themselves was moral hazard on steroids. The government would not only refinance the two established GSEs (government-sponsored enterprises), Fannie Mae and Freddie Mac, that had politicized mortgage finance to ruinous effect, but it would establish new GSEs in commercial banking, investment banking, and insurance, which like Fannie and Freddie would operate with special political protections but also special political obligations.

All involved, both in the Bush Administration and in the Obama Administration when it took charge in January 2009, vowed to return the rescued firms to private ownership as promptly as possible. But all of the political incentives ran in the opposite direction—and indeed the most prominent proposal for new financial regulation was precisely that the government select particular firms in each financial sector for special "systemic" supervision. As the Bush Administration came to a close, the prospect was for GSEs throughout American finance.[50]

V. Conservatism and Regulation—The Prospect

In the inauspicious circumstances described in the preceding pages, members of the deregulation wing of the conservative movement, and economic conservatives in general, would do well to double down with time-tested principles and methods. Our intellectual traditions have always been in tension with the natural propensities of the political world that we study and sometimes participate in. Yet our traditions have continued to grow and have developed their own structure and integrity. They have proven useful in understanding, explaining, and solving exigent problems; although they are now out of fashion, practical developments may summon them and demonstrate their utility once again. Some economic conservatives of more activist bent will stay in political arena, finding opportunities for small improvements as they adventitiously arise. But most will regroup in their think tanks, academic departments, journals, and fringe parties, where they will study what has transpired, construct new arguments, seek new alliances—maybe even propound a bracing new synthesis—and await the call of crisis or counter-revolution. The political wilderness can be liberating; the intellectual is first and foremost a critic, and the boldness of the interventionist ambitions of the Obama Administration and Democratic Congress may stimulate critical clarity.

The traditions of regulatory conservatism suggest three intellectual strategies for the new political environment.

The first is renewed emphasis on regulatory policies that are ineffective or perverse in achieving their formal purposes. A showing that regulations are very costly or flunk a cost/benefit test will be regarded as "good enough for government work" by many people in and out of the policy world. It is quite another thing to show that regulations are making problems positively worse. Such demonstrations have been politically effective in the past—for example, when it was shown that unregulated intrastate airline fares were lower than regulated interstate fares, and that FDA regulation was preventing the introduction of valuable pharmaceuticals widely in use in other nations. There are many such cases in current policy that are already proven or are plausible candidates for proof. These include the growing panoply of energy conservation and alternative-energy regulations (and subsidies) and the increasingly strict regulation of new pharmaceuticals and medical devices. They may come to include the imposition of pharmaceutical price controls (although the presentation of counterfactuals may be difficult—the U.S. market would be the last to succumb) and the increasing regulation of financial markets and corporate governance (provided that the efforts to “harmonize” such regulations at the international level are unsuccessful). The advantage of such arguments in the current political environment is that they are philosophy-free. They do not require adherence to distinctively conservative precepts concerning the value of property rights or efficacy of markets and consumer choice; they appeal directly to the all-American spirit of pragmatism.

The second strategy is to look for alliances with genuine liberals, as was done with great effect in the cases of airline and surface transportation deregulation. The Democratic Party now in power has evolved into a strongly statist party and instrument of special-interest protection. Yet there are many traditional liberals in the academic and intellectual worlds, and some in active politics, who take their egalitarianism, environmentalism, and other isms seriously. In the regulation of labor markets, education, and insurance, in civil litigation, and in the vast fields of state regulation and licensure, populist rhetoric is used to mask policies that enrich tightly organized groups by restricting the freedoms and opportunities of the less-well-connected and less-well-off. Environmental regulation has become so costly, and so encrusted with ineffective rules and endless litigation, that fundamental reform now promises large gains to all sides. Two examples of thoroughly cross-partisan reform efforts are Common Good, devoted to reforming civil litigation with special emphasis on medical care, schooling, and recreation,[51] and Breaking the Logjam, devoted to producing a new generation of environmental laws.[52] There are many more such opportunities. In regulatory policy, economic conservatives work in a small political tent but big intellectual tent.

