2012

Law in the Hands of the Politicians: The Cycles of American Politics

Richard A. Epstein

Follow this and additional works at: http://chicagounbound.uchicago.edu/journal_articles

Part of the Law Commons

Recommended Citation

LAW IN THE HANDS OF THE POLITICIANS*

The Cycles of American Politics

RICHARD A. EPSTEIN*

Classical Liberal versus Progressive

It is a very great honor for me to address all the distinguished guests from journalism, banking, law, and other professions who have come to attend this lecture. I should like to thank the students sitting in the gallery, many of whom have heard me speak three or four times previously. I regard their appearance on this occasion as a tribute to their endurance, and not necessarily to their judgment.

The designated title of this talk is Law in the Hands of Politicians. Josef Sima hinted to me that I might want to talk about the various activities of the Obama administration, but I have decided to leave that topic to the last part of the talk. On this occasion, I think that it is more important to offer some sense of the historical sweep of how law works and how it fails, when its formulation is consigned, without serious constitutional limitations, to the hands of politicians. I shall undertake this task with reference to American politics, not with reference to the local situations in the Czech Republic, with which I have at most only a passing familiarity. I shall proceed at a fairly high level of generality in order to cover close to a hundred years of political evolution in forty five minutes, which essentially leaves me just under two minutes for a year. Given these constraints, I ask you to forgive me for the occasional sin of superficiality.

Now, to approach this daunting task at a general level is to isolate a single fundamental conflict that helps organize the entire field. The conflict that occupies my thought over the last five to ten years—the conflict between progressivism and classical liberalism—is playing itself out quite dramatically in the modern American context, but its roots go back certainly to at least 1913, when Woodrow Wilson became the president of the United States. Wilson, you may not know, was a political theorist of no little influence in the decades before he became a governor of New Jersey between 1911 and 1913 and President of the United States between 1913 and 1921. In his earlier academic role at Princeton University, where he served both as professor and university president, he was in fact one of the great defenders of the modern progressive state, as against its classical liberal alternative, having written two important monographs on the topic, Congression als Government: A Study in American Politics in 1885, and Constitutional Government in the United States in 1908, in which he argued strongly against the American constitutional design with its system of divided government. My own intellectual orientation strongly resists any effort, Wilson's included, to create a more unified system of government.

The classical liberal position for these purposes contains a couple of key elements, which I shall mention briefly in order to set the stage for the subsequent evolution of American constitutionalism. Most critically, it sets its presumption against the wisdom of state intervention at a global level, and therefore embraces at the federal level the twin doctrines of separation of powers on the one hand and checks and balances on the other. It also embraces the notion that federal powers should be few and determinate, leaving many issues to the internal governance of the states. It reaches to this position because it accepts the view that on average, new laws are unlikely to generate any kind of a social improvement. Indeed, the more laws we have, the less likely it is that a randomly selected new law will do any good. The rules of diminishing marginal utility to effort apply to legislation as they do to anything else.

The first battle between classical liberals and progressives concern their opposite views on the presumptive desirability of government action. Progressives believe that the nation contains a class of individuals whose scientific expertise insulates them from the petty influences of daily politics, so that the nation can wisely entrust them with vast amounts of administrative discretion. Far from thinking of separation of powers as a political virtue, they tend to regard it as a chronic nuisance which prevents the much needed consolidation of power in the hands of administrative experts who can use their scientific wisdom to make inroads into our major social problems. In my view, no one is immune from political temptations, least of all those experts who turn out to harbor strong political views after all. Trusted with power, they cannot make good on the claim of dispassionate scientific enquiry. Clearly, the Progressives are comfortable with a far larger state than the classical liberals.

The second battle has to do with the organization of different types of government power. A classical liberal treads cautiously in developing systems of taxation, systems of eminent domain, systems of regulation, and systems of infrastructure formation and maintenance. As we see it, the central question asks how expansive are the administrative power that any nation should confer on government agencies. All governments have to enjoy some monopoly power to maintain order. The challenge is how to erect a set of competitive institutions on a structure on top those state-run monopolies. Competition unleashes a set of creative forces that no government initiatives can hope to match. The challenge is to make sure that the state powers needed to protect the competitive system from its private enemies do not become the com-

* Prague Spring Lecture of the Liberalni Institut, delivered on March 18, 2010 in Prague, Czech Republic. Published with permission of the Liberalni Institut and the CEWEK Institut.

A I wish to thank Isaac Gruber of the University of Chicago, Class of 2012, for his usual valuable research assistance.
petitive system's greatest nemesis. It is characteristic for governments to like order, which is always easier to regulate than chaos and confusion. But the dynamism in markets rests in just that chaotic environment in which large numbers of individuals engage in businesses that do not, either in fact or appearance, conform to any central plan. Yet when the pieces sort themselves out, the resulting advances are far greater than any of those which a government could create on its own.

By way of simple example, it is far better to have a patent system that allows private individuals to register and protect their inventions than to have one in which government agents determine through national grants, pursuant to some industrial policy, which new ventures shall receive financial support from government and which shall be left by the wayside. Cognizant of these difficulties with state power, the classical liberal opts for small government, in which businesses rise and fall, come and go, succeed and fail. The classical liberal embraces bankruptcy as a sign of the system's health, even though it may be a personal tragedy. It is far too costly to empower large government agencies to create state monopolies which, in virtue of their public origin, become impervious to the forces of change.

