

# OCCUPY PENNSYLVANIA AVENUE: HOW THE GOVERNMENT'S UNCONSTITUTIONAL ACTIONS HURT THE 99%

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## I. INTRODUCTION

Economic freedom is the best tool man has ever had in the perpetual struggle against poverty. It allows people to employ their faculties to a multitude of opportunities, and it has fueled the economic growth that has lifted millions out of poverty in the last century alone.<sup>1</sup> Moreover, it

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1. See, e.g., James D. Gwartney et al., *Economic Freedom, Institutional Quality, and Cross-Country Differences in Income and Growth*, 24 CATO J. 205, 230–31 (2004) (“Countries with institutions and policies more consistent with economic freedom both grow more rapidly and achieve higher income levels.”); Gerald W. Scully, *The Institutional Framework and Economic Development*, 96 J. POL. ECON. 652, 661 (1988) (“Politically open societies, which bind themselves to the rule of law, to private property, and to the market allocation of resources, grow at three times (2.73 to

provides a path for individuals and communities to free themselves from coercive government policies that serve political elites and discrete political classes at the expense of the politically weak. Because of their relative political weakness, the poor and working classes tend to suffer the most from these inescapable power disparities.<sup>2</sup>

Yet economic freedom—and ultimately, economic growth—is not self-sustaining. This tool of prosperity requires sound principles that provide a framework for cooperation and voluntary exchange in a free society. Principles equally applied to all and beyond the arbitrary discretion of government actors; principles that provide a degree of certainty and predictability in an otherwise uncertain world. That is, economic freedom requires the rule of law, not men.<sup>3</sup>

In this Article, we discuss the corrosive effects that unconstitutional actions have on the rule of law, economic growth, and in turn, on the ability of the poor to improve their economic misfortune. We focus on the institutional dangers and adverse incentives that unconstitutional policies tend to create. These dangers are not just abstract or theoretical; this

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0.91 percent annually) the rate and are two and one-half times as efficient as societies in which these freedoms are circumscribed or proscribed.”); *see also* Sylvia LeRoy, *Economic Growth Will Make Poverty History*, FRASER INST. (Oct. 20, 2006), <http://www.fraserinstitute.org/research-news/news/display.aspx?id=11566> (discussing a study documenting the large drop in world poverty rates between 1970 and 2000 and concluding that “[t]he lesson is clear: economic growth, not foreign aid, will make poverty history”).

2. *See* Ilya Somin, *The Political Weakness of the Poor: An Argument for Limiting Government Power*, THE VOLOKH CONSPIRACY, (Nov. 6, 2006, 9:29 PM), <http://volokh.com/posts/1162870163.shtml> (concluding that “the political weakness of the poor is a strong argument against claims that big government is justified by the need to fight poverty and empower the disadvantaged”).

3. *See, e.g.*, Richard Epstein, *Government by Waiver*, 7 NAT’L AFF. 39, 39 (2011) (“The rule of law requires that all disputes—whether among private parties or among the state and private parties—be tried before neutral judges, under rules that are known and articulated in advance. Every party must have notice of the charge against him and an opportunity to be heard in response; each governing rule must be consistent with all the others, so that no person is forced to violate one legal requirement in order to satisfy a second. In the United States, our respect for such principles has made our economy the world’s strongest, and our citizens the world’s freest.”); Todd Zywicki, *Economic Uncertainty, the Courts, and the Rule of Law*, 35 HARV. J.L. & PUB. POL’Y 195, 197 (2012) (“Hayek’s central insight about the value of the rule of law is that in a world defined by flux and dynamism, economic activity requires as much stability as possible from institutions like the legal regime that make economic coordination possible.” (footnote omitted)).

Article shows how specific unconstitutional actions adversely affect the lives of poor Americans. And, while Part IV shows that even constitutional violations by local governments can have disastrous effects, our central theme is that the federal government's disregard for the U.S. Constitution has led to policies that kill jobs, stymie economic growth, and ultimately exacerbate the problems of those living in poverty.

Part II focuses on the Patient Protection and Affordable Care Act, President Barack Obama's signature piece of legislation that seeks to drastically reorganize the U.S. healthcare industry. This part begins by analyzing the aspects of the Act, commonly known as "Obamacare," that have raised serious constitutional questions, particularly the individual mandate. We then point out the negative effects that Obamacare will have on the economy generally and low-wage earners specifically.

In Part III we discuss the recent industry bailouts resulting from the 2008 financial crisis. More specifically, we analyze the Troubled Asset Relief Program and the bailouts of General Motors and Chrysler through a constitutional lens. After showing that these policies also lay on shaky legal ground, we conclude that their effects will be to hinder economic growth by undermining the rule of law and institutionalizing systemic risks.

Part IV covers two financial regulatory regimes implemented over the last decade: the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Again, we analyze the legal authority behind these historic pieces of legislation and conclude that the massive new bureaucracies they create violate separation of powers and other first principles. We then discuss the economic and institutional pitfalls of such overreaching regulatory structures.

In Part V, we examine housing policies—at both the national and local levels—that are of questionable constitutionality and lead to perverse consequences in local housing markets. Specifically, we discuss how disparate-impact claims under the Federal Housing Act and local rent control laws conflict with the Equal Protection, Takings, and Due Process Clauses. We then explain how these policies distort markets and lead to negative, unintended side effects, such as constrained housing supplies and lower housing quality, which disproportionately fall on the poor.

As examples throughout this Article demonstrate, disregard for the U.S. Constitution and the rule of law have increased economic uncertainty, stymied growth and innovation, and weakened legal equality, leading to diminished opportunities for America's poor.

## II. OBAMACARE: AN UNCONSTITUTIONAL, UNHEALTHY PRESCRIPTION

The Patient Protection and Affordable Care Act was signed into law by President Barack Obama on March 23, 2010.<sup>4</sup> Its primary objectives, as explained by the Act's proponents, are to expand health insurance coverage and reduce healthcare costs.<sup>5</sup> Yet, Obamacare does little of what its title suggests and much of the opposite. Rather than protecting patients and reducing costs, it will reduce the quality of healthcare while driving costs higher. And though some subsidies to low-income individuals will rise, many of Obamacare's negative effects will disproportionately fall on the poor.

Moreover, the legal challenges brought against the legislation suggest, at best, a questionable basis of legal authority supporting its most important provisions and, at worst, a complete disregard for the Constitution's limits on federal power. Perhaps nothing better exemplifies this disregard for the Constitution than then-House Speaker Nancy Pelosi's response when asked about the constitutional authority supporting the individual mandate: "Are you serious?"<sup>6</sup> When the Supreme Court took up and set aside a historic *six hours* of oral argument over three days on these legal challenges, Pelosi had her answer long before the justices even voted.<sup>7</sup>

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4. Patient Protection and Affordable Care Act (PPACA), Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 26 U.S.C. & 42 U.S.C.).

5. See, e.g., David M. Cutler, *Repealing Health Care Is a Job Killer: It Would Slow Job Growth by 250,000 to 400,000 Annually*, POLITICO 1 (Jan. 2011), [http://www.politico.com/pdf/PPM182\\_110107\\_cutler.pdf](http://www.politico.com/pdf/PPM182_110107_cutler.pdf) (stating that "combined legislation guarantees health insurance coverage to all Americans and promotes significant cost reductions").

6. See, e.g., Ilya Shapiro, *A Long, Strange Trip: My First Year Challenging the Constitutionality of Obamacare*, 6 FLA. INT'L U. L. REV. 29, 31 (2010). To be sure, Rep. Pelosi has not been the only elected official to doubt the continued relevance of the Constitution. For example, when pressed with similar questions about the constitutionality of the PPACA's main provisions, Rep. James Clyburn of South Carolina stated, "There's nothing in the Constitution that says the federal government has anything to do with most of the stuff we do," and Rep. Phil Hare of Illinois revealed, "I don't worry about the Constitution on this, to be honest." David Bernstein, *Democratic Congressman and Senators on Constitutional Authority for the ACA*, THE VOLOKH CONSPIRACY (Mar. 28, 2012, 2:26 PM), <http://volokh.com/2012/03/28/democratic-congressman-and-senators-on-constitutional-authority-for-the-aca/> (quoting Reps. Clyburn and Hare).

7. It is now beyond credible dispute that the claims raised were serious and

### A. *Obamacare's Constitutional Defects*

At least four aspects of Obamacare and the way in which the law is being implemented are of doubtful constitutionality: the individual mandate, the Medicaid expansion provisions, the Independent Payment Advisory Board, and the specific waivers to various requirements. Although a full examination of Obamacare's constitutional problems is beyond the scope of this Article, this section sketches out the constitutional defects in these specific provisions.

#### 1. *The Individual Mandate Exceeds Congress's Regulatory Authority*

The individual mandate—the requirement that all Americans purchase health insurance or else pay a penalty<sup>8</sup>—is unprecedented and exceeds Congress's regulatory authority.<sup>9</sup> With limited exemptions—though ones that undermine the claim that Obamacare eliminates “free-riding” by individuals who receive uncompensated care and thereby shift costs onto the taxpayer—the mandate applies to all U.S. residents.<sup>10</sup> Its supporters have argued that the mandate is constitutional under the

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forced the Court to grapple with issues like never before. As Georgetown Law Professor Randy Barnett, the intellectual force behind the lawsuits, explained, “When the Supreme Court grants six hours of oral arguments over three days, I don't have to win that case to know that my challenge is serious.” Sheryl Gay Stolberg & Charlie Savage, *Vindication for Challenger of Health Care Law*, N.Y. TIMES, Mar. 26, 2012, at A1 (quoting Barnett).

8. 26 U.S.C. § 5000A(a) (Supp. IV 2011) (“An applicable individual shall for each month beginning after 2013 ensure that the individual, and any dependent of the individual who is an applicable individual, is covered under minimum essential coverage for such month.”).

9. While the Court ultimately reinterpreted and upheld the mandate as a tax, a different constellation of five justices rejected the idea that the government can impose economic mandates pursuant to its regulatory authority. Nat'l Fed. of Indep. Bus. (NFIB) v. Sebelius, No. 11-393, slip op. at 58 (June 28, 2012); *partial accord id.* at 4–16 (joint opinion of Scalia, Kennedy, Thomas, and Alito, JJ., dissenting as to the taxing power but also rejecting the commerce-power argument). An analysis of this ruling is far beyond the scope of this Article, but the taxing-power holding is likely to have little practical effect on legislation (or possible legislation) other than Obamacare. See, e.g., Randy Barnett, *Roberts Decision Didn't Open Floodgates for “Compulsion Through Taxation,”* WASH. EXAMINER, July 5, 2012, available at <http://washingtonexaminer.com/roberts-decision-didnt-open-floodgates-for-compulsion-through-taxation/article/2501386>.

10. See *id.* § 5000A(d)–(e) (carving out limited religious, poverty, and hardship exemptions and excluding illegal aliens and incarcerated persons from the mandate).