The third strategy is to grind away on problems that, although they may not present conspicuous self-defeating consequences or immediate opportunities for intellectual alliances, are of fundamental importance in their own right. That importance may consist of their sheer costliness and harmfulness or to their relationship to critical features of private enterprise and limited government. Among the most important are ending the cartelization of communications markets through the FCC, devising more cost-effective methods of providing transportation security, and averting the threat of pharmaceutical price controls. But the top priorities are protecting the efficiency and competitiveness of financial markets in the aftermath of the collapse of 2009, and of international markets against the threats of protectionism and “policy harmonization.”

Financial markets are the heart of capitalism—they *are* capitalism, in the sense that they provide capital by market competition rather than political direction to projects whose economic value is yet to be realized. Because modern banking operates at fractional reserves and also serves as an arm of monetary policy, the case is very strong for safety-and-soundness regulation and obligatory insurance of some categories of assets. But financial markets are also vulnerable to harmful regulation and “politicization,” and the fact that they will already be regulated for good reasons increases this vulnerability. Exchanging money for future obligations whose money value is more-or-less uncertain involves an inherent, irreducible degree of uncertainty and speculation, and also raises the possibility of bubbles (there are no bubbles in goods except where, as in the case of homes, they also serve as financial vehicles). These circumstances mean that, when mistakes are made, financial markets are exposed to political second-guessing and reallocation of gains and losses, and to the imposition of supposedly corrective regulation that can succeed only where regulators are more prescient than market participants. Finally, even in advanced market economies, political officials are especially interested in the allocation of capital. They do a good deal of it in the course of customary government functions (as in the financing of roads, bridges, and national defense), and come to realize that participation in financial markets presents opportunities for pursuing political objectives outside the customary constraints of taxation and appropriation. The housing boom and bust, which took the entirety of the financial system down with it, is an instructive example of the “systemic risk” of rigging financial markets for redistributive ends. A worthy program of post-2008 financial regulatory reform would combine (a) sensible safety-and-soundness regulation and insurance against financial runs; (b) removal of regulatory impediments to competition in corporate control and in financial risk-assessment and price-discovery; (c) commitment to clear ex ante rules for government response to financial bubbles and busts and resolution of failed financial firms; and (d) development of transparent, on-budget substitutes for politicized finance such as Fannie Mae and Freddie Mac.[53]

Free trade was, until recently, a bipartisan, consensus issue in American politics. It has ceased to be so—because of the rise of China as an economic power, the resurgence of unions in domestic politics, and the severe economic downturn. But free trade remains a well-grounded consensus issue among economists, and it is a critical moment to deploy that consensus to counter protectionist temptations. Trade wars, like bank runs, are a special hazard during economic busts because they can greatly deepen and prolong the agony. And today there is an additional reason for protecting freedom in international markets: to preserve competition not just in goods and services but in government policy.

Globalization—the increasing mobility of capital, commerce, people, and ideas across national boundaries—constrains national governments by reducing their effective policy jurisdiction. One example, mentioned earlier and documented in recent research, is that relatively burdensome U.S. regulation of financial markets drives firms to relocate their businesses to overseas financial centers. In an earlier era, before the arrival of today's travel, communications, and information technologies, the geographic market for most financial activities was no larger, and often much smaller, than the territory of a single nation, especially that of a very large nation such as the United States. In that world, a U.S. regulator such as the Securities and Exchange Commission held a strong policy monopoly. If the SEC's rules were inordinately costly, regulated firms and their customers could adapt to them as best they could—but could not escape them altogether by (for firms) moving their operations in whole or part to friendlier jurisdictions or (for customers) taking their business to other firms operating from such jurisdictions. Today, many financial markets are effectively global and many firms have achieved international scale. In these circumstances, some firms will shift their operations to jurisdictions with more efficient regulatory regimes, and those that do not will lose business to firms in more efficient jurisdictions.