The progressives in fact hold exactly the opposite view on this subject. Hand in hand with the strong administrative state, they tend to favor various kinds of systems which will create either private monopolies or private cartels. They fear disorder and they tend to be very hostile to entry by new groups, because they know that these new economic forces can upset the political domination of the organs of the administrative state that they control.

These two clashing views are often in equipoise. In the United States, we have had three major cycles of progressivism and classical liberalism over the last hundred years. Generally, the cycles take this form: in the initial stage, the progressives push hard with their grand agenda, and made substantial headway in intellectual, political and constitutional discourse. Next, the classical liberals (or, more accurately, conservative groups) return to power and are able to undo some, but not all, of the previous cycle's progressive innovations. Some major exogenous event then returns the Progressives to power, and the cycle starts anew. In the United States, the history ran as follows. The Progressive innovations of the Wilson administration are followed by the Republican contraction in the 1920s. The New Deal ushers in a new wave of government regulation, which meets opposition by the Republican control right after World War II. The Johnson administration introduces another wave of regulation in the 1960s, which is met by the Reagan reaction of the 1980s. The start of the fourth cycle is the Obama election of 2008 which introduced major initiatives in health care and financial reform, and have sparked a Republican reaction in 2010, whose significance cannot yet be measured. Let us look at each of these cycles.

Progressivism, Round 1: 1910-1920
The theoretical views of Woodrow Wilson were put to a practical test when Wilson was elected Governor of New Jersey. There his major achievement was to impose a stringent set of regulations on the corporations, most of which had at that time their headquarters in New Jersey. The consequence of his initiative was that these corporations marched in droves across the river to Delaware, where they found a more favorable regulatory climate to set up shop, and where, after reincorporation, they still remain until this day. Wilson should have learned from this episode that excessive regulation invites the exit from regulated parties, but he remained undeterred in his convictions after he became President.

I cannot talk about all of his initiatives that were put into place before World War I intervened, but the list is impressive: the creation of the Federal Reserve System, the Federal Trade Commission, the progressive income tax under the Revenue Act of 1913, the Federal Farm Loan Act, and the Clayton Antitrust Act of 1914. This last statute was devoted to increasing the enforcement of the antitrust against monopolies, chiefly by attacking mergers that might threaten competition, which is a hazardous endeavor at best. The most conspicuous feature of the Clayton Act is one sense were Section 6 and Section 20, which essentially exempted from the antitrust laws all agricultural organizations and all labor organizations. Its effect was to allow the formation of agricultural cartels free of federal interference, and to facilitate the formation of labor unions with the real force of market power, also free of federal interference.

The effects of this initiative were socially undesirable. An overwhelming intellectual consensus shows supports the view that monopolies raise prices, reduce entry and reduce overall consumer welfare. The antitrust laws, as a way to counter monopoly power, is a perfectly sensible form of intervention in labor markets, where unionization can pose those exact threats. It was a threat, for example, that Adam Smith well understood when he talked about the dangers of contracts in restraint to trade, by tending towards monopoly.

Retrenchment Round One: 1920-1930
The force of the progressive initiatives was blunted by World War I, which directed our attention overseas. There is no question that when Warren Harding and Calvin Coolidge became president, there were few new initiatives in labor regulation that increased the power of the state, with the notable exception of the Railway Labor Act of 1926, which did much to freeze labor union dominance of the railroads. The effects of the RLA included featherbedding—the most famous example being the requirement to keep firemen onboard trains to shovel coal even after the well-nigh universal adoption of diesel engines—were not undone until many years later, and then only at a very high price. So it is not as though we undid most of happened in the progressive era; rather, the nation did not do much to expand its scope much further. At that point, new forms of technology and industrial organization tended to erode slowly the control that government regulation can exert over the larger economy.

Hoover and Roosevelt, The Odd Couple 1930-1945 In 1929, Herbert Hoover became president of the United States. He was a man of impeccable public credentials who had served in the Harding and Coolidge cabinets after a distinguished career in private business and government service, both during and in the aftermath of World War I. He, more than any other person, was responsible for staving off mass starvation in Western Europe at the end of World War I. In light of his failed presidency, however, few people today remember him for these major achievements early on in his career. Hoover was in fact a progressive Republican who had been mentioned as a possible Democratic presidential nominee before the 1920 election of Harding, a Republican. Franklin Roosevelt (who ran as Vice President on the 1920 Democratic ticket) ran on a explicit New Deal program that embraced much
of the progressive agenda as developed in the first three decades of the 20th Century.

The conventional wisdom in both the United States and elsewhere is that Hoover and Roosevelt ran quite different presidencies. The obvious point of separation was that Hoover was a Republican and that Roosevelt was a Democrat, such that the New Deal really began somewhere in 1933 when Roosevelt took over after Hoover had bollixed everything up during the previous four years. Part of that conventional wisdom is indeed true; Hoover did bollix up just about every major policy issue he faced as President. Indeed, as a senior fellow of the Hoover Institution, which Hoover with commendable foresight funded with his own money in 1921, I often pass by the modest monument on the Stanford University campus that marks Hoover’s long life from 1874 to 1964. It mentions his great work as an author, engineer, humanitarian, public servant, and statesman. But it makes no mention that he was President of the United States. He knew afterwards that his term as President was not his finest hour, which becomes evident by looking at the various kinds of initiatives that he championed before Roosevelt took office. They all are evidence of a big government frame of mind. Let me just mention three of them to you or four of them to why this is the case.