Commerce Clause<sup>11</sup> because individual decisions not to obtain insurance coverage affect the larger market for healthcare that Congress can indisputably regulate. Indeed, since the New Deal case of *Wickard v. Filburn*,<sup>12</sup> Congress's power to regulate commerce, when read in conjunction with the Necessary and Proper Clause,<sup>13</sup> has included the power to regulate even certain classes of intrastate "economic activity [that] substantially affects interstate commerce."<sup>14</sup> But, Congress cannot pass *any* law it pleases so long as the resulting action facilitates a national regulation of interstate commerce; the means it chooses must be both "necessary" and "proper."<sup>15</sup>

The government has argued that the individual mandate is constitutional because it is "necessary" to Obamacare's general regulatory scheme.<sup>16</sup> But, the government gets it backwards: Congress cannot pass an otherwise unconstitutional means of regulating the people and then legitimize that means by asserting it is "necessary" to that scheme. Nor can Congress create commerce in order to regulate it.<sup>17</sup> By requiring all individuals to purchase health insurance, the government forces people into the market. Yet never before has the Supreme Court held that Congress can mandate that otherwise inactive individuals engage in economic activity simply because it is "necessary" to a broader regulation.<sup>18</sup>

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11. U.S. CONST. art. I, § 8, cl. 3 (granting Congress the power to "regulate Commerce . . . among the several States").

12. *Wickard v. Filburn*, 317 U.S. 111 (1942).

13. U.S. CONST. art. I, § 8, cl. 18 (granting Congress the power to "make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers" of the Constitution).

14. *Gonzales v. Raich*, 545 U.S. 1, 25, 32–33 (2005) (quoting *United States v. Lopez*, 514 U.S. 549, 560 (1995)).

15. See Brief of Cato Institute et al. *Amici Curiae* Supporting Respondents on the Individual Mandate Issue at 2–6, *Dept. of Health & Human Servs. v. Florida*, 132 S. Ct. 1618 (2012) (No. 11-398), 2012 WL 37168.

16. See Brief for Petitioners at 32, *Dep't of Health & Human Servs. v. Florida*, 132 S. Ct. 1618 (2012) (No. 11-398), 2012 WL 37168 (concluding that because "[t]he minimum coverage provision is key to [Congress's] insurance reforms . . . [t]he provision is therefore within Congress's commerce power" (footnote omitted)).

17. See, e.g., Justice Anthony Kennedy, U.S. Supreme Court, First Question at Day Two of Oral Arguments in *Dept. of Health and Human Servs. v. Florida* (Mar. 27, 2012) (questioning whether the federal government can create commerce in order to regulate it).

18. See Shapiro, *supra* note 6, at 52 (citing *Thomas More Law Ctr. v. Obama*, 720 F. Supp. 2d. 882, 893 (E.D. Mich. 2010)).

Moreover, the government has been unable to articulate a judicially administrable limiting principal for this extraordinary new power. Even the lower courts that upheld the mandate have acknowledged the government's failure in this regard.<sup>19</sup> If the individual mandate stands, there will be no limit to such economic mandates because compelling economic activity or commerce can effectuate any number of regulatory schemes. Such boundless authority is antithetical to the very notion of a federal government of enumerated and, therefore, limited powers.<sup>20</sup>

## 2. *The Medicaid Expansion Coerces the States*

Obamacare's Medicaid expansion compels states to drastically increase their Medicaid expenditures and reorganize their healthcare bureaucracies, on penalty of losing all of their Medicaid funds—not just funds specific to the new legislation.<sup>21</sup> This is an improper use of the Constitution's Spending Clause,<sup>22</sup> whereby the federal government uses its incredible leverage to force the states to do its bidding. That is, states never contemplated such a condition when they signed onto Medicaid—whether in 1965 or when the last state, Arizona, joined in 1982—and now, with their dependence on federal funds complete, no state can afford to withdraw.<sup>23</sup> Even if some mechanism existed for the states to withdraw, taxpayers in withdrawn states would be forced to fund Medicaid programs in other complying states. As the Supreme Court has held, at some point “the financial inducement offered by Congress might be so coercive as to pass the point at which ‘pressure turns into compulsion.’”<sup>24</sup> Obamacare's

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19. See, e.g., *Seven-Sky v. Holder*, 661 F.3d 1, 14–15 (D.C. Cir. 2011) (“[I]ndeed, at oral argument, the Government could not identify any mandate to purchase a product or service in interstate commerce that would be unconstitutional, at least under the Commerce Clause.”).

20. See THE FEDERALIST NO. 45, at 292 (James Madison) (Clinton Rossiter ed., 1961) (“The powers delegated by the proposed Constitution to the federal government are few and defined”).

21. See PPACA, Pub. L. No. 111-148, § 1331, 124 Stat. 119 (2010).

22. U.S. CONST. art. I, § 8, cl. 1 (“The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the United States.”).

23. See, e.g., Michelle Oxman, *Is the Medicaid Expansion an Offer the States Can't Refuse?*, WOLTERS KLUWER L. & BUS.: L. & HEALTH (Mar. 27, 2012), <http://health.wolterskluwerlb.com/2012/03/Is-the-medicaid-expansion-an-offer-the-states-cant-refuse/>.

24. *South Dakota v. Dole*, 483 U.S. 203, 211 (1987) (quoting *Steward Machine Co. v. Davis*, 301 U.S. 548, 590 (1937)).



Medicaid expansion passed that point.<sup>25</sup>

### 3. *IPAB Violates Separation of Power Principles*

Under Obamacare, an Independent Payment Advisory Board (IPAB) composed of fifteen presidential appointees is tasked with reducing Medicare spending.<sup>26</sup> IPAB decisions will automatically become law and can only be overridden by a three-fifths majority vote in the Senate.<sup>27</sup> In effect, Congress has granted broad law-making power to a completely independent and self-perpetuating agency. Congress may not delegate “powers which are strictly and exclusively legislative,”<sup>28</sup> but Congress may delegate authority if it “lay[s] down . . . an *intelligible principle* to which the person or body authorized . . . is directed to conform.”<sup>29</sup> This is known as the nondelegation doctrine, which is rooted in separation of powers principles.<sup>30</sup> Obamacare provides no such “intelligible principle” concerning an IPAB’s powers.

### 4. *There Is No Legal Authority for the Healthcare Regulation Waivers*

Finally, Obamacare’s implementation has led to other executive actions that are of questionable constitutionality. For example, the Department of Health and Human Services has granted thousands of waivers to employers seeking relief from the Act’s new regulations, with many of these waivers going to gourmet restaurants and other businesses in San Francisco—Congresswoman Pelosi’s home district—and a blanket waiver for Nevada—Senator Reid’s home state.<sup>31</sup> Beyond the unseemly

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25. Seven justices agreed on this point in the recent Obamacare ruling. Nat’l Fed’n of Indep. Bus. v. Sebelius, No. 11-393, slip op. at 58–59 (U.S. June 28, 2012).

26. 42 U.S.C. § 1395kkk (Supp. IV 2011).

27. See *id.* § 1395kkk(d)(3) (Supp. IV 2011) (providing limitations on congressional actions concerning Board proposals).

28. Wayman v. Southard, 23 U.S. 1, 42–43 (1825).

29. J.W. Hampton & Co. v. United States, 276 U.S. 394, 409 (1928) (emphasis added).

30. See Gary Lawson, *Burying the Constitution Under a TARP*, 33 HARV. J.L. & PUB. POL’Y 55, 62 (2010) (“The Constitution’s nondelegation principle flows from the more basic principle of enumerated powers. Any federal actor or institution can exercise only those powers granted to it pursuant to the Constitution.”).

31. See, e.g., Robert Pear, *Health Law Waivers Draw Kudos, and Criticism*, N.Y. TIMES, Mar. 20, 2011, at A21; Milton Wolf, *Obamacare Waiver Corruption Must Stop*, WASH. TIMES, May 20, 2011, available at <http://www.washingtontimes.com/news/2011/may/20/obamacare-waiver-corruption-must-stop/>.

political favoritism of these waivers, such arbitrary dispensations violate constitutional and administrative law principles like equal protection and the “intelligible principle” required for congressional delegation of authority to executive agencies.<sup>32</sup> Moreover, Congress never provided for most of these waivers.

### B. *Obamacare’s Costs*

Even if Obamacare is riddled with unconstitutional provisions or should have been struck down in its entirety, how does it negatively affect the plight of America’s poor? Surely legislation intended to expand coverage and reduce costs could only improve the lot of low-income earners, right? Actually, the diagnosis is not good. While the scope and complexity of the legislation makes it difficult to accurately estimate the effects on overall healthcare spending, it is clear that the healthcare reform law has fallen far short of any meaningful cost reduction. Worse yet, it seems likely to *increase* expenditures for most individuals and businesses.<sup>33</sup> These cost increases will have the greatest impact on poor communities, threatening opportunities for social mobility.

#### 1. *Higher Implicit Marginal Tax Rates on Low-Wage Earners*

Although Obamacare offers increased subsidies to assist low-income households and individuals with the purchase of health insurance,<sup>34</sup> its hidden costs on low-wage earners are significant. For example, “those subsidies shrink or disappear when household income exceeds certain thresholds . . . [creating] effective marginal tax rates in excess of 100 percent on low-income households.”<sup>35</sup> As a result, “[t]hose implicit marginal rates are far higher than the marginal tax rates faced by the wealthiest Americans.”<sup>36</sup>

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32. See, e.g., Epstein *supra* note 3, at 39–41 (explaining how government waivers undermine the rule of law and the legitimacy of the regulatory state).

33. See, e.g., Investors Bus. Daily, *ObamaCare Mandate No Fix-All*, Mar. 29, 2012, available at <http://finance.yahoo.com/news/obamacare-mandate-no-fix-185800892.html> (“A number of reports suggest that, at best, the Affordable Care Act will keep premiums the same, while others say it could actually push them higher than they would otherwise be.”).

34. 26 U.S.C. § 5000A(e) (Supp. IV 2011).

35. *Effect of Poverty: Hearing Before the Subcomm. On Primary Health and Aging of the S. Comm. on Health, Educ., Labor, and Pensions*, 111th Cong. (2011) (statement of Michael F. Cannon, Director of Health Policy Studies, Cato Institute).

36. *Id.*

Additionally, these implicit taxes create perverse incentives that make it increasingly costly for lower-income individuals to move up the economic ladder.<sup>37</sup> A step up in one's income level, accompanied by a loss in healthcare subsidies, could result in a net loss in earnings. And, shifting subsidy cutoff levels only moves the disincentive threshold to other income levels.<sup>38</sup> The result: a low-wage trap.<sup>39</sup>

## 2. *Greater Uncertainty, Slower Growth, and Fewer Low-Income Jobs*

Obamacare's most insidious effects on the poor relate to general economic growth and job prospects. Many of the law's supporters have argued that it spurs economic growth by reducing healthcare costs and creating jobs.<sup>40</sup> But, there is evidence to suggest that the opposite is true. The government's own Centers for Medicare & Medicaid Services (CMMS) estimates that "overall national health expenditures under the health reform act would increase by a total of \$311 billion" in the next decade.<sup>41</sup> Even supporters of the legislation have conceded that, "[f]or the most part, the Act does not take on the major drivers of higher costs"<sup>42</sup>

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37. Cf. Janet Holtzblatt & Benjamin Page, *Effects of Changes to the Health Insurance System on Labor Markets*, CONG. BUDGET OFF. ECON. & BUDGET ISSUE BRIEF, July 13, 2009, at 6, available at <http://www.cbo.gov/ftpdocs/104xx/doc10435/07-13-HealthCareAndLaborMarkets.pdf> ("[Medicaid] is structured so that eligibility for benefits is completely eliminated at a specified income . . . . For individuals whose income is close to that threshold, working more and earning a higher income can lead to the loss of Medicaid benefits, creating a disincentive to work more." (footnote omitted)).