Government policies are hardly the only factors affecting a nation's relative commercial attractiveness. A nation such as the United States, which offers a large internal market, wealthy consumers, and laws that are relatively transparent and fairly enforced, can compensate for a multitude of policy sins. The policy effects of globalization are marginal, not molar. But three general tendencies are important. First, globalization increases policy competition among nation-states and reduces each state's monopoly power over its citizens. Second, the loss of monopoly power leads individual states to seek less burdensome policies. Third, the loss of monopoly, and therefore the tendency to seek less burdensome policies, will be most pronounced with regard to more mobile factors of production such as capital and information. Taxes on corporate income and capital-gains were previously very difficult to avoid (other than through the unattractive means of reducing income and asset values); they have recently become the subject of intense international competition and consequent reductions in tax rates. The FDA tried for a time to restrict the access of U.S. citizens to foreign websites that contained information on pharmaceuticals that went beyond officially approved U.S. uses; the effort was only partially successful, and the increased information will surely dampen the FDA's long-time enthusiasm for suppressing domestic information about drug efficacy.

Governments have devices of their own for forestalling the decline in their policy discretion. Individually, they can attempt to expand the extra-territorial reach of their policies; collectively, they can attempt to harmonize their policies—in effect forming policy cartels. They have been pursuing both strategies, especially in taxation, antitrust, and labor, environmental, and financial market regulation, and the financial crisis has prompted renewed efforts at creating a global financial regulator. So far these efforts have been less than successful, because of the immense coordination problems and increasing diversity of national economic interests. But policy harmonization efforts will continue with increasing intensity so long as efforts to subdue globalization through overt trade protectionism fail. There are certainly many cases, such as public health and climate change, where the nature of the problem requires a coordinated international response. But where harmonization aims to suppress competition in domestic policy-making, it should be strongly opposed.

The importance of international policy competition is particularly urgent in light of the decline in traditional conservative political values such as limited-government and spending and regulatory restraint. The vigor of American democracy has depended on a continuous tension between liberalism and conservatism. The liberal viewpoint is activist, comfortable with government power, and eager to reform society and launch new projects to address social ills and redress injustices. The conservative viewpoint is cautious, alert to the dangers and corruptions of power and the advantages of private ordering, and desirous of maintaining established arrangements and institutions. The liberal-conservative argument, as we have noted, has worked to the disadvantage of the full-blooded conservative vision over time. But it has presumably had some moderating effect on the growth of government and the enthusiasms of power, and some improving effect on the substance of individual policies. The worry today must be that the big-government activism of the Bush Administration, although a failure in immediate partisan terms, was not an episode but a trend. In the presidential primary elections of 2008, the Republican electorate's choices included a traditional economic conservative (Mitt Romney), a social conservative (Mike Huckabee), and a libertarian (Ron Paul). Its choice, John McCain, was a conservative moralist exactly in the Bush mold—an adherent of the ethics of conviction with a strong populist streak who saw even the most complex economic issues in terms of good people needing protection and bad people needing punishment.

If the wariness of government power has disappeared from our politics, then the natural constrains on power arising from international policy competition may be critical. Indeed we may speculate that growing intergovernmental policy competition could be a *cause* of the decline of limited-government values in domestic politics. The principle of limited government may have been appealing, in times when governments held much greater effective power over citizens than they do today, as a constitutional self-denying ordinance—an assurance that those in authority would exercise power with restraint and within generally accepted limits. Globalization may be a substitute for that principle. In a world where government power is being naturally eroded—and especially one where that power is minutely distributed among a multitude of specialized government bureaus, each one operating in a tiny ambit of the economy or society—it may be more realistic to conceive of government as a holding company for numerous small firms operating in competitive markets. Business firms do not talk about limits on their ambitions or seek to reassure investors or consumers that they do not intend to grow or to seek new markets; in general, they do just the opposite. U.S. governors, to take a closer analogy, are state boosters because they have to be. National governments that are feeling the competitive heat and sensing their effective power slipping away may behave increasingly in this manner. Bold political talk and anemic policy action may be the wave of the future.