First, Hoover reluctantly signed on to the Smoot-Hawley Tariff, which created very powerful barriers to trade with foreign countries, which in turn generated all sorts of retaliation against the United States. It thus set into motion a set of government initiatives that slowed world trade about by 50 percent, give or take. U.S. imports declined by close to two-thirds between 1929 and 1933, and exports declined by 61 percent, at a time when GDP declined by about 50 percent. Hoover was warned of the dangers; in fact one of the great University of Chicago economists of the time, Paul Douglas, later a U.S. senator, organized a petition signed by 1000 economists who told him exactly what would happen. But Hoover yielded to his business constituents—Henry Ford was a notable exception—many of whom had highly skewed views of the world from their own narrow perspective.

One can imagine the litany: “my steel foundaries would do great, if you just kept those pesky overseas steel makers from exporting goods into the United States.” But the problem, of course, is that imports and exports are always intertwined. If you keep foreign steel out, the manufacturers in the export markets will not have the the kinds of equipment and products that they need to compete effectively in world markets. We make inferior goods not have the the kinds of equipment and products that they need to compete effectively in world markets. We make inferior goods and foreigners who should accept our exports but not dare send imports to our shores. To support American exports and deplore American imports is not the kind of message that resonates well in the Czech Republic. How can American intellectuals serve as credible defenders of international free trade when our President endorses this peculiar one-sided world view? Free trade, in fact, helps all nations in both the long and the short run. Indeed, as Smoot-Hawley’s implementation clearly illustrated, high tariffs hurt some American businesses severely for a whole variety of reasons, some technical, and some obvious.

The second Hoover mistake made was the 1931 Davis-Bacon Act, which essentially provided that government projects should hire workers at “prevailing wages” rather than competitive wages. Davis-Bacon is still on the books and by entrenching union positions, it raises the labor cost of government projects between 15 to 20 percent. It is worth noting that the explicit rational for its passage was to prevent itinerant “colored” workers from competing head to head for employment with locals.

The third reform that Hoover championed was included in the Revenue Act of 1932, which raised the taxes on the highest incomes to a rate of about 63 percent. The effect of that statute was to impair the ability of firms to accumulate capital for private investment, which is one reason why the New Deal doldrums lasted until the onset of the Second World War. Once the high taxes were in place, the Roosevelt forces refused to undo them. Instead, they adopted an early version of stimulus programs to put that money to work, which resulted in an inefficient substitution of private investment by public spending. The same pattern is going on in the United States today, to a somewhat lesser extent. But the lesson should be clear. Stimulus programs do more harm than good insofar as they crowd out private investments by emulating the Keynesian ideal of digging large holes in the ground only to fill them up again.

Fourth, it was on Hoover’s watch that Congress passed the Norris-La Guardia Act of 1932. Norris was a Republican progressive from Nebraska and La Guardia was a liberal Republican Congressman from New York City, who later became its mayor. The gravamen of Norris-La Guardia was to displace the common law rules that prevent conspiratorial behavior by unions seeking to organize workers in secret so that they could be called out on strike at the optimal time. By narrowing restricting injunctions in federal court to cases of imminent violence, it tilted the scales of government power in favor of union organization, in a continuation of the earlier policies of the Wilson administration, embedded in the Clayton Act. The Clayton Act kept antitrust enforcement on the side lines in cases of union organization. The Norris-La Guardia Act did much the same for common law injunctions in federal court.

When Roosevelt got into power, he did nothing to undo any of these unsound Hoover policies. The four statutes that I have mentioned remain on the books. And Roosevelt added many more. I can’t begin to go into all of his policies because the man essentially had a new scheme every day, most of them bad. But let me just mention two of them, which still remain, I think, as serious problems in the United States. One of them took a large step beyond the Norris-La Guardia Act: the National Labor Relations Act of 1935, commonly called the Wagner Act, after the New York senator who did the most to secure its passage. That statute introduced direct government administrative controls over labor relations by the creation of a National Labor Relations Board, which legitimated the system of collective bargaining, which had, and has, two features. First, it organized elections in which unions could become, by majority vote, the representatives of all the workers in some bargaining union designated by the National Labor Relations Board. Second, once the union was in place, the employer was placed under a statutory duty to bargain with the union in good faith.

Competitive labor markets were thus subject to a huge dose of government monopoly power. In the short run, the 1935 scheme looked very grand for the unions and their members. Sure enough,
by 1954, American unions reached their zenith when they represented about 35 percent of the total labor force. Unions like the United Auto Workers offered testimony to the rise of union power. But in the long run, successful unionization killed the goose that laid the golden egg. A succession of labor agreements solidified high wages and onerous work rules that made the once-dominant American "big three" of General Motors, Ford, and Chrysler near basket cases, shedding workers right and left because they could not keep up with foreign competitors organized along far more efficient lines. General Motors shrank from 500,000 workers in 1979 to about 41,000 workers in 2009, and all union representatives attribute that blood letting to pro-management labor policies that limited their ability to organize and bargain. To this day, union leaders do not understand essentially that no one, unions included, can sustain that kind of monopoly power in the world of global competition. The reforms that ushered in an age of wine and roses for the workers between 1935 and 1960 have wreaked devastation on the workers of 1990, 2000, and 2010. One need only look at the condition of Rust Belt towns that have been decimated—Akron, Youngstown, Flint—and the list goes on. This breakdown of formerly prosperous towns in the Midwest is not a laughing matter. It is is a very serious situation. The failure of the union movement is reflected in shifts of population away from union strongholds like Illinois, Michigan, New Jersey, Massachusetts, New York, and Ohio—all of which have lost electoral votes in both the 2000 and 2010 census. The winning states tend to be those which stronger protections against unions, led by Texas, which picked up four seats in the electoral college after the 2010 census.