38. Cf. *id.* ("Proposals that would simply extend Medicaid eligibility to families whose income was slightly higher than allowed under current law would effectively . . . reduc[e] disincentives to work for families at the current threshold but creat[e] new disincentives for families whose income was somewhat higher.").

39. See generally Michael F. Cannon, *Obama's Prescription for Low-Wage Workers: High Implicit Taxes, Higher Premiums*, POL'Y ANALYSIS, Jan. 13, 2010, at 3–9 (providing empirical statistics to demonstrate harm to low-income individuals).

40. See, e.g., *Affordable Care Act*, U.S. SENATOR HARRY REID, <http://www.reid.senate.gov/issues/upload/health-care-law-creates-jobs.pdf> (last visited June 10, 2012) (stating that "[t]he health care law makes investments in health care jobs"); see also Cutler, *supra* note 5 (noting that repealing healthcare reform would increase medical spending and "[d]estroy 250,000 to 400,000 jobs annually").

41. DEP'T OF HEALTH & HUMAN SERVS., OFFICE OF THE ACTUARY, ESTIMATED FINANCIAL EFFECTS OF THE "PATIENT PROTECTION AND AFFORDABLE CARE ACT," AS AMENDED (2010).

42. David Orentlicher, *Cost Containment and the Patient Protection and Affordable Care Act*, 6 FLA. INT'L U. L. REV. 67, 72 (2010) (arguing that cost-reduction

Yet, as the CMMS also noted, any cost estimates are “very uncertain” because of the unprecedented nature of the legislation.<sup>43</sup>

For similar reasons, Obamacare’s effect on jobs is difficult to calculate. But even some who doubt the law will lead to a major loss in jobs, acknowledge that the legislation is likely to result in a disproportionate shedding of low-wage jobs. For example, healthcare expert John Sheils of the The Lewin Group believes the number of jobs lost is likely to be “relatively small,” but acknowledges that his company’s “analysis showed 150,000 to 300,000 jobs lost, *all minimum wage or near minimum wage positions that would be lost permanently.*”<sup>44</sup>

Furthermore, the uncertainty created by the size and scope of the law is itself a barrier to growth. Under Obamacare’s employer mandate, employers that do not provide minimum “essential health benefits” will be penalized.<sup>45</sup> Businesses straddled with the likelihood of higher but uncertain costs are unlikely to create new jobs and far more likely to slash the ones that already exist.<sup>46</sup> Moreover, because increased employer costs will result in disproportionate downward pressures on unskilled labor markets, the jobs most affected by these costs will be the low-wage jobs relied upon by the poor.<sup>47</sup> Beyond calculable job loss, stymied economic

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measures were the trade-off for measures allowing wider coverage).

43. DEP’T OF HEALTH & HUMAN SERVS., *supra* note 41. Significantly, the CMMS recognized that Obamacare’s future impacts are “very uncertain” because

The legislation would result in numerous changes in the way that health care insurance is provided and paid for in the U.S., and the scope and magnitude of these changes are such that few precedents exist for use in estimation. Consequently, the estimates presented here are subject to a substantially greater degree of uncertainty than is usually the case with more routine health care legislation.

*Id.* This uncertainty makes it difficult for companies and individuals to calculate healthcare related costs accurately.

44. Brooks Jackson & Lori Robertson, *A “Job-Killing” Law?*, FACTCHECK.ORG (Jan. 7, 2011), <http://factcheck.org/2011/01/a-job-killing-law/> (emphasis added).

45. PPACA §§ 1302, 1513, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended at 42 U.S.C. § 18022 (Supp. IV 2011)).

46. See Paige Winfield Cunningham, *At Two-Year Mark, Health Law’s Legacy is Confusion*, WASH. TIMES (Mar. 19, 2012), <http://www.washingtontimes.com/news/2012/mar/19/at-two-year-mark-health-laws-legacy-is-confusion> (“Business owners say they can’t begin to comply with the law because it’s too baffling.”).

47. See James Sherk, *Obamacare Will Price Less Skilled Workers Out of Full-*

growth places an untold cost on the lives of the poor, as it is impossible to measure the number of *unrealized* job opportunities.

### III. WELFARE FOR THE WELL-CONNECTED: BAILOUTS AND CRONY CAPITALISM

Perhaps no federal actions in recent years have left a worse taste in the mouth of the American public than the handouts given to large corporations and entire industries deemed “too big to fail.” The understandable outrage, voiced through the Tea Party and Occupy movements, has called into question not just the policy rationales behind such corporate welfare, but the legal authority supporting it.<sup>48</sup> While many experts and politicians, including both Presidents Bush and Obama, have maintained that these bailouts were necessary to save the economy from a severe depression,<sup>49</sup> agreement on the causes of and solutions to the financial crisis is anything but absolute.

Indeed, many scholars and economists concluded that such interventions were not only unnecessary but dangerous because they likely reinforce the same risky behavior that led to the crisis.<sup>50</sup> According to these critics, by bailing out businesses that would have otherwise dissolved or gone into bankruptcy, the government has created implicit guarantees

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*Time Jobs*, THE HERITAGE FOUND. (Oct. 11, 2011), [http://thf\\_media.s3.amazonaws.com/2011/pdf/wm3390.pdf](http://thf_media.s3.amazonaws.com/2011/pdf/wm3390.pdf) (concluding that the employer mandate will increase the cost of hiring full-time employees and place many unskilled workers out of such positions).

48. See, e.g., *The Corporate Welfare State: A Cause to Unite the Tea Party and the Occupy Wall Street Crowd*, WALL ST. J. (Nov. 8, 2011), <http://online.wsj.com/article/SB10001424052970204002304576631192120542046.html> (discussing the mutual opposition of corporate welfare by both the Tea Party and Occupy Wall Street); *What is the Tea Party?*, TEAPARTY.ORG, <http://www.teaparty.org/about.php> (identifying as a core belief the idea that bailouts and stimulus plans are illegal).

49. See, e.g., Barack Obama, U.S. President, State of the Union (Jan. 24, 2012), in *President Obama's State of the Union Address*, N.Y. TIMES, Jan. 24, 2012, available at <http://www.nytimes.com/2012/01/25/us/politics/state-of-the-union-2012-transcript.html> (discussing the impact of the auto industry bailouts); Larry Kudlow, *Bush: TARP Bailout Needed to Avoid Depression*, MONEYNEWS (Nov. 22, 2010, 9:28 AM), <http://www.moneynews.com/LarryKudlow/Bush-Defends-TARP-presidency/2010/11/22/id/377759>.

50. See, e.g., Burton Abrams et al., *With All Due Respect, Mr. President, That is Not True*, CATO INST., [http://www.cato.org/special/stimulus09/cato\\_stimulus.pdf](http://www.cato.org/special/stimulus09/cato_stimulus.pdf) (last visited June 10, 2012) (stating that as a collective group of more than 300 economists, the government stimulus was not the proper response to the financial crisis).

that institutions facing similar financial uncertainty will be treated similarly. That is, more government intervention will be expected whenever another institution is widely believed to pose a systemic risk.

As a result, “bailout economics” both encourages and institutionalizes risky behavior. Such behavior, as the recent crisis has shown, creates enormous legal and market uncertainty that stifles economic growth. Furthermore, bailout policies have been characterized by a breakdown in the rule of law and an increase in ad hoc decision making, resulting in even more uncertainty that further exacerbates economic instability.

#### A. *TARP’s Dubious Constitutionality*

On October 3, 2008, in response to the incipient financial crisis, President George W. Bush signed into law the Emergency Economic Stabilization Act (EESA).<sup>51</sup> This legislation created the Troubled Asset Relief Program (TARP), under which the Treasury Secretary was authorized to buy toxic assets from insolvent banks.<sup>52</sup> But the program quickly morphed—from one designed to buy and secure troubled assets to a scheme equipped to inject capital directly into financial institutions by acquiring their stock.<sup>53</sup> TARP’s initial implementation thus gave Treasury Secretary Henry Paulson a \$700 billion blank check to infuse capital into the ailing U.S. financial system.<sup>54</sup> Moreover, the unprecedented price tag was accompanied by an equally unprecedented—and unconstitutional—use of federal power.

##### 1. *TARP Does Not Properly “Regulate” Commerce*

Under our system of enumerated powers, the federal government’s authority to act must come from some explicit constitutional grant. Where, then, does Congress get the power to spend taxpayer money to buy assets

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51. Pub. L. No. 110-343, 122 Stat. 3765 (2008).

52. EESA, tit. I, §§ 101–136, 12 U.S.C. §§ 5211–5241 (Supp. II 2009).

53. See, e.g., Jon Hilsenrath et al., *Central Banks Launch Coordinated Attack*, WALL ST. J., Oct. 9, 2008, available at <http://online.wsj.com/article/SB122346445779914857.html> (“Treasury Secretary Henry Paulson, in a marked shift in rhetoric, played up [the] Treasury’s newfound authority to ‘inject capital into financial institutions.’ [The] Treasury is trying to figure out how to structure such capital infusions so that banks can recapitalize and begin lending . . .”).

54. See Matthew Ericson et al., *Tracking the \$700 Billion Bailout*, N.Y. TIMES, [http://www.nytimes.com/packages/html/national/200904\\_CREDITCRISIS/recipients.html](http://www.nytimes.com/packages/html/national/200904_CREDITCRISIS/recipients.html) (last visited June 10, 2012).

and ownership interests in private financial institutions? Under modern constitutional theory, the instinctive answer might seem to be the Commerce Clause, because the financial institutions at issue certainly operate within interstate (and international) commerce.<sup>55</sup> Still, just as Congress can't do *anything* it wants to manage the healthcare market, it can't do *anything* it wants to regulate the financial market, regardless of how substantial an effect solving the financial crisis might have on interstate commerce. The Commerce Clause gives Congress the power to “‘regulate,’ but commerce is not regulated by eliminating private risk and substituting tax-funded handouts to favored economic actors.”<sup>56</sup> Moreover, it has never been shown that TARP was both a “necessary” and “proper” use of the commerce power. Just as with the individual mandate in relation to the larger Obamacare scheme, acquiring ownership interests in private financial institutions goes beyond federal regulatory authority, let alone the questionable legal basis for such actions *under TARP's own terms*.