Notes

[1] Christopher DeMuth, "What is Regulation?" in *What Role for Government?*, ed. Richard J. Zeckhauser and Derek Leebart, 262-278 (Duke University Press, 1983), www.chrisdemuth.com/id58.html.

[2] David Schoenbrod, *Power Without Responsibility: How Congress Abuses the People Through Delegation* (Yale University Press, 1995).

[3] Estimating the costs of government regulations to the private economy is problematic in the extreme, but the reigning guestimate that federal regulation imposes more than $1 trillion annually in compliance and transfer costs is certainly reasonable. The best recent discussion and compilation is W. Mark Crain, "The Impact of Regulatory Costs on Small Firms," U.S. Small Business Administration, September 2005, www.sba.gov/advo/research/rs264tot.pdf. Cf. 2008 Report to Congress on the Benefits and Costs of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities, U.S. Office of Management and Budget, 2008, www.whitehouse.gov/omb/assets/information_and_regulatory_affairs/2008_cb_final.pdf. The budgets of the federal regulatory agencies currently total about $50 billion. Veronique de Rugy and Melinda Warren, "Regulatory Agency Spending Reaches New Height: An Analysis of the U.S. Budget for Fiscal Years 2008 and 2009," Mercatus Center, George Washington University, and Weidenbaum Center, Washington University St. Louis, August 2008, www.mercatus.org/uploadedFiles/Mercatus/Publications/1-regulatoryagency20080807_wc-regulators_budget_09.pdf.

[4] Robert W. Hahn and Robert E. Litan, "An Analysis of the Tenth Government Report on the Costs and Benefits of Federal Regulations," Regulatory Analysis 07-02, AEI Center for Regulatory and Market Studies, June 2007, www.reg-markets.org/publications/abstract.php?pid=1197.

[5] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press, 1965, 1971); *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (Yale University Press, 1982); George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 2, no. 1 (1971): 3-21; Richard A. Posner, "Theories of Economic Regulation," *Bell Journal of Economics and Management Science* 5, no. 2 (1974): 335-358.

[6] Bryan Caplan, *The Myth of the Rational Voter: Why Democracies Choose Bad Policies* (Princeton University Press, 2008); Bryan Caplan, "Special-Interest Secret," *The Wall Street Journal*, May 12, 2007; David Romer, "Misconceptions and Political Outcomes," *The Economic Journal* 113 (January 2003): 1–20, http://elsa.berkeley.edu/~dromer/papers/EJ_January03.pdf.

[7] Sam Peltzman, *Regulation and the Natural Progress of Opulence*, AEI-Brookings Joint Center for Regulatory Studies, September 2004, http://aei-brookings.org/admin/authorpdfs/redirect-safely.php?fname=../pdffiles/phpUS.pdf.

[8] Christopher DeMuth, "Regulatory Policy in the Reagan Administration," in *American Economic Policy in the 1980s*, ed. Martin Feldstein (University of Chicago Press, 1993), www.chrisdemuth.com/id52.html.

[9] Peter Huber, *Law and Disorder in Cyberspace: Abolish the FCC and Let Common Law Rule the Telecosm* (Oxford University Press, 1997); Jack Shafer, "New Wave: The Case for Killing the FCC and Selling Off Spectrum," *Slate*, January 12, 2007, www.slate.com/id/2157734.

[10] Christopher DeMuth, "Guns, Butter, and the War on Terror," *The American Enterprise*, June 2004, http://chrisdemuth.tripod.com/sitebuildercontent/sitebuilderfiles/gunsbutter.pdf; Robert Higgs, *Crisis and Leviathan* (Oxford University Press, 1987).