The second major mistake during the New Deal was the conscious decision of the federal government to strengthen agricultural cartels. The several Agricultural Adjustments Acts of the New Deal period are still on the books, and these essentially require the government to pay farmers huge subsidies for farm goods. The United States then takes the artificial glut thereby created and resells it at bargain basement prices overseas, where cheap imports can wreck small struggling economies whose domestic production cannot compete with subsidized American farm goods. The subsidies remain, even though American agricultural production has improved mightily. The proper response is to let any excess capacity go out of business so that the resources can be redeployed elsewhere. But the refusal to bite the bullet on this key issue results in huge transfer payments which impose penalties on all other economic activities. One lesson about free trade that needs constant repetition is that the creation of government subsidies can do as much harm as government tariffs. In one sense, the subsidies are more dangerous. The source of payment is hard to isolate so that it is difficult to organize political opposition to so unworthy a cause. In addition, these subsidies are far more difficult to root out because they are often embedded in other programs, such as below-market government services to farmers who have widespread political influence, especially in the United States Senate.

Reaction and Consolidation: 1945-1960 After the Second World War, the Republican reaction did not lead to any major changes in agricultural policy, given that the farm states were often a bastion of Republican electoral restraint. But it did result in two responses to the large grant of administrative power that defined the New Deal. Two statutes stand out from this period. First, the general statute, the Administrative Procedure Act of 1946, sought to place greater limits on how these agencies dealt with both matters of law and of fact. On the legal question, the APA conferred final authority over legal questions to the courts. On factual questions, it required these to be supported by substantial evidence. The APA did make a difference, especially in the short run, but by no stretch of the imagination did it return matters to the place they were in before the advent of the New Deal reforms.

The APA did nothing to repeal or modify any substantive statute. The major development on that front—the second statute—was the bitterly contested Taft-Hartley Act, enacted into law over President Harry Truman's veto in 1947. The law was enacted in large measure as a response to the massive amounts of labor unrest that had been unleashed in the immediate postwar period, after the no-strike arrangements of World War II were no longer in place. I own an compendium volume of New York Times front pages, which which contains selected headlines and stories from 1851 to the present. One of the most conspicuous features of the pre-and post-War front pages is the level of labor unrest, strikes, and stalemates during that period. Taft-Hartley was meant to take back some of the advantages that the unions had won under the earlier Wagner Act. It did not, however, restore the situation to what it was in 1928-29 before the major New Deal reforms were put into place. So, the government itself still gets bigger.

The Eisenhower era of the 1950s was a period of consolidation. President Eisenhower was not a rebel; nor was he devotee of big government. So one of his major initiatives, interestingly enough, was to secure passage of the Federal-Aid Highway Act of 1956, whose full name, in fact, is the Dwight D. Eisenhower National System of Interstate and Defense Highways. Owing to the Cold War, the word defense was put into the title of most major government initiatives, including the National Defense Education Act of 1958, another Eisenhower initiative that was enacted in response to the Soviet launch of the Sputnik on October 4, 1957. Both of these programs concentrated on relatively traditional areas of government involvement; infrastructure in the case of the highway act, and education, under the NDEA. The modest level of aspiration produced a pretty solid period of performance, including large dents in U.S. poverty levels, all on the basic assumption that general economic prosperity is shared by all people up and down the economic spectrum. It is not that things were perfect. Nonetheless, if the state does not enact major new social programs, it gives private institutions breathing space to adapt to the regulations already in place. Indeed, one of the famous sayings of John F. Kennedy, that "a rising tide lifts all boats," captures the proper approach perfectly. General improvements work. Fractional efforts produce social dislocations in both the long and the short run.


The situation starts to shift more dramatically with the massive dislocations of the 1960s, starting with the attack on racial segregation by the civil rights movement, and the ever-greater unease over the Vietnam War. With the death of John F. Kennedy, the populist Lyndon Johnson takes over. The defeat of Barry Goldwater generated strong Democratic majorities in Congress, paving the way for the next chapter of the powerful progressive agenda. It is, moreover, important to note that much of that agenda was entirely consistent with the small government classical liberal position. The systematic exclusion of African-Americans from political power was totally demeaning and political inexcusable. The maxim that each person should count for one and only one gives some clue to the massive
injustice involved with segregationist practices. The only question was to figure out how best to straighten out the voting system in the South, a difficult task that, without question, required a heavy dose of federal intervention to undo the underserved power of entrenched segregationist majorities in all too many places. The difficulties in this area were not immediately apparent, but they largely stemmed from the sin of overambition. It made perfectly good sense to open the polls. But federal oversight was on much shakier ground when it shifted its target to the gerrymandering of local districts in order to maximize the level of black representation in Congress and the state houses.