## 2. *The EESA Unconstitutionally Delegates Power*

Even if TARP can be linked to a constitutionally granted congressional power, the manner in which the EESA delegates power is itself constitutionally defective. The stated purpose of the EESA—“to purchase . . . troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system”<sup>57</sup>—is too vague to adequately provide the necessary “intelligible principle” required by the nondelegation doctrine.<sup>58</sup> The Treasury Secretary was given near-plenary power over the allocated funds, while Congress remains a mere sideline observer to how these funds are used. Such delegations of authority undermine the political accountability that the nondelegation doctrine promotes allowing Congress to take credit for any benefits associated with

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55. See, e.g., Randy E. Barnett, *Commandeering the People: Why the Individual Health Insurance Mandate is Unconstitutional*, 5 N.Y.U. J.L. & LIBERTY 581, 588 (2010) (noting that “so long as Congress establishes a sweeping and ambitious regulatory scheme, it can reach any activity—whether economic or not—that it deems to be essential to that scheme” and stating that “for the first time in American history, [Congress may] use its commerce power to mandate that all individuals . . . engage in economic activity” (footnote omitted)).

56. Robert Levy, *Is the Bailout Constitutional?*, LEGAL TIMES, Oct. 20, 2008, available at <http://www.cato.org/publications/commentary/is-bailout-constitutional>.

57. EESA, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

58. See *supra* notes 28–30 and accompanying text.

TARP's bailouts, but disassociate itself from the political costs.<sup>59</sup>

In short, both the legal authority for TARP and the method by which it was implemented are constitutionally defective. As one constitutional scholar put it, "The federal government has no constitutional authority to spend taxpayers' money to buy distressed assets, much less to take an ownership position in private financial institutions."<sup>60</sup> Nor does Congress have the "constitutional authority to delegate nearly plenary legislative power to the Treasury secretary, an executive branch official."<sup>61</sup>

### B. *The Auto Bailouts' Rocky Legal Road*

The initial reactions to the financial crisis were no small affront to the Constitution, but they were just the beginning. After Congress debated and rejected an "automobile bailout bill" in December 2008, President Bush and Secretary Paulson intervened and diverted \$17.4 billion in TARP funds to General Motors and Chrysler.<sup>62</sup> And in March 2009, the new Obama Administration forced out GM's chairman and CEO and gave Chrysler thirty days to finalize a merger with Italian automaker Fiat in exchange for both companies' receiving additional TARP funds.<sup>63</sup> Nearly \$77 billion in TARP funds were eventually diverted to the automakers.<sup>64</sup> But, perhaps more troubling, these interventions involved a number of constitutionally dubious executive actions, the most notable being the illegal diversion of TARP funds and the undermining of bankruptcy law.

#### 1. *Illegal Diversion of TARP Funds to GM and Chrysler*

The EESA authorizes the Executive Branch, through TARP, to

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59. See David Schoenbrod, *The Delegation Doctrine: Could the Court Give It Substance?*, 83 MICH. L. REV. 1223, 1224 (1985) ("Unchecked delegation would undercut the legislature's accountability to the electorate and subject people to rule through ad hoc commands rather than democratically considered general laws." (footnote omitted)).

60. Levy, *supra* note 56.

61. *Id.*

62. David Rogers & Mike Allen, *Bush Announces \$17.4 Billion Auto Bailout*, POLITICO (Dec. 19, 2008, 8:22 AM), <http://www.politico.com/news/stories/1208/16740.html>.

63. Sheryl Gay Stolberg & Bill Vlasic, *U.S. Lays Down Terms for Auto Bailout*, N.Y. TIMES, Mar. 30, 2009, at A1.

64. Todd Zywicki, *The Auto Bailout and the Rule of Law*, 7 NAT'L AFF. 66, 68 (2011).



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“purchase . . . *troubled assets* from any *financial institution*.”<sup>65</sup> For purposes of the Act, “troubled assets” are defined as “residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability.”<sup>66</sup> And, “financial institutions” are defined as including any U.S. “bank, savings association, credit union, security broker or dealer, or insurance company.”<sup>67</sup> From the terms of the statute itself, an automobile company is not a “financial institution,” and none of the transactions related to the auto bailouts involved “residential or commercial mortgages” or real estate-related securities.

If the plain language of the statute is not enough to clarify the purpose of the EESA and TARP, the legislative history is even more telling. The congressional record shows that both the House and Senate contemplated that TARP funds would only be used for financial institutions.<sup>68</sup> Moreover, after President Bush announced that TARP funds would be used to bail out the auto giants, “26 irate Republican lawmakers sent a sharp letter to the president complaining that ‘Congress never voted for a federal bailout of the automobile industry, and the only way for TARP funds to be diverted to domestic automakers is with explicit congressional approval.’”<sup>69</sup> Even Treasury Secretaries Paulson and Geithner have publicly acknowledged that Congress had only intended TARP to bail out financial institutions.<sup>70</sup>

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65. EESA § 101, 12 U.S.C. § 5211(a)(1) (Supp. II 2009) (emphasis added).

66. *Id.* § 5202(9) (Supp. II 2009).

67. *Id.* § 5202(5).

68. See H.R. 1424, 110th Cong. (2007–2008).

69. Zywicki, *supra* note 64, at 73.

70. See “*Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Government Lending and Insurance Facilities: Impact on the Economy and Credit Availability: Hearing Before the H. Fin. Servs. Comm.*, 110th Cong. 18–19 (2008) (“The TARP was aimed at the financial system. That is what the purpose is.” (quoting Secretary of the Treasury Henry Paulson)); *Highlights: Geithner Testifies to House Appropriations Panel*, REUTERS (May 21, 2009, 2:41 PM), <http://reuters.com/article/2009/05/21/financial-geithner-idUSN2052531520090521> (“We are restricted to giving [TARP funds] to financial institutions.” (quoting Treasury Secretary Timothy Geithner)).

## 2. *Subversion of Creditors' Rights*

Despite the unconstitutional attempt to resuscitate GM and Chrysler, both companies eventually filed for Chapter 11 bankruptcy. “Instead of a regular bankruptcy proceeding, the Obama Administration, working with the automakers, patched together a process without precedent—a bankruptcy combined with a bailout, incorporating the worst elements of both.”<sup>71</sup> And, while both involved instances of questionable legality, the Chrysler bankruptcy was more egregious.

During Chrysler’s bankruptcy proceedings, the federal government subverted the rights of secured creditors—including teachers and police officers whose pensions were invested in the automaker—to appease politically powerful interests such as labor unions.<sup>72</sup> That is, it acted in contravention to the “absolute priority rule,” which is the linchpin of modern bankruptcy law and gives secured creditors first priority payment over junior creditors.<sup>73</sup> In the Chrysler case, secured creditors were forced to accept twenty-nine cents on the dollar, while the unsecured creditors of the United Auto Workers received more than forty cents on the dollar.<sup>74</sup> Such disregard for the normal course of bankruptcy law introduced both legal and economic uncertainty in the form of politically favored redistributions. As Professor Richard Epstein has explained, “Upsetting this fixed hierarchy among creditors is just an illegal taking of property from one group of creditors for the benefit of another, which should be struck down on both statutory and constitutional grounds.”<sup>75</sup>

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71. Zywicki, *supra* note 64, at 74.

72. See Zywicki, *supra* note 3, at 200 (“With Chrysler, the government intervened to take money from the company’s secured creditors—which included the pension funds for teachers and policemen—and give it to the retirement and health care funds of the politically powerful United Auto Workers, who had an unsecured claim in the case.” (footnote omitted)).

73. See generally Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738 (1988); see also Todd J. Zywicki, *Chrysler and the Rule of Law*, WALL ST. J. (May 13, 2009), <http://online.wsj.com/article/SB124217356836613091.html> (applying the absolute priority rule to the automaker bailout cases).

74. See Zywicki, *supra* note 64, at 74.

75. Richard A. Epstein, *The Deadly Sins of the Chrysler Bankruptcy*, FORBES (May 12, 2009, 12:00 AM), <http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html>.

### C. *The Real Costs of Bailout Economics*

Recently, voices as diverse as President Obama and Clint Eastwood have hailed the 2008–2009 bailouts as examples of successful government intervention.<sup>76</sup> While these bailouts may have prevented the dissolution of a number of America’s largest financial institutions and two of its largest automakers, they have come at significant costs to the respective industries and to the national economy.<sup>77</sup> And, while the fiscal costs are certainly staggering, the institutional costs may be even more consequential.

#### 1. *The Financial Burden of Bailouts*

From a pure dollars-and-cents budgetary perspective, the costs of TARP and the auto bailouts are obvious and astounding. Based on the most conservative estimates, hundreds of billions of dollars were spent on these various government bailout programs.<sup>78</sup> And, there is reason to believe the real-dollar costs of these policies were much higher. On November 27, 2011, *Bloomberg Markets Magazine* reported that the Federal Reserve (the Fed) bailed out banks struggling from the 2008 financial crisis with tens of billions of dollars in emergency loans that Congress didn’t even know existed.<sup>79</sup> Indeed, analysts estimated the Fed

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76. See, e.g., *Chrysler Halftime in America 2012 Superbowl Commercials* (NBC television broadcast Feb. 5, 2012), available at <http://www.nfl.com/videos/nfl-super-bowl-commercials/09000d5d826a09d0/Halftime-in-America>; Jim Kuhnenn, *Obama Hails Auto Bailout, Hits Back at GOP Critics*, BOSTON.COM (Feb. 29, 2012), [http://articles.boston.com/2012-02-29/nation/31106782\\_1\\_auto-industry-auto-bailout-uaw](http://articles.boston.com/2012-02-29/nation/31106782_1_auto-industry-auto-bailout-uaw); see also Obama, *supra* note 49.

77. Although preventing GM and Chrysler from folding up was one of the justifications for the auto bailouts, that outcome was not inevitable. True, the companies were bleeding cash and straddled in debt, but in the absence of government intervention, their financial positions would have forced GM and Chrysler into (normal) bankruptcy. They would then, in due course, have been restructured, albeit under vastly different terms. The rest of the industry—both Ford and the U.S. subsidiaries of Toyota, Nissan, BMW, and other companies with manufacturing plants in right-to-work states less beholden to union pressure—would have been better off not having to compete with the taxpayer-subsidized “Government Motors.”

78. CONG. BUDGET OFFICE, CBO 4253, REPORT ON THE TROUBLED ASSET RELIEF PROGRAM 2 (2011), available at <http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/121xx/doc12118/03-29-tarp.pdf>.