[11] See the articles by John D. Graham, Cary Coglianese, Jerry Mashaw, Roger Noll, and others in a symposium on Bush Executive Order 13,422 in the 25 *Yale Journal on Regulation* 1 (January 2008). See also Stuart Shapiro, "Presidents and Process: A Comparison of the Regulatory Process under the Clinton and Bush (43) Administrations," AEI-Brookings Joint Center for Regulatory Studies, October 2006, http://aei-brookings.org/admin/authorpdfs/redirect-safely.php?fname=../pdffiles/RP06-30_topost.pdf.

[12] OMB 2008 Report to Congress, *id.* no. 3; [comparative numbers forthcoming].

[13] Cesar V. Conda and Lawrence J. Spiwak, "Kevin Martin's Record of Success**,**" *The Washington Times,* January 22, 2009, www.washingtontimes.com/news/2009/jan/22/kevin-martins-record-of-success.

[14] See *Innovations in Compassion: The Faith-Based and Community Initiative*, The White House, December 2008, 30-34, http://georgewbush-whitehouse.archives.gov/government/fbci/pdf/innovation-in-compassion.pdf; and Melissa Rogers and E.J. Dionne Jr., *Serving People in Need, Safeguarding Religious Freedom: Recommendations for the New Administration on Partnerships with Faith-Based Organizations*, The Brookings Institution (December 2008), 22-26, www.brookings.edu/~/media/Files/rc/papers/2008/12_religion_dionne/12_religion_dionne.pdf.

[15] "Obama Announces White House Office of Faith-based and Neighborhood Partnerships," The White House, February 5, 2009, www.whitehouse.gov/the_press_office/ObamaAnnouncesWhiteHouseOfficeofFaith-basedandNeighborhoodPartnerships.

[16] For an egregious example see Bruce Barcott, "Changing All the Rules," *New York Times Sunday Magazine*, April 4, 2004.

[17] The most important being *New York vs. Environmental Protection Agency,* U.S. Court of Appeals for the District of Columbia Circuit, March 17, 2006, http://news.findlaw.com/nytimes/docs/epa/nyepa31706opn.pdf.

[18] Robert W. Hahn, "Climate Policy: Separating Fact from Fantasy," Working Paper 8-22, AEI Center for Regulatory and Market Studies (November 2008), www.reg-markets.org/publications/abstract.php?pid=1296.

[19] *Massachusetts vs. Environmental Protection Agency,* 549 U. S. ____ (2007) (April 2, 2007).

[20] See Sidney M. Milkis and Jesse H. Rhodes, "George W. Bush, the Party System, and American Federalism," *Publius* 37, no. 3 (2007): 478-504; and Tim Conlon and John Dinan, "Federalism, the Bush Administration, and the Transformation of American Conservatism," *Publius* 37, no. 3 (2007): 279-303.

[21] President Bush's election platform had three additional domestic policy planks: tax reduction, which succeeded in legislation enacted in 2001 and 2003, and immigration reform and Social Security reform, both of which failed despite energetic efforts. None of these was "big-government conservatism" and only one was a departure from established Republican precepts—the proposal to provide illegal immigrants with a path towards legal resident status and eventual citizenship. That proposal was the only one of this group with direct regulatory implications: it would have eventually eliminated the requirements that employers police their workforces for the presence of illegal immigrants.

[22] Thomas Rice, Katherine Desmond, and Jon Gabel, "The Medicare Catastrophic Coverage Act: A Post-Mortem," *Health Affairs* (Fall 1990): 75-87, http://content.healthaffairs.org/cgi/reprint/9/3/75.pdf.

[23] See the papers collected in Frederick M. Hess and Chester E. Finn Jr., eds., *No Remedy Left Behind: Lessons from a Half-Decade of NCLB* (The AEI Press, 2007), and Gail L. Sunderman, ed., *Holding NCLB Accountable: Achieving Accountability, Equity, & School Reform* (Corwin Press, 2007).

[24] Joseph Antos, "Ensuring Access to Affordable Drug Coverage in Medicare," AEI Working Paper No. 118, American Enterprise Institute for Public Policy Research (December 6, 2005), www.aei.org/publication23518.