The civil rights movement of the 1960s was not directed just toward toppling public segregation. It also targeted labor markets for comprehensive regulation in ways that undermined the vitality of competitive forces. On this score, there was little objection to federal efforts that sought to control the level of explicit segregation in public employment. But the effort to introduce a strong antidiscrimination principle in private employment raised more difficult questions. As a transition measure, it had much to commend itself as a counterweight to the excessive levels of segregation that were a result of state policies directed toward that end. Between, say, 1965 and 1975, the effects of the Civil Rights Act of 1964 were generally positive. But once that transition period was over, the picture turned more cloudy. Ironically, the one place in which they may have been justified was in the effort to curb the extensive racial discrimination by unions, which was made possible largely because of the exclusive representation that they received under both the Railway Labor Act and the National Labor Relations Act. But apart from that (important) application, it has been difficult to find any positive effect associated from the impact of these laws in otherwise competitive labor markets, where it is likely that they have done more harm than good. Thus, these statutes made it very difficult to sort workers by various kinds of psychological tests, given that most of them tended to have a disparate impact by race. And the ability to fire and hire were heavily limited by judicial decisions that were quick to find some racial animus behind various decisions.

In the late 1980s, some judicial decisions sought to cut back on these laws, but they were quickly rebuffed by the passage of the Civil Rights Act of 1991, engineered in the first Bush administration. That statute marked a bipartisan consensus on the continued role of civil rights laws in the American future. By that time, the adjustments on race and sex had changed the importance of the law. Indeed, the real focus came to be whether affirmative action programs could survive the colorblind injunctions of the civil rights laws, which they generally have, with only some modest difficulty. The real shifts in this area came with the extension of the age discrimination laws in 1986, which removed mandatory retirement limitations from just about every occupation except for a seven-year exemption law enforcement officers, firefighters, and, yes, tenured academic faculty. The latter exemption was blown away by 1994, and the long-term aging of American universities is attributable in part to this intervention, which prevents an orderly shift of power and influence across the generations. There is a real danger that universities will be staffed by people who are too old to do there their best work. Faced with this restriction, however, there is nothing that the university can do except to buy them off. Unfortunately, in bad times, many people aren't taking money because they fear that once the buy-out money is gone, their depleted pensions will not be sufficient to maintain their life styles. In saying all this, I have no objection to universities voluntarily hiring faculty members that other private institutions have asked to retire under their own internal policies. Indeed, it is just that lure of a fresh second career which helps keep people who are at the end of their original appointments working at a higher level than might otherwise be the case.

The burst of government activity in the Johnson administration was matched by the level of government activity under Richard M. Nixon, who also turned out to be a big-government figure. The early 1970s saw the passage of the Environment Protection Act in 1970, the Occupational Safety and Health Act of 1970, the Endangered Species Act of 1973, The Employee Retirement Income Security Act (ERISA) of 1974, the Civil Rights Act of 1972, including Title IX's requirements of "gender equity" that has exerted a continuous, pronounced, and adverse impact on intercollegiate athletics at the college level. Coverage under early statutes, such as the Civil Rights Act, and the Medicare and Medicaid programs of 1965 also expanded apace. The combined impact of these programs doubtless had something to do with the economic stagnation of the 1970s under the Carter Administration. I still remember that when my wife and I were seeking a home mortgage in April, 1980, the going rate for a long-term mortgage was 16 percent, which tumbled to under 12 percent by July of that year. Carter lost the election that fall, because those inflation rates turned out to be utterly unsustainable and politically unacceptable. Yet even here there was some notable instances of deregulation, most notably in air transportation with the repeal of the Roosevelt-era Civil Aeronautics Act of 1938, gutted by the Airline Deregulation Act of 1978, which with bipartisan support stripped the CAB of its authority to set fares, routes, and conditions of entry into the airline industry. In at least one area, the lesson that free entry trumps administered prices had been learned.


The arrival of Ronald Reagan in the White House in January 1981 did mark a change in governing philosophy and return to the philosophy of small government. But again it is critical to be careful of what is meant by this retrenchment. In technical terms, Reagan changed the second derivative, but he did not change the first derivative on the rate of growth in government. What I mean by that cryptic statement is that government continued to get larger under Reagan, but it did so at a slower rate than earlier. On the positive side, the Reagan tax reform legislation of 1986 did both lower rates and remove a number of tax loopholes, both of which are consistent with the general prescription of Adam Smith in favor of a lower rates off a broader tax base. On balance, these reforms did put some pop into the economy.

With respect to regulation, for the most part, Reagan introduced no major new initiatives in this period to expand the size of the government market. This was also the period where Margaret Thatcher in Great Britain pursued a similar policy. The Reagan era did see the expansion of the role of government in health care, with the passage of the National Organ Transplant Act of 1984, and Emergency Medical Treatment and Active Labor Act (EMTALA) of 1986. The former killed any emergent market for the sale of organs, and has precipitated chronic shortages of kidneys and needless deaths to boot. The latter has put enormous pressure on hospital emergency rooms, which has led to many closures. The former represents a negation of freedom of contract. The latter represents the dangers of forced association. It
seems clear that the public at large may well have been skeptical of supposed virtues of larger government, but it did not coalesce around any coherent laissez-faire orientation.