79. See Bob Ivry et al., *Secret Fed Loans Gave Banks \$13 Billion Undisclosed to Congress*, BLOOMBERG MARKETS MAG. (Nov. 27, 2011, 6:01 PM), <http://www.bloomberg.com/news/2011-11-28/secret-fed-loans-undisclosed-to-congress-gave-banks-13-billion-in-income.html> (“Add up guarantees and lending limits, and the Fed had

had committed about \$7.77 trillion to rescuing the financial system by March of 2009.<sup>80</sup>

Unfortunately, while the size and scope of TARP and auto bailouts may be unprecedented, the policies behind them are not: corporate subsidies are far too common in American politics. The Cato Institute estimates that the government hands out \$125 billion per year in corporate welfare, with some of the biggest beneficiaries being companies like Boeing, Xerox, IBM, Motorola, Dow Chemical, and General Electric.<sup>81</sup> Worse yet, corporate welfare leads to more corporate welfare, as competitors seek to get their slice of the taxpayer-baked pie.<sup>82</sup> So, while the American public was told that these most recent corporate welfare programs were a unique fix to stop the Great Recession from turning into a depression, crony capitalism appears to be a constant force perverting the American political system.<sup>83</sup>

## 2. Institutionalized Risks and Socialized Costs

Beyond their enormous financial costs, government bailouts and crony capitalism have far-reaching systemic and social costs. The socialization of private debt not only burdens current and future

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committed \$7.77 trillion as of March 2009 to rescuing the financial system, more than half the value of everything produced in the U.S. that year.”).

80. *Id.*

81. Michael Tanner, *No More Bipartisan Bailouts*, NAT'L REV. ONLINE (Feb. 1, 2012, 12:00 AM), <http://www.nationalreview.com/articles/289778/no-more-bipartisan-bailouts-michael-tanner#>.

82. This may be why the Obama Administration was quick to approve a \$5.6 billion retooling loan for Ford, which initially took on \$23 billion in debt to avoid being bailed out like its competitors, GM and Chrysler. See Shikha Dalmia, *GM Profits, But Taxpayers Are Still on the Hook*, BLOOMBERG VIEW (Feb. 12, 2012, 6:00 PM), <http://www.bloomberg.com/news/2012-02-13/gm-profits-but-taxpayers-are-still-on-the-hook-shikha-dalmia.html>.

83. “Bailout supporters maintain that it was a one-time deal necessary to shore up companies in acute economic times. In reality, the rush for the bailout’s spoils has produced ripple effects that may well haunt the economy for a long time.” *Id.*; see generally TIMOTHY P. CARNEY, *THE BIG RIPOFF: HOW BIG BUSINESS AND BIG GOVERNMENT STEAL YOUR MONEY* (2006) (examining how the government and big business assist one another to their own benefit). Such cronyism is just as pervasive at the state and local levels. “[W]hile baseball may be the national pastime of the citizenry, dishing out special economic benefits to certain in-state industries remains the favored pastime of state and local governments.” *Powers v. Harris*, 379 F.3d 1208, 1221 (10th Cir. 2004) (footnote omitted).

generations through a rapidly increasing federal deficit, but it undermines the rule of law, creates moral hazard in the industries propped up by government handouts, and stifles economic growth and innovation.

By ignoring constitutional limits on power, separation of powers principles, and skirting bankruptcy laws to benefit politically favored interests, elected officials have seriously undermined the rule of law—the founding ideal that our nation should be governed by laws, not the arbitrary predilections of men.<sup>84</sup> A breakdown in the rule of law means greater uncertainty to individuals and businesses that rely on predetermined rules in their everyday lives.<sup>85</sup> Ad hoc rulemaking renders calculating risk even more difficult, resulting in slower economic growth.<sup>86</sup> Few things threaten a stable business climate more than a regulatory regime defined by ever-shifting political winds.

Moreover, implicit government guarantees of industry bailouts create moral hazard in these industries—that is, they encourage, rather than discourage, risky behaviors that lead to large-scale crises.<sup>87</sup> Only institutions “too big to fail” will be treated so generously, so these policies create a perverse incentive for financial institutions to expand and diversify

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84. See Zywicki, *supra* note 73 (“The rule of law, not of men—an ideal tracing back to the ancient Greeks and well-known to our Founding Fathers—is the animating principle of the American experiment. While the rest of the world in 1787 was governed by the whims of kings and dukes, the U.S. Constitution was established to circumscribe arbitrary government power. It would do so by establishing clear rules, equally applied to the powerful and the weak.”).

85. Cf. Brief *Amici Curiae* of National Federation of Independent Small Business Legal Center & Cato Institute in Support of Respondents at 13, *United States v. Home Concrete & Supply, LLC*, 132 S. Ct. 1836 (2011) (No. 11-139), 2011 WL 6468701 (concluding that under the IRS’s ad hoc rulemaking approach “[t]axpayers would be unable to assess liability at the time it was incurred or anticipate what rules would be applied to them at a later date”).

86. See, e.g., Todd Zywicki, *The Rule of Law, Freedom, and Prosperity* 10 (George Mason Law & Econ., Research Paper No. 02-20, 2002) (“Rule-bound decision-making tends to be more predictable than other forms of behavior. Thus, bright-line legal rules also tend to the promotion of economic growth.”).

87. “Moral hazard” is a term used in economic theory to describe a situation in which one person or entity decides how much risk to take while the costs of that risk are covered, at least in part, by other persons or entities. As the *Wall Street Journal* has defined it, moral hazard is “the distortions introduced by the prospect of not having to pay for your sins.” Eric Weiner, *Subprime Bailout: Good Idea or “Moral Hazard?”*, NPR.ORG (Nov. 29, 2007), <http://www.npr.org/templates/story/story.php?storyId=16734629> (quoting the *Wall Street Journal*).

risky balance sheets.<sup>88</sup> Large institutions can pursue abnormally high returns with less concern for the high risks that often accompany such investments, as the government assumes the risk that would otherwise temper such behavior.<sup>89</sup> The fix is in: heads, the financial giants win; tails, the U.S. taxpayers lose. Instead of reducing the reckless investment behavior that led to the bailouts, these interventions have institutionalized “too big to fail.”<sup>90</sup>

Likewise, policies that pick industry winners and losers and increase government ownership stakes in financial institutions have their own costs. Rather than let these companies dissolve or restructure through bankruptcy courts, government intervention prevents resources and capital from being more efficiently—and legally—allocated. New jobs and industries are sacrificed for the sake of old, politically favored jobs and mismanaged companies. “The overall effect of such state capitalism is a kind of controlled stasis, in which the preservation of old jobs takes priority over the creation of new ones.”<sup>91</sup> It is no surprise, then, that empirical studies have shown greater government ownership in financial institutions is associated with lower growth in per capita income and productivity.<sup>92</sup> What we get is an economy defined by “[m]anaged decline, rather than

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88. See, e.g., Emmanuel Farhi & Jean Tirole, *Collective Moral Hazard, Maturity Mismatch, and Systemic Bailouts*, 102 AM. ECON. REV. 60, 62 (2012) (“Refusing to adopt a risky balance sheet then lowers banks’ rate of return. It is unwise to play safely while everyone else gambles.”).

89. See Kevin Dowd, *Moral Hazard and the Financial Crisis*, 29 CATO J. 141, 142–43 (2009) (describing this “increased risk-taking” as “if I can take risks that you have to bear, then I may as well take them; but if I have to bear the consequences of my own risky actions, I will act more responsibly”).

90. See, e.g., Editorial, *Halftime in Detroit: Taxpayers Will Be Paying for the Auto Bailouts for Decades to Come*, WALL ST. J., Feb. 25, 2012, available at <http://online.wsj.com/article/SB10001424052970204909104577235241393891490.html> (“The bailouts signaled that major companies with union labor are too politically big to fail and undermined confidence in the rule of law.”).

91. See Zywicki, *supra* note 64, at 80.

92. See Rafael La Porta et al., *Government Ownership of Banks*, 57 J. FIN. 265, 290 (2002), available at <http://www.economics.harvard.edu/faculty/shleifer/files/GovtOwnershipBanks.pdf>. More than three years after the first TARP funds were distributed, the U.S. government still has an equity interest in 371 banks and majority ownership in a small number of those institutions. Mark A. Calabria, *Some Consequences of Government Ownership of Banks*, CATO@LIBERTY (Mar. 1, 2012, 1:17 PM), <http://www.cato-at-liberty.org/some-consequences-of-government-ownership-of-banks/>.

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dynamic growth.”<sup>93</sup>

In sum, rather than promote stability, bailouts have led to greater uncertainty in an already-fragile business environment. Such volatility has no doubt impeded broader growth. An economy defined by political favoritism may benefit those who are in the favored industries, but the vast majority of Americans will not be so lucky.

#### IV. SARBANES-OXLEY AND DODD-FRANK: THE OVERREACH AND UNINTENDED CONSEQUENCES OF CRISIS REGULATION

In the wake of far-reaching crises, a common instinct is to respond with equally far-reaching government action.<sup>94</sup> New, expansive laws and bureaucracies are often seen as the only means of preventing such crises from reoccurring. Because the federal government is the only entity capable of enacting such sweeping responses on a national scale, it is Congress and the President who are pressured—or take it upon themselves—to pursue such actions. Much of the modern regulatory state has developed in just this way.

Yet, it is also too often the case that, when pursuing such policies, little attention is paid to whether there exists constitutional warrant for the federal power asserted. Even less attention seems to be paid to the unintended consequences of the new regulatory regimes. Two recent examples of such crisis responses came over the course of the last decade in the form of the Sarbanes-Oxley and Dodd-Frank Acts.

##### *A. Sarbanes-Oxley’s Constitutional Defects*

The Sarbanes-Oxley Act (Sarbox) was enacted on July 30, 2002, after near-unanimous votes in both houses of Congress in response to a national crisis in corporate governance.<sup>95</sup> In the wake of the major accounting

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93. See Zywicki, *supra* note 64, at 80.

94. “You never want a serious crisis to go to waste.” Rahm Emanuel, *quoted in* Gerald F. Seib, *In Crisis, Opportunity for Obama*, WALL ST. J., Nov. 21, 2008, available at <http://online.wsj.com/article/SB122721278056345271.html>.

95. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002); *H.R. 3763 (107th): Sarbanes-Oxley Act of 2002 (On the Conference Report)*, GOVTRACK.US, <http://www.govtrack.us/congress/votes/107-2002/s192> (last visited June 25, 2012); *H.R. 3763 (107th): Sarbanes-Oxley Act of 2002 (On the Conference Report)*, GOVTRACK.US, <http://www.govtrack.us/congress/votes/107-2002/h348> (last visited June 25, 2012).

scandals that engulfed Enron, WorldCom, and others, this unprecedented response was deemed necessary to restore public confidence in the U.S. securities markets after investors lost billions.<sup>96</sup> At the time, President Bush touted Sarbox as “the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt.”<sup>97</sup> Unfortunately, the means chosen to remedy this crisis were of questionable constitutionality and have placed an enormous burden on America’s economy. As discussed later in this Article, Sarbox has cost far more in both compliance costs and forestalled growth than it ever hoped to save in preventing waste and fraud.<sup>98</sup>

The constitutional problems with Sarbox primarily lie with the enforcement body that enforces the new regulatory regime—the Public Company Accounting Oversight Board (PCAOB)—and the broad discretionary and rulemaking powers granted to this body. For example, the statute required decisions to remove PCAOB members be made by the Securities and Exchange Commission, another independent agency, and not the President.<sup>99</sup> In *Free Enterprise Fund v. PCAOB*, the Supreme Court rolled back part of this unconstitutional power-grant when it struck down Sarbox’s prohibition on removing PCAOB members without cause.<sup>100</sup> In its ruling, the Court concluded:

Without the ability to oversee the Board, or to attribute the Board’s failings to those whom he *can* oversee, the President is no longer the judge of the Board’s conduct. He is not the one who decides whether Board members are abusing their offices or neglecting their duties. He can neither ensure that the laws are faithfully executed, nor be held responsible for a Board member’s breach of faith. This violates the basic principle that the President “cannot delegate ultimate

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96. See Elisabeth Bumiller, *Corporate Conduct: The President; Bush Signs Bill Aimed at Fraud in Corporations* (July 31, 2002), <http://www.nytimes.com/2002/07/31/business/corporate-conduct-the-president-bush-signs-bill-aimed-at-fraud-in-corporations.html?src=pm>.