[25] Mark McClellan et al., "Medicare Part D and Prescription Drug Prices," AEI Policy Fact Sheet, American Enterprise Institute for Public Policy Research, January 5, 2007, www.aei.org/publication25420.

[26] As recounted in Christopher DeMuth, "Unlimited Government," *The American Enterprise*, January/February 2006, www.chrisdemuth.com/id120.html.

[27] As documented by Colleen J. Shogan **in** *The Moral Rhetoric of American Presidents* (Texas A&M University Press, 2006).

[28] I find fewer than ten references to limited government, federalism, private enterprise, or regulation in President Bush's Inaugural and State of the Union addresses—all of them brief, formulaic, and qualified. Here are representative passages on each of the four subjects: "Government should be active but limited, engaged but not overbearing" (2001 State of the Union); "We should not, and we will not, run public schools from Washington, DC. Yet when the Federal Government spends tax dollars, we must insist on results" (2001 State of the Union); "We will work for free markets, free trade, and freedom from oppression" (2001 State of the Union); "We must free small businesses from needless regulation and protect honest job-creators from junk lawsuits" (2005 State of the Union).

[29] Max Weber, "Politics as a Vocation," *The Vocation Lectures* (Hackett Publishing, 2004), 32-95. Weber's "ethics of conviction" is sometimes rendered as "ethics of ultimate ends." "Conviction" is the closer translation of Weber's *gesinnungsethik*, but "ultimate ends" captures an additional strand of his argument: because government policies rest ultimately on the application of force and violence, and because the politician makes and executes policies on behalf of citizens whose ends, moral and other, differ and often conflict, the responsible politician cannot be content with identifying an ultimate good but must compromise and balance goods and bads. The ethics of conviction means that ". . . if an action performed out of pure conviction has evil consequences, then the responsibility must lie not with the agent but with the world, the stupidity of men—or the will of God who created then thus. With the ethics of responsibility, on the other hand, a man reckons with exactly those average human failings. . . . Whoever makes a pact with the use of force, for whatever ends (and every politician does so), is at the mercy of its particular consequences." Id. at 84, 89.

[30] On this and other Bush tax reforms see Alan D. Viard, ed., *Tax Policy: Lessons from the 2000s* (The AEI Press, 2009), www.aei.org/book975.

[31] See Ted Frank, "The Class Action Fairness Act Two Years Later," *AEI Liability Outlook*, March 2007, www.aei.org/publication25851.

[32] See Kimberley A. Strassel, "Competence Man: The Dr. McClellan Medicare cure," *The Wall Street Journal*, April 20, 2007, www.opinionjournal.com/columnists/kstrasselpw/?id=110009964.

[33] See "President Discusses Stem Cell Research," The White House, August 9, 2001, http://georgewbush-whitehouse.archives.gov/news/releases/2001/08/20010809-2.html; and *Advancing Stem Cell Science*

Without Destroying Human Life, The White House (April, 2007), http://georgewbush-whitehouse.archives.gov/dpc/stemcell/2007/index.html.

[34] President Bush's longtime speechwriter and policy adviser, Michael J. Gerson, in his book *Heroic Conservatism* (HarperOne, 2007), makes the case for big government conservatism on both ethical and political grounds, but even the political arguments are strongly moralistic, even Biblical, in tenor: "My party . . . must carry this message of idealism and courage to a tired nation in a pivotal moment or face a severe judgment of history."

[35] See de Rugy and Warren, *Id.,* 5.

[36] See Jamie Belcore and Jerry Ellis, "Homeland Security and Regulatory Analysis: Are We Safe Yet?", Working Paper No. 08-13, Mercatus Center, George Mason University (June 2008), www.mercatus.org/uploadedFiles/Mercatus/Publications/WP0813_RSP_Homeland Security and Regulatory Analysis.pdf; Jeffrey Goldberg, "The Things He Carried," *The Atlantic*, November 2008, www.theatlantic.com/doc/200811/airport-security; Robert Poole, "Airport Security: Time for a New Model," Reason Foundation, January 1, 2006, www.reason.org/news/show/127389.html; and any issue of Poole's "Airport Policy and Security Newsletter," www.reason.org/areas/topic/313.html.