Perhaps the greatest achievement of Ronald Reagan, and those most dear in the Czech Republic, was the breakdown of the Soviet domination over eastern Europe in 1989. For those of us old enough to remember the rise of the Berlin Wall in the summer of 1961, the transformation was at once both stunning and unexpected. The public failure of the socialist system may not have ensured that all was well inside the Western democracies, but it did provide an object lesson of the major dangers, both political and economic, of all variations of Marxism and socialism—a lesson that we would all do well never to forget.

The presidency of George H.W. Bush marked, in my view, a start of the return to the policies of the progressive era. The two most notable events in that period on the domestic front were the tax increase that he introduced in 1990, in violation of a campaign promise. That may well have cost him the 1992 election, in a three-cornered race with Bill Clinton and Ross Perot. Of longer significance—and greater mischief—was the passage, with Bush’s support, of the Americans with Disabilities Act. The ADA has transformed architecture for the worse, as the requirements for wheelchair access alone can add as much as 20 to 25 percent to the cost of new construction and improvements and modifications. The statute has also transformed employment markets, with constant tension over the question of just what accommodations for disabled workers are required and which of them could be rejected as “undue.” In and of itself, this change is one that can be absorbed without undermining labor markets. But when conceived as a part of a larger system of employment regulation, it has to count as one of the key drivers of the present high levels of unemployment. Consistent with economic predictions, the adaptive responses of employers anxious to avoid the onerous obligations of hiring workers with disabilities, the percentage of disabled persons in the workforce shrank after passage of the statute. It is a classic instance in which unintended consequences matter.

The presidency of Bill Clinton should not in my view be regarded as a period on which there has been a massive expansion of government authority. Once we put aside his evident personal peccadilloes, he had a sense of the limits of what types of economic regulation could be attempted by a President who wished to remain in office. He did not learn that lesson at the outset, but rather had committed himself to a national health care bill that was simplicity itself relative to the ObamaCare legislation a generation later. But he sensed that the country was not ready for this proposal, and backed off so that by 1994, with the Republican Congress in place, he was able to moderate his ambitions. At that point, he registered some solid accomplishments. His general program to ease people off of welfare has to count as a solid success, and his willingness to pursue trade liberalization with foreign nations is, if anything, even a larger plus to the overall situation. He did in fact raise taxes, which did not produce major negative consequences given the tremendous rate of technological advances in the period, which produced huge stock market gains until they ended in the Internet bubble of early 2000, which was, fortunately, far more confined than the dislocations that took place in 2008 under the second George Bush.

The cycle of reaction sputtered some with the second George Bush, whose record on the size of government in domestic matters was decidedly mixed. The second Bush scores well on tax reform, where he sought to lower both capital gains and ordinary income taxes. But in his first term especially, he did badly on many other domestic measures. He was a Republican he was willing to pass major legislation that tied into a big government agenda. He was instrumental in extending federal control over education through the No Child Left Behind statute which marked a huge increase in government funding for education at the federal level and a huge expansion in the effort to monitor teacher performance in the classroom, with a set of metrics that never quite seemed to work out as intended. The problem of teacher evaluation is exceedingly difficult even when done at the school level, where all sorts of direct observational inputs can be had. But from a remote perch using only test data, the task is truly difficult and has led to constant complaints from nearly every quarter, some of which are not just a union response to the effort to introduce management into an area in which tenured teachers have all too much protection.

On the corporate side, the Sarbanes-Oxley legislation, pushed through in 2002 after the Enron scandal of the previous year, has been the source of immense frustration with its heavy disclosure obligations on senior management, and the huge exposure to liability when the internal audits are not done in the right fashion. The issue is not criminal prosecutions, of which there have been virtually none. It is with the routine costs of compliance that have hampered the operations of public companies. Today, many private corporations do not go public, lest they be caught in this regulatory web. The decision to be bought out by a public corporation may ease compliance costs, but it could easily spell the end of getting the next eBay or Google to go public: Facebook did not take that path in its recent effort to expand its ownership base, for example. Many public corporations have been taken private in the effort to escape the regulatory burden. And many foreign corporations have decided to delist from the American exchanges to escape regulation. The number of new offerings done in London and Hong Kong has gotten quite large relative to New York. No one thinks that Sarbanes-Oxley has nothing to do with this. The only real question is how much.

Third, Bush II created a huge new Medicare entitlement for prescription drugs under Medicare Part D, passed in 2003, which went into effect in 2006. The program has been run far better than might have, had it relied on government monopoly power to drive down prices at the expense of innovation. But the long term cost implications are not clear, given the huge cost overhang that Medicare places over the economy.

Barack Obama: The Progressive Revival 2009-????
So at last we arrive at the presidency of Barack Obama, who in March 2010 managed to pass the Patient Protection and Affordable Care Act (aka ObamaCare), followed up in July with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This pair arguably counts as the most massive regulatory innovations ever, given their incredible complexity. There is no way to discuss their intricacies here, but it is important to note the narratives that led to the passage of these statutes.

In dealing with the financial issues, the winning party line was on the interventionist side. In their narrative, the tragedy of
2008 was attributable to greed on Wall Street, for which legislation twenty-one months later was the answer. One part of the legislation created the Financial Services Oversight Council, to allow the government massive oversight over the way in which large firms in the financial sector operated. Another part created the Bureau of Financial Consumer Protection, charged with guarding consumers against various types of frauds, deceptions, and abusive practices that surely happen in some cases, but which did not happen in all.