97. *Id.*

98. See *infra* Part IV.C.

99. 15 U.S.C. § 7211(e)(6) (2006); see also Hans Bader, *Free Enterprise Fund v. PCAOB: Narrow Separation-of-Powers Ruling Illustrates That the Supreme Court is Not “Pro-Business,”* 2009–2010 CATO SUP. CT. REV. 269, 270 (“Under the statute, any decision to remove PCAOB members had to be made not by the president, but by another independent agency whose members can also only be removed for cause, the Securities and Exchange Commission.” (footnote omitted)).

100. *Free Enter. Fund v. PCAOB*, 130 S. Ct. 3138, 3151–61 (2010).



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*responsibility or the active obligation to supervise that goes with it . . . .*<sup>101</sup>

While recognizing the unconstitutionality of the non-removal provisions and the lack of a severability clause, the Court refused to strike down Sarbox in its entirety—or any other equally offensive provisions.<sup>102</sup> “Even after the Court’s decision, the PCAOB members, whose pay exceeds the president’s, retain considerable power.”<sup>103</sup> Nor has the Court addressed the Board’s legislative-like features or many of its other sweeping powers. Thus, the PCAOB remains “an enforcement body that is at once lawmaker, tax collector, inspector, sheriff, prosecutor, judge and jury.”<sup>104</sup>

In the decade since its passage, there has been widespread recognition of Sarbox’s flaws; even its authors have acknowledged the profound errors in the originally drafted legislation,<sup>105</sup> and the Obama administration also “tacitly recognized that the PCAOB had overregulated when it joined Republicans and moderate Democrats in backing an exemption to the PCAOB’s internal-controls rules for small public companies.”<sup>106</sup> Despite broad agreement over Sarbox’s failures, much of the law remains in place, as this regulatory behemoth has taken on a life of its own.

#### B. *Dodd-Frank’s Constitutional Defects*

One of the most consequential responses to the 2008 financial crisis was the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.<sup>107</sup> Signed into law on July 21, 2010, Dodd-Frank was intended “to promote the financial stability of the United States by improving

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101. *Id.* at 3154 (second emphasis added) (quoting *Clinton v. Jones*, 520 U.S. 681, 712–13 (1997) (Breyer, J., concurring)).

102. *See id.* at 3161.

103. Bader, *supra* note 99, at 271 (footnote omitted).

104. Ilya Shapiro & Travis Cushman, *Peekaboo, I See a Constitutional Violation*, THE AMERICAN (Dec. 5, 2009), <http://www.american.com/archive/2009/december-2009/peekaboo-i-see-a-constitutional-violation>.

105. *See Sarbanes Oxley: Five Years Under the Thumb*, ECONOMIST, July 26, 2007, at 73 (“Even its authors have reservations, conceding that its hasty passage into law meant it was badly drafted in parts. ‘Frankly, I would have written it differently,’ Michael Oxley, one of the former congressmen who drafted the act said in March. He added that the same was true of his co-author, Paul Sarbanes.”).

106. Bader, *supra* note 99, at 282 (footnote omitted).

107. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

accountability and transparency in the financial system, to end ‘too big to fail,’ to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”<sup>108</sup> As with Sarbox, however, Dodd-Frank is more likely to stunt economic growth while doing little to cure the problems it was intended to cure. Moreover, as Senator Richard Shelby (R-AL) put it, despite the purported intent of its authors, Dodd-Frank “reinforce[s] the expectation that the government stands ready to intervene on behalf of large and politically connected financial institutions at the expense of Main Street firms and the American taxpayer. Therefore, the bill *institutionalizes* ‘too big to fail.’”<sup>109</sup>

Dodd-Frank raises several issues related to constitutional structure. These include vagueness in legislative power-grants, improper delegation of power, and other separation of powers concerns. First, the vagueness of the terms, phrases, and standards found throughout the Act grant unchecked authority to the new agencies the law created, especially when combined with a curtailing of judicial review. Second, the Act raises serious concerns under the nondelegation doctrine; Dodd-Frank requires from 240 to 540 new rules by about a dozen different agencies, and Congress has delegated a broad area of lawmaking to these agencies with (again) no intelligible limiting principle.<sup>110</sup>

Finally, and perhaps most troubling, are the separation of powers concerns raised by Dodd-Frank’s express limits on judicial review. The Act severely limits the scope of judicial review by: (1) only allowing courts to review whether the Treasury Secretary’s determinations of receivership are “arbitrary and capricious”; (2) forcing courts to accept the statutory interpretations of the Consumer Financial Protection Bureau director; and (3) preventing courts from reviewing whether the Financial Stability Oversight Council (FSOC) has correctly interpreted the statute.<sup>111</sup> Moreover, given the broad discretionary authority granted to bureaucratic agencies, Dodd-Frank provides insufficient oversight by *any* branch of

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108. *Id.*

109. Letter from Richard Shelby, U.S. Senator, to Timothy Geithner, Treasury Sec’y (Mar. 25, 2010) (emphasis added), *available at* [http://msnbcmedia.msn.com/i/CNBC/Sections/News\\_And\\_Analysis/\\_News/\\_EDIT%20Englewood%20Cliffs/ShelbytoGeithner.pdf](http://msnbcmedia.msn.com/i/CNBC/Sections/News_And_Analysis/_News/_EDIT%20Englewood%20Cliffs/ShelbytoGeithner.pdf).

110. C. Boyden Gray & John Shu, *The Dodd-Frank Wall Street Reform & Consumer Protection Act of 2010: Is It Constitutional?* 11 ENGAGE 66, 66 (2010).

111. Dodd-Frank, 12 U.S.C. § 5323(h) (Supp. IV 2011).

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government. An analysis of the law's new agencies, as well as of the appointment of one of their directors, will highlight these constitutional deficiencies.

1. *The Financial Stability Oversight Council*

The FSOC raises many of the vagueness and nondelegation concerns mentioned above.<sup>112</sup> This body is granted broad discretion in regulating companies whose activities threaten “financial stability,” a term used throughout the Act but left undefined.<sup>113</sup> It also has the power to make recommendations to the Federal Reserve Board of Governors “concerning the establishment and refinement of prudential standards and reporting and disclosure requirements.”<sup>114</sup> Additional vagueness concerns arise from the FSOC’s authority over companies that pose “a grave threat to the financial stability of the United States”<sup>115</sup> and over practices that “could create or increase the risk of significant liquidity, credit, or other problems spreading among bank holding companies and nonbank financial companies, financial markets of the United States, or low-income, minority, or underserved communities.”<sup>116</sup> None of these phrases is defined. Without further legislative guidance, the FSOC is likely to interpret these terms to enhance its authority in unforeseeable and unbounded ways.

2. *The Consumer Financial Protection Bureau*

Similar problems plague the Consumer Financial Protection Bureau (CFPB). This new executive agency was given the mandate to “regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws,”<sup>117</sup> which means it essentially “has the authority to implement and enforce all consumer-related laws involving finance and credit, and thus will dictate credit allocation in the U.S. economy.”<sup>118</sup> Its authority is based on such vague terms as “unfair,”

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112. *See supra* Part IV.B.

113. *See, e.g.,* Dodd-Frank, 12 U.S.C. §§ 5325, 5330, 5331, 5361, 5365, 5373 (Supp. IV 2011). Conducting a general search for “financial stability” within the Act demonstrates how extensively this term is used.

114. *Id.* § 5325(a)(1) (Supp. IV 2011).

115. *Id.* § 5331(a) (Supp. IV 2011).

116. *Id.* § 5330(a) (Supp. IV 2011).

117. *Id.* § 5491(a) (Supp. IV 2011).

118. *See* Gray & Shu, *supra* note 110, at 70 (footnote omitted).

“deceptive,” “abusive,” and “discrimination.”<sup>119</sup> But, even more troublesome, the CFPB has also been given: (1) the authority to define these vague terms; and (2) the discretion to determine how to apply them to financial products, services, and the consumer-financial industry generally.<sup>120</sup>

Moreover, Dodd-Frank houses the CFPB within the Fed, thus “placing one protected entity . . . within another.”<sup>121</sup> Congress does not even “have the power of the purse over the CFPB because the CFPB director determines his own budget, which the Federal Reserve Board ‘shall transfer to the [CFPB] from the combined earnings of the Federal Reserve System.’”<sup>122</sup> The CFPB is thus yet another entity subject to little oversight and given the ability to define its own authority.

### 3. *The Orderly Liquidation Authority*

The Orderly Liquidation Authority (OLA) raises serious separation of powers and due process concerns.<sup>123</sup> Upon two-thirds vote of both the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board, the OLA “shall consider whether to make a written recommendation” as to whether the Treasury should appoint the FDIC as a company’s receiver.<sup>124</sup> Furthermore, courts cannot restrain the receiver from exercising their powers, and the Treasury can petition district courts to seize not just banks that receive government support but any non-bank financial institution that the government thinks is in danger of default and could pose a systemic risk.<sup>125</sup> If the entity resists seizure, the proceedings go secret and a federal judge is given twenty-four hours to decide “on a strictly confidential basis” whether to allow receivership.<sup>126</sup> There is also no provision for a stay to limit judicial review and the (secret) court can eliminate all judicial review by doing nothing for twenty-four hours—at which point the petition is automatically granted and liquidation proceeds.<sup>127</sup> On top of all that, judicial review is limited to the entity’s

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119. Dodd-Frank, 12 U.S.C. § 5511(b)(2) (Supp. IV 2011).

120. *See id.* §§ 5512(a)–(b) (Supp. IV 2011).

121. *See Gray & Shu, supra* note 110, at 71.

122. *Id.* (quoting Dodd-Frank § 1017(a)(1)).

123. Do you see a theme here?

124. Dodd-Frank, Pub. L. No. 111-203, § 203(a)(1)(A), 124 Stat. 1450 (2010).

125. *Id.* § 202(a)(1)(A)(i).

126. *Id.* §§ 202(a)(1)(A)(iii), (v).

127. *Id.* § 202(a)(1)(A)(v).

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soundness.<sup>128</sup>

#### 4. *The Cordray Recess Appointment*

The January 2012 appointment of Richard Cordray as director of the CFPB is an example of the same constitutional disregard in the implementation of Dodd-Frank that plagues the Act's text. In pertinent part, the Constitution states that the President can "fill up all Vacancies that may happen *during the Recess of the Senate*."<sup>129</sup> It further states, however, that "[n]either House . . . shall, *without the Consent of the other*, adjourn for more than three days."<sup>130</sup> Just as Democrats had done during the Bush Administration, the Republican-controlled House in the 112th Congress refused to consent to adjourn, precisely to block President Obama from making recess appointments.<sup>131</sup> Yet the President ignored both the spirit and letter of the Constitution by appointing Cordray.