[37] See Henry N. Butler and Larry E. Ribstein, *The Sarbanes-Oxley Debacle: What We've Learned, How to Fix It* (The AEI Press, 2006); Roberta Romano, "The Sarbanes-Oxley Act and the Making of Quack Corporate Governance," 114 *Yale Law Journal* 1521 (2005); papers presented and discussed at "Is Sarbanes-Oxley Impairing Corporate Risk-Taking?", Seminar, American Enterprise Institute, June 18, 2007, www.aei.org/event1534; Alex Pollock, "Has Sarbanes-Oxley Harmed Entrepreneurs, Speech, Hudson Institute, May 24, 2007, www.aei.org/publication26375; and Peter J. Wallison, "Sarbanes-Oxley As an Inside-the-Beltway Phenomenon," *AEI Financial Services Outlook*, May 2004, www.aei.org/publication20582. www.aei.org/publications/pubID.19123/pub_detail.asp.

[38] *Arthur Andersen LLP vs. United States*, 544 U. S. 696 (2005).

[39] See Pietro S. Nivola and Robert W. Crandall, *The Extra Mile: Rethinking Energy Policy for Automotive Transportation* (The Brookings Institution, 1995); Pietro Nivola, *The Long and Winding Road: Automotive Fuel Economy and American Politics*, Brookings Governance Studies, February 25, 2009, www.brookings.edu/~/media/Files/rc/papers/2009/0225_cafe_nivola/0225_cafe_nivola.pdf; Sam Kazman, "Automobile Fuel Economy Standards," Competitive Enterprise Institute (2008), http://cei.org/cei_files/fm/active/0/EnvironmentalSource_EnergyAuto.pdf;
Robert Crandall and Hal J. Singer, *Don't Drink the CAFE Kool-Aid*, AEI-Brookings Joint Center for Regulatory Studies, Publication 07-24 (September 2007), http://www.reg-markets.org/policy/page.php?id=297&PHPSESSID=2e3fd8046d998889d5bbc045ab15e6a9; Andrew Kleit, *CAFE Adieu*, AEI-Brookings Joint Center for Regulatory Studies, Publication 04-14 (July 2004), http://aei-brookings.org/admin/authorpdfs/redirect-safely.php?fname=../pdffiles/phpsO.pdf, and papers cited therein; Kenneth Green, *Ethanol and the Environment*, American Enterprise Institute *Environmental Policy Outlook* (July 29, 2008), http://www.aei.org/publications/pubID.28396/pub_detail.asp;
Pietro S. Nivola and Robert W. Crandall, *The Extra Mile: Rethinking Energy Policy for Automotive Transportation* (Brookings Institution Press, 2002).

[40] Of the many accounts to date of the causes and implications of the 2008 financial crisis, I can recommend John B. Taylor, *Getting Off Track: How Government Actions and Interventions Caused, Prolonged and Worsened the Financial* Crisis (Hoover Press, 2009), briefly summarized in "How Government Created the Financial Crisis," *The Wall Street* Journal, February 9, 2009, http://online.wsj.com/article/SB123414310280561945.html#mod=todays_us_opinion; Richard A. Posner,

A Failure of Capitalism: The Crisis of '08 and the Descent into Depression (Harvard University Press, 2009); Niall Ferguson, *The Ascent of* Money (Penguin Press, 2008), ch. 5; Allan H. Meltzer, "Epilogue: The United States in the Global Financial Crisis of 2007-2009," in *A History of the Federal Reserve: Volume II* (University of Chicago Press, forthcoming 2009); Steven Gjerstad and Vernon L. Smith, "From Bubble to Depression?" *The Wall Street Journal*, April 6, 2009, http://online.wsj.com/article/SB123897612802791281.html#mod=todays_us_opinion; Peter J. Wallison, "Cause and Effect: Government Policies and the Financial Crisis," *AEI Financial Services Outlook*, November 2008, www.aei.org/publication29015; Jerry Z. Muller, "Our Epistemological Depression," *The American*, January 29, 2009, http://www.american.com/archive/2009/our-epistemological-depression/?searchterm=Jerry%20Z.; Alex J. Pollock, "The Human Foundations of Financial Risk," *AEI Financial Services Outlook,* May 2008, www.aei.org/publication27982.