I think that both halves of this statute represents a serious overreaction to what transpired, for the proper approach to the financial meltdown is to divide the burdens. On the private side, one conspicuous failure was that the models used to securitize mortgages were surely too optimistic. They did not take into account the risk of common mode failure, such as those which stemmed from bad government policies or adverse economic events elsewhere. Hence, they were mispriced in ways that understate risk, and which contributed to the initial boom.

Once the entire situation started to unravel, a second risk emerged. There was no doubt to my mind that firms under huge financial pressures will take desperate measures today in the hope that they can recoup their losses. For example, Lehman Brothers booked some loan transactions as if they were sales, in order to disguise their weak financial condition, at least in the short run. All these technical maneuvers take their toll. If a transaction is a bona fide sale, it means that assets are taken off the books, and debt is reduced with the proceeds of sale. The reduction in leverage stabilizes against long-term risk. But if the sale is really a loan, because of an option to resell given to the supposed buyer, all the risks of a leveraged operation remain.

One sobering note, however, is that these actions took place while the Securities and Exchange Commission was on the job. But it missed most of the risks, just the way it missed the Ponzi scheme of Bernard Madoff that collapsed with the downturn in stock prices. The risk here with the SEC is, in part, explained by mission creep. The SEC lost sight of its chief function, which should be to prevent fraud, and it sought to introduce a regime of fairness into capital markets. That regime is often counterproductive because its desire to equalize the flow of information tends to reduce the returns to investments in finding information, so that less information is gathered. The costs of running this new venture is thus a distraction from the more routine business of fraud prevention.

The lackluster performance of the SEC was not the government's only failure. Some key financial decisions during the Bush administration helped create the devastating bubble in home mortgages in the first place. During the Bush administration, a liberal Democratic Congress pushed for an expansion of loans from Fannie Mae and Freddie Mac to high-risk borrowers. The Federal Housing Administration followed suit, as did private lenders under the influence of the Community Reinvestment Act, and the Department of Housing and Urban Development until over twenty-three million (19 million out 27 million) were either issued or guaranteed by one or another government entity. At the same time, the Federal Reserve ushered in an era of cheap money that allowed people to bid up the value of housing to what turned out to be unsustainable levels. Private lenders followed suit because they thought, correctly as it turned out, that they were protected by an implicit government guarantee against failure.

Now, what is the definition of the guarantor? The old Yiddish joke is that a guarantor is a jerk with a fat wallet and a fountain pen. Quite simply, a guarantee is an invitation for lenders and borrowers to engage in high-risk actions at the expense of third parties. The only way to stop the flood of bad transactions is to put conditions upon the use of borrowed money so that the guaranteed parties will be prevented from playing the high-risk game—heads, I win; tails, the guarantor takes all the losses. The government agencies did not attempt to put these safeguards in place. Thus, on the inevitable collapse of the market, much of the losses came straight back to the United States government, in sums that may eventually exceed $300 billion. The episode was a desperate failure of central planning. Yet this lesson was not learned, so that to this very day, many people insist that the market, and only the market, bred the dislocations that followed.

Against those serious risks of disguised transactions, some oversight in the eleventh hour might be able to protect against these devices, assuming that one knew what was happening and how it should be countered, which is not easy to do given the very rapid pace of events. But Dodd-Frank is likely to make matters worse. Its use of regulation to protect against "systematic risk" in the private sector has the unfortunate consequence of creating huge systematic risks by putting the entire financial sector under the control of a financial services czar, the Financial Stability Oversight Council, which concentrates truly awesome powers in the Secretary of the Treasury, and the key heads of other financial agencies in the United States. The same can be said on the consumer protection side of Dodd-Frank, in the form of the Bureau of Financial Consumer Protection, which likewise has enormous powers that are answerable chiefly to the Oversight Council, one of whose members is the head of the BFCP. There is good reason to believe that the supposed cure will be the source of greater instability, precisely because of the want of decentralized decision-making authority, which remains the single best protection against common mode failure.

I have similar fears about the peculiar complex programs that are used in ObamaCare, which now sits on the books. Its first weakness is that it distributes new entitlements to health care as if they were cotton candy. Some degree of subsidy is offered to persons that receive 400 percent of poverty income, which embraces well over half the population. Yet it is never made clear that the taxes that are cobbled together will hit by indirection the very people who are supposed to receive subsidies. Needless to say, the costs are driven up further by the huge increases in the mandated benefit packages for private insurers, and a large expansion in the Medicaid population which cannot be fully funded. There are layer upon layer of oversight by a combination of state and federal officials, the likely consequence of which is to induce employers to close out their plans so that workers will have to get coverage from government plans whose contours are as yet completely uncertain until vast new reams of regulations issue. The original sale of this program depended on the famous promise that "if you like your current health care plan, you can keep it." Well, the answer is that you cannot. The final legislation has made a five-year survival rate system the most optimistic outcome. Most plans will have to meet federal guidelines sooner to survive. It turns out that in the hasty press of political reform, the grandfathering protection just disappeared.

In the end, the entire system will be either government run or government regulated. But how will it work? No one knows for sure. I have studied this program in detail and confess that as of present I have but only a slight sense of what it all entails and how it should be managed. But the ultimate fear is that the strict controls on cost that will be put into place will not match with the
mandated benefits, so that the entire system could collapse from overambition. Right now in the United States, there is a concerted effort to repeal, postpone, or modify the entire legislation. No one knows how this will proceed. The President can veto any major reform. But the Republican House of Representatives can put the kibosh on major appropriations for these programs. The tug of war shall continue throughout the next Congress.