Beyond the constitutional defects, the Cordray appointment *violates Dodd-Frank itself*. The Act clearly states: "The Secretary is authorized to perform the functions of the Bureau under this subtitle until the Director of the Bureaus is confirmed by the Senate in accordance with section 1011."<sup>132</sup> Cordray has no authority to perform the functions of the CFPB director because he was never confirmed by the Senate.

From its text to its execution, Dodd-Frank and the regulatory regime it seeks to implement are legally infirm.

#### C. *Regulatory Costs*

Much like the bailout policies discussed above, the costs of massive regulatory schemes such as those created by Sarbox and Dodd-Frank are both financial and institutional. These immense bureaucracies inhibit innovation and growth while restructuring regulated sectors in ways that tend to give more power to entrenched interest groups. And once in place, they are nearly impossible to dismantle.

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128. *Id.* §§ 202(a)(1)–(2).

129. U.S. CONST. art. II, § 2, cl. 3 (emphasis added).

130. U.S. CONST. art. I, § 5, cl. 4 (emphasis added).

131. *See, e.g.*, Roger Pilon, *Obama's Sham Constitutionalism*, DAILY CALLER (Jan. 5, 2012, 5:35 PM), <http://dailycaller.com/2012/01/05/obamas-sham-constitutionalism/>.

132. Dodd-Frank, Pub. L. No. 111-203 § 1066(a).

1. *Compliance Costs and Arbitrary Rules Stymie Innovation and Growth*

The compliance costs associated with such massive regulatory bureaucracies are themselves enough to restrain innovation and growth. For example, in a letter to prospective shareholders accompanying his company's initial public offering (IPO) filings, Facebook founder and CEO Mark Zuckerberg explained that compliance with Sarbanes-Oxley, Dodd-Frank, and other regulations "will increase our legal and financial compliance costs, make some activities more difficult, time-consuming, or costly, and increase demand on our systems and resources."<sup>133</sup> And, while the costs of Dodd-Frank compliance are still highly speculative due to many questions surrounding its legality and implementation, the financial burden of Sarbanes-Oxley is clearer.<sup>134</sup> Since its enactment in 2002, Sarbox has cost the U.S. economy \$1.4 trillion.<sup>135</sup>

The broad discretion given to regulators under Sarbox and Dodd-Frank also fuels greater market uncertainty, leading to even higher costs and slower growth. Former Fed Chairman Alan Greenspan has noted that "the unprecedented complexity of final rulemaking required in the massive Dodd-Frank bill" will create "inevitable uncertainty" that will "inhibit financial innovation and intermediation, and render the rules that will govern a future financial marketplace disturbingly conjectural."<sup>136</sup> As the former Chairman notes, "This is bound to have a significant impact on economic growth."<sup>137</sup>

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133. Facebook, Inc., Registration Statement (Form S-1) 30 (Feb. 1, 2012), available at <http://www.sec.gov/Archives/edgar/data/1326801/000119312512034517/d287954ds1.htm>; see also John Berlau, *Facebook Filing Blasts Obama-Bush Overregulation of Sarbanes-Oxley and Dodd-Frank*, CEI OPENMARKET.ORG (Feb. 2, 2012), <http://www.openmarket.org/2012/02/02/facebook-filing-blasts-obama-bush-overregulation-of-sarbanes-oxley-and-dodd-frank/>.

134. See, e.g., *Sarbanes-Oxley*, *supra* note 105 ("It soon became clear that the costs of implementing SOX's provisions . . . far exceeded the modest sums initially predicted.").

135. HENRY N. BUTLER & LARRY E. RIBSTEIN, *THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT* 5 (2006); Bader, *supra* note 99, at 269 (footnote omitted); see also Editorial, *Sarbanes-Oxley on Trial*, WALL ST. J. (Dec. 4, 2009), <http://online.wsj.com/article/SB10001424052748704107104574571662869948676.html>.

136. Alan Greenspan, *Fear Undermines America's Recovery*, FIN. TIMES, Oct. 6, 2010, available at <http://www.ft.com/intl/cms/s/0/4524339a-d17a-11df-96d1-00144feabdc0.html>.

137. *Id.*; see also *The Dodd-Frank Act: Too Big Not to Fail*, ECONOMIST, Feb. 18, 2012, at 5 (noting that the biggest problem with Dodd-Frank is the risk that it "will

Maneuvering through these costly rules and regulations may be feasible for companies as large and profitable as Facebook, but the effects of such schemes on smaller businesses and startups are devastating.<sup>138</sup> High compliance costs make it difficult for smaller businesses to keep their doors open and stay competitive, while preventing many businesses from ever opening their doors in the first place.<sup>139</sup>

## 2. *Regulatory Capture and Regulatory Gaming*

Regulatory capture is the phenomenon by which an agency charged with serving the public interest actually advances the special interests of the industry or sector it was created to regulate.<sup>140</sup> In such instances, market-replacing regulations remove power from consumers and put it in the hands of industry-insiders who are often the same actors being regulated. Even those who doubt the use of capture analysis as a general tool for analyzing regulatory policy acknowledge that it is “very relevant in the context of contemporary financial regulation.”<sup>141</sup> That’s because large financial institutions “have secured such dominant influence that it may be

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smother financial institutions in so much red tape that innovation is stifled and America’s economy suffers”).

138. See *Effect of Dodd-Frank on Small Financial Institutions and Small Business Before the Subcommittee on Financial Institutions and Consumer Credit of the H. Comm. On Financial Services*, 112th Cong. 13–14 (statement of Chris Stinebert, President and CEO, American Financial Services Association) (expressing concern about the cost of compliance with federal regulations, noting that it is 45% higher for small businesses and that such businesses lack access to credit as a result of Dodd-Frank).

139. See *id.*; *The Dodd-Frank Act: Too Big Not to Fail*, *supra* note 137 (stating the cost of compliance is “staggering,” estimating \$400–\$600 million annually in costs to JP Morgan Chase and \$9–\$16 billion for manufacturers).

140. See George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) (developing regulatory capture theory and explaining “that as a rule, regulation is acquired by the industry and is designed and operated primarily for its [own] benefit”); see also Frédéric Boehm, *Regulatory Capture Revisited—Lessons from Economics of Corruption*, 4–7 (Internet Ctr. for Corruption Research, Working Paper No. 22, 2007), available at <http://www.icgg.org/downloads/Boehm%20-%20Regulatory%20Capture%20Revisited.pdf> (“The idea that powerful organizations with private interests may capture the government in order to foster their private goals is certainly not a recent one. At least, similar ideas go back to Montesquieu and, later, to Karl Marx in the 19th Century.”).

141. Lawrence G. Baxter, “*Capture*” In *Financial Regulation: Can We Channel It Toward the Common Good?*, 21 CORNELL J.L. & PUB. POL’Y 175, 181 (2011).

said that they have captured the regulators, the regulatory process, and the regulatory outcomes” at the expense of “many other important interests.”<sup>142</sup>

Related to the capture problem is the extent to which such regulatory schemes allow or encourage actors to game the system by exploiting loopholes in the relevant legislation. For instance, one of Dodd-Frank’s most controversial provisions—the “Volcker Rule”<sup>143</sup>—is a perfect example of how shifting incentives can lead to such gaming. In response to the Volcker rule’s ban on “proprietary trading,” some “bank departments previously using the word ‘proprietary’ have been dropped, renamed or quietly shifted to sheltered corners.”<sup>144</sup> According to Goldman Sachs CFO David Viniar, “inefficiencies in the market resulting from Volcker could make trading more profitable” for some, “which was hardly the point.”<sup>145</sup> And, just as high compliance costs are more easily covered by large firms, the biggest industry actors are the ones best positioned to exploit loopholes and wield the most influence in an ever-growing regulatory state.<sup>146</sup> Consequently, the costs of such perversions will fall most heavily on those, such as the poor, who are unable to exercise such influence.

#### V. UNCONSTITUTIONAL HOUSING POLICIES: DISPARATE IMPACT AND RENT CONTROL

The effects of unconstitutional government policies on the poor are not confined to the general health of the economy and job opportunities. Such policies also affect another area that is of constant concern for those living in poverty: affordable, quality housing. Moreover, the effects of these policies go well beyond whether or not the government is subsidizing or providing housing for poor individuals and families. Indeed, many

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142. *Id.* (footnote omitted).

143. Dodd-Frank, 12 U.S.C. § 1851 (Supp. IV 2011) (provision named after former Federal Reserve Chairman, Paul Volcker). *See also* Victoria McGrane & Scott Patterson, “Volcker Rule” Timeline Is Set, WALL ST. J., Apr. 19, 2012, available at <http://online.wsj.com/article/SB10001424052702303513404577354012090783798.html>.

For more on Volcker’s views on financial reform, see Paul Volcker, *How to Reform Our Financial System*, N.Y. TIMES, Jan. 30, 2010, at WK11.

144. *The Dodd-Frank Act: Too Big Not to Fail*, *supra* note 137, at 6.

145. *Id.*

146. *Id.* at 8 (“A few [bankers] also see the possibility of gaining an edge: some well established banks consider themselves better able to handle the costs than smaller or newer ones, particularly those that don’t have cushy relationships with regulators.”).



government housing policies that infringe on constitutionally protected rights actually work to undermine other policies seeking to expand the availability and improve the quality of low-income housing. Two such policies are particularly noteworthy: disparate-impact claims under the Fair Housing Act (FHA) and rent control.

A. *The Unequal Protection of Disparate-Impact Claims*

The FHA makes it unlawful “[t]o refuse to sell or rent after the making of a bona fide offer . . . or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.”<sup>147</sup> While the language and intent of this statute is directed at intentional discrimination,<sup>148</sup> the Department of Housing and Urban Development (HUD) has joined some federal courts in supporting a “disparate impact” approach to FHA actions.<sup>149</sup> Under such an approach, plaintiffs unable to show intentional discrimination based on race need only show that an otherwise neutral practice has a

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147. 42 U.S.C. § 3604(a) (2006).

148. See, e.g., 114 CONG. REC. S5643 (daily ed. Mar. 7, 1968) (statement of Sen. Mondale) (“The bill permits an owner to do everything that he could do anyhow with his property . . . except refuse to sell it to a person solely on the basis of his color or his religion. That is all it does.”); 114 CONG. REC. S2283 (daily ed. Feb. 6, 1968) (statement of Sen. Brooke) (“[A]ll we are saying in this amendment is that we are giving the opportunity for people to live where they want to live and where they can live. . . . A person can sell his property to anyone he chooses, as long as it is by personal choice and not because of motivations of discrimination.”).