[41] For an exhaustive chronological account, updated regularly and with links to source materials for each event, see, Federal Reserve Bank of St. Louis, "The Financial Crisis: A Timeline of Events and Policy Actions," http://timeline.stlouisfed.org/pdf/CrisisTimeline.pdf.

[42] See Posner, *supra* note 40, at pp. 22-23. 45, 130-131.

[43] For some empirical evidence on the point, see George J. Benston, "Interest Payments on Demand Deposits and Bank Investment," *The Journal of Political Economy*, Vol. 72, No. 5 (October, 1964), pp. 431-449, http://www.jstor.org/stable/1828478. *Cf*., R. Alton Gilbert, "Requiem for Regulation Q: What It Did and Why It Passed Away," Federal Reserve Bank of St. Louis, February 1986, http://research.stlouisfed.org/publications/review/86/02/Requiem_Feb1986.pdf.

[44] See Joseph E. Stiglitz, "Capitalist Fools," *Vanity Fair*, January 2009, www.vanityfair.com/magazine/2009/01/stiglitz200901.

[45] Although these restrictions and their eventual removal had been largely matters of state law, federal law played a part, and the decontrol of interstate and branch banking was sealed by the national Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. On the repeal of state usury laws, see Christopher DeMuth, "The Case Against Credit Card Interest Rate Regulation," *Yale Journal on Regulation*, Vol. 3, No. 2 (April 1986), p. 201, www.chrisdemuth.com/id69.html.

[46] See Charles W. Calomiris, "Prudential Bank Regulation: What's Broke and How to Fix It," in Terry Anderson, et al., *Reacting to the Spending Spree: Policy Changes We **Can** Afford* (Hoover Institution Press, 2009), http://media.hoover.org/documents/PRTF-02-calomiris.pdf.

[47] See Peter J. Wallison, "Healthy Hedge Funds, Sick Banks," *AEI Financial Services Outlook*, February 2008, www.aei.org/outlook/27558.

[48] This following paragraphs draw heavily on Peter J. Wallison, "Cause and Effect," and references cited therein, and Allan H. Meltzer, "Epilogue," *supra* note 40. See also Phil Gramm, Allan H. Meltzer, et al., "Is Deregulation a Cause of the Financial Crisis?" AEI Seminar, January 23, 2009, American Enterprise Institute for Public Policy Research, www.aei.org/event1862; Phil Gramm, "Deregulation and the Financial Panic," *The Wall Street Journal,* February 20, 2009, http://online.wsj.com/article/SB123509667125829243.html; and Thomas Sowell, *The Housing Boom and Bust* (Basic Books, 2009).

[49] E.g., Jessica Silver-Greenberg, "The Next Meltdown: Credit-Card Debt," *Business Week*, October 9, 2008, www.businessweek.com/magazine/content/08_42/b4104024799703.htm.

[50] See Peter J. Wallison, "Reinventing GSEs: Treasury's Plan for Financial Restructuring," *AEI Financial Services Outlook,"* March/April 2009, www.aei.org/outlook/100027.

[51] The Common Good website is http://commongood.org. Cf. Philip K. Howard, *Life Without Lawyers* (Norton, 2009).

[52] Breaking the Logjam is a project of the New York University School of Law and New York Law School. Its website is www.breakingthelogjam.org.

[53] On the last proposition see Edward L. Glaeser and Joseph Gyourko, *Rethinking Federal Housing Policy: How to Make Housing Plentiful and* Affordable (AEI Press 2008).