These two statutes on health and finance are consistent with the general New Deal program whose reach they extend. The SEC was itself big into consumer protection; health care could be regarded as an extension of the original Social Security program, which is now out of financial whack. On other issues, moreover, the Obama Administration has returned to the misguided progressive principles that long animated the New Deal. Thus on free trade, Obama continues to show an icy hostility to all sorts of free trade treaties, be it with Colombia or South Korea. On this matter, he serves the interest of organized labor whose high wage packages cannot survive foreign competition. Yet it comes at the cost of opening up our own markets to foreign products that are needed here, not only for consumption, but also to make the goods with which American firms hope to compete overseas. Leo Gerard, who heads the United Steelworkers, is the number one complainer for the trade union movement in the United States, and is willing to initiate major antidumping litigation to keep out foreign products.

Secondly, like Roosevelt and Hoover before him, but unlike John Kennedy, Obama is at heart a champion of high progressive taxes, stiff capital gains levies, and a tough estate tax. These policies were thwarted in the short term, i.e., for two years, by the tax compromise legislation in the lame duck session of Congress after the November 2010 election. Right now, he has been held in check. But left to his own devices, he would surely drive taxes increases, notwithstanding their adverse effect on investment. He is a man who is all-too convinced that strong policies are the key measures as the corporate tax rate in order to attract capital and labor markets, and there it will stay until the government starts to liberalize both capital and labor markets, a consistent program of growth through deregulation and lower taxation.

Unfortunately, the road to disaster lies in the effort to cure government disasters by higher taxes (which mean a larger public sector). What is needed in all cases is a lowering of public expenditures so as to allow more private investment. What is needed are vibrant capital markets that can attract the foreign capital now being driven from American shores under our jingoistic economic policy. I can say from personal knowledge of Obama from his days at the University of Chicago Law School that he simply has never internalized any of the insights or lessons from neoclassical economics. Obama had some economics advisors—Christina Romer was one—who thought that high taxes had counterproductive tendencies. But Obama’s gut instincts run in the opposite direction.

The third point is that, consistent with his confidence in high taxes, Obama is a great defender of stimulus programs, without having any knowledge of how they work, or, more accurately, don’t work. The first point about the stimulus program is that, unlike everything else, it is subject to diminishing marginal returns. If a president really believes that every dollar spent by the federal government generates 1.5-fold levels of economic activity, when every dollar spent by private parties generates no such positive multiplier, then by all means load up on public expenditures. But the price tag is high: what happens in practice is that society will use more and more dollars to produce fewer and fewer things. In the end, the only way to create jobs by a stimulus program is to count the jobs that are funded by the government cheques and to ignore all the jobs that were lost because of the tax revenues that were sucked out of the private sector to fund those government programs. Looking at direct benefits and ignoring indirect costs is a sure way to undermine sound public accounting.

How do we know in fact that that this approach is wrong? Well, the unemployment rate remains stubbornly close to ten percent, and there it will stay until the government starts to liberalize both capital and labor markets, by a consistent program of growth through deregulation and lower taxation. (I made this point in March of 2010, and it remains true in January of 2011.) Money spent on compliance produces little or no gains. In no matter can it be regarded as a mark of economic probity. So in principle, it is back to Adam Smith. A prosperous nation must have a stable legal regime; it must have low and stable taxes so that people can have confidence in their long time horizons. But the current tendency is the opposite. Even the 2010 tax cuts last only for two years on ordinary income capital gains, and the estate tax. Other gimmicks last for one, and are only awarded to people who meet exacting conditions that do not reflect rational resource use. Those constant reliance on stop-and-go economics is the bane of a return to prosperity. The real question is whether political leaders of either party are prepared to acknowledge this truth. Or will they, as is all too common, resort to the excuse that they have to push hard for a new subsidy in their favor in order to offset an illicit subsidy given to their competitors.

This last observation points out a grim truth: political life in America will remain in a downward equilibrium unless and until key government actors press for fundamental reform. Unless that is done, here is what will happen. The American capital markets will lose their dominant status under the weight of misguided taxation, regulation, and subsidies. It is quite clear that domestic markets cannot generate the capital needed for funding the chronic deficits, so that the U.S. will have to borrow from overseas to fund its current standard of living, leaving the next generation to fend for itself. The risk is that the United States will start to look like Argentina—or is it Greece, Spain, or Portugal? The United States as a nation has passed the point where it can make excuses for its low growth rate and high level of transfer programs. It has to compete with other nations that have decided to lower such key measures as the corporate tax rate in order to attract capital. The nation cannot live with the illusion that it can maintain any respectable level of growth with its current level of transfer payments and regulation. Many people in the United States have trembled in light of these truths. The question for us as a nation is whether they will be able to prevail against the powerful interests that are working hard to maintain an unsustainable status quo.

R. A. Epstein is a Laurence A. Tisch Professor of Law, New York University School of Law; the Peter and Kirstin Bedford Senior Fellow, The Hoover Institution, and a senior lecturer at the University of Chicago, where he is also the James Parker Hall Distinguished Service Professor of Law, Emeritus.