149. See Editorial, *The Loan Quota Rule: HUD Tries to Pre-Empt the Supreme Court on Loan Discrimination*, WALL ST. J., Jan. 27, 2012, available at <http://online.wsj.com/article/SB10001424052970204616504577171092486999610.html?mod=article-outset-box> (noting that HUD “is pushing through a rule to support racial loan quotas a few months before the Supreme Court will rule on whether that’s legal”); see also *Gallagher v. Magner*, 619 F.3d 823, 833–38 (8th Cir. 2010). In *Gallagher*, property owners in the city of St. Paul, Minnesota brought a disparate-impact claim against St. Paul under the FHA in an attempt to prevent enforcement of the city’s housing code. *Id.* at 829–30. Although the Supreme Court took the case and scheduled it for oral argument, the city agreed to dismiss in February 2012 after being pressured by the Obama Administration and its political allies. See, e.g., Joan Biskupic, *Analysis: Rights Groups Try to Avoid US High Court Setback*, REUTERS (Mar. 2, 2012, 12:23 PM), <http://www.reuters.com/article/2012/03/02/us-usa-court-civil-rights-idUSTRE82117X20120302>; Editorial, *Squeezed in St. Paul*, WALL ST. J., Feb. 13, 2012, available at <http://online.wsj.com/article/SB10001424052970203824904577215514125903018.html>.

disproportionate effect on some racial group.<sup>150</sup> But, unlike Title VII of the Civil Rights Act of 1991,<sup>151</sup> Congress has not amended the FHA to allow for disparate-impact claims. Absent such explicit congressional direction, HUD's support for FHA disparate-impact claims amounts to an executive agency creating new legislation, yet again, in violation of constitutional structure.

Furthermore, the disparate impact approach sanctioned by HUD and some federal courts raises serious equal protection concerns. The Supreme Court has repeatedly recognized that “[d]istinctions between citizens solely because of their ancestry are by their very nature odious to a free people whose institutions are founded upon the doctrine of equality.”<sup>152</sup> For that reason, the constitutional guarantees of equal protection are directed at eliminating government classifications and discrimination based on race. Thus, “[r]acial and ethnic distinctions of any sort are inherently suspect”<sup>153</sup> and “presumptively invalid” under equal protection analysis.<sup>154</sup>

Disparate-impact claims directly conflict with equal protection guarantees by forcing potential government defendants to engage in race-conscious decision making in order to avoid liability.<sup>155</sup> The Supreme Court acknowledged this conflict and recognized the pitfalls of disparate-impact claims three years ago in *Ricci v. DeStefano*.<sup>156</sup> In *Ricci*, white and Hispanic firefighters sued the City of New Haven after the City voided their promotion-examination results because of the exam's disparate impact on minority firefighters. The Court found that the City's nullification of the exam results discriminated against the nonminority firefighters in violation of Title VII of the Civil Rights Act of 1964.<sup>157</sup>

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150. See, e.g., *Gallagher*, 619 F.3d at 833.

151. See Civil Rights Act of 1991, Pub. L. No. 102-166, § 105, 105 Stat. 1071 (1991) (codified as amended at 42 U.S.C. § 2000e (2006)) (permitting disparate impact claims in very limited circumstances).

152. *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200, 214 (1995) (alteration in original) (quoting *Hirabayashi v. United States*, 320 U.S. 81, 100 (1943)).

153. *Regents of the Univ. of Cal. v. Bakke*, 438 U.S. 265, 291 (1978) (plurality opinion).

154. *Shaw v. Reno*, 509 U.S. 630, 643–44 (1993) (quoting *Pers. Adm'r of Mass. v. Feeney*, 442 U.S. 256, 272 (1979) (citations omitted)).

155. See, e.g., *Ricci v. DeStefano*, 129 S. Ct. 2658, 2664 (2009); Brief Amicus Curiae of Pacific Legal Foundation et al. in Support of Petitioners at 22, *Magner v. Gallagher*, 132 S. Ct. 1306 (2011) (No. 10-1032), 2011 WL 6949342 (citations omitted).

156. *Ricci*, 129 S. Ct. at 2664.

157. *Id.*

Significantly, New Haven had claimed that it was motivated out of fear of being sued by minority applicants under a Title VII disparate-impact claim, but the Court rejected this argument.<sup>158</sup> Any policy that forces the government to make such race-motivated decisions is manifestly unconstitutional.

*B. Rent Control Laws Violate the Takings and Due Process Clauses*

To be sure, unconstitutional policies are not just pursued at the national level. The violation of property rights, in particular, often occurs at the behest of state and municipal governments using their power of eminent domain.<sup>159</sup> Nor is it only national policies that negatively distort housing markets. Aside from the FHA and various other civil rights-related laws, most housing policies are in the hands of local governments, with serious consequences for poor residents. One such policy, which has led to well-documented, devastating results in urban housing markets, is rent control.

American cities first passed rent control laws to address overwhelmed housing markets during World War II.<sup>160</sup> As military families were relocated to cities around the country, local governments implemented rent restrictions to protect tenants from excessive or “unreasonable” rent increases by landlords who might have taken advantage of such market pressures.<sup>161</sup> While the specifics and severity of such laws vary across cities and localities,<sup>162</sup> all of them seek to maintain low rent by limiting a

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158. *Id.* at 2673–74.

159. *See, e.g.,* *Kelo v. City of New London*, 545 U.S. 469, 474–75 (2005) (involving a city’s condemnation of privately owned property for the benefit of a private developer).

160. Blair Jenkins, *Rent Control: Do Economists Agree?*, 6 *ECON J. WATCH* 73, 74 (2009).

161. *Id.*

162. *See* Richard A. Epstein, *Rent Control and the Theory of Efficient Regulation*, 54 *BROOK. L. REV.* 741, 742–43 (1988) (“Rent control statutes come in all types, shapes and sizes. In some instances the law pegs the allowable rent to historic rents for the unit at some base time. Rent increases may then be allowed upon a change in ownership of the apartment unit, upon the completion of certain necessary improvements, upon some formula that reflects the increasing costs of maintenance and repair, upon some general rule that is tied to the consumer price index or any other neutral yardstick, or even upon proof of tenant or landlord hardship.” (footnote omitted)).

landlord's ability to adjust rent to meet market conditions.<sup>163</sup> These policies infringe on property rights for the alleged purpose of maintaining "reasonable" rental housing rates, yet they severely undermine this justification—and raise at least two constitutional concerns.

First, the broad interference with a landlord's property rights constitutes an uncompensated taking in violation of the Fifth Amendment Takings Clause, which provides that private property shall not "be taken for public use, without just compensation."<sup>164</sup> While an owner still retains some rights in the rental unit, rent control statutes constitute a taking in that they force landlords into transferring a lease interest to a tenant at a price determined by a government administrative body, rather than a price determined by negotiations between the landlord and tenant.<sup>165</sup> Even assuming such takings are for "public use," no "just compensation" is provided to the property owner.<sup>166</sup> Instead, the government deprives one citizen of his property right for the benefit of another, without providing anything in return.<sup>167</sup>

But even if a specific rent control statute does not effect a taking under Supreme Court precedent, the arbitrariness and poor justification for these laws violates the Fourteenth Amendment's Due Process Clause.<sup>168</sup> In his concurrence in *Lingle v. Chevron U.S.A., Inc.*, Justice Kennedy recognized that some regulations that do not violate the Takings Clause "might be so arbitrary or irrational as to violate due process."<sup>169</sup> He

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163. *Id.* at 746 ("Every rent control statute has only one raison d'être—to insure that the landlord's rent is kept below the fair market rental of the property.").

164. U.S. CONST. amend. V.

165. See Epstein, *supra* note 162, at 744.

166. Although current constitutional doctrine has expanded the phrase "public use" beyond its original and natural meaning, see, e.g., *Kelo*, 545 U.S. at 483–84, there is a strong argument that a "naked transfer from A to B" that solely benefits B is still clearly prohibited by the Constitution. Epstein, *supra* note 162, at 745–46.

167. See, e.g., George F. Will, *Supreme Court Should Take on New York's Rent Control Laws*, WASH. POST, Feb. 15, 2012, [http://www.washingtonpost.com/opinions/rent-control-laws-foolish-and-unconstitutional/2012/02/14/gIQAcZvbGR\\_story.html?wpisrc=emailtoafriend](http://www.washingtonpost.com/opinions/rent-control-laws-foolish-and-unconstitutional/2012/02/14/gIQAcZvbGR_story.html?wpisrc=emailtoafriend) (describing one landlord who is unable to rid of their tenants because of rent control laws and stating that "[r]ent control is unconstitutional because it is an egregious and uncompensated physical occupation of property").

168. U.S. CONST. amend. XIV, § 1 ("No State shall . . . deprive any person of life, liberty, or property, without due process of law.").

169. *Lingle v. Chevron U.S.A., Inc.*, 544 U.S. 528, 548 (2005) (Kennedy, J., concurring) (citing *Eastern Enters. v. Apfel*, 524 U.S. 498, 539 (1998) (Kennedy, J.,

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further noted that “[t]he failure of a regulation to accomplish a stated or obvious objective would be relevant to that inquiry.”<sup>170</sup> As we shall see in the next section, rent control laws are perfect examples of such arbitrary and irrational regulations that fail to accomplish any stated or obvious objective. Depriving an individual of property rights for the sole purpose of benefiting a select group of tenants clearly violates due process.<sup>171</sup>

### *C. Housing Policies’ Unintended Harms to the Poor*

Beyond their doubtful constitutionality, disparate-impact claims and rent control laws are bad public policy. They manipulate housing markets in ways that encourage risky behavior and reduce the quality and quantity of housing. Such effects tend to benefit those with the greatest resources and further disadvantage those of lesser means.

#### *1. Disparate-Impact Claims Reduce Housing Quality*

Under HUD’s preferred policy, disparate-impact claims would preclude all institutions subject to the FHA—both public and private—from implementing many practical policies.<sup>172</sup> This development would have profound and adverse economic consequences in the many markets subject to the FHA, creating unintended systemic risks. For example, “because [the FHA] applies to financial institutions, banks and mortgage companies would be pressured to provide loans to unqualified applicants in order to avoid disparate impact liability. Similar actions played a key role in triggering the mortgage crisis of 2007-2008.”<sup>173</sup>

Furthermore, disparate-impact claims would threaten many housing codes and provisions that set housing standards in cities across the country. That’s because facially neutral codes that improve housing quality could be shown to displace a disproportionate percentage of minorities by creating demand for otherwise unattractive housing. When passing the FHA, Congress surely did not intend for the Act to be used as a means to

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concurring in the judgment and dissenting in part)).

170. *Id.* at 548–49.

171. *See, e.g.*, Brief Amicus Curiae of Pacific Legal Foundation et al. in Support of Petitioners, *Harmon v. Kimmel*, No. 11-496, 2011 WL 5892325 (U.S. Nov. 21, 2011).

172. *See* Brief Amicus Curiae of Pacific Legal Foundation in *Magner v. Gallagher*, *supra* note 155, at 31–33 (arguing that an extension of the disparate impact doctrine to the FHA would lead to adverse results).

173. *Id.* at 5.

suspend the enforcement of housing codes. Such a result would condemn low-income minorities to substandard living conditions.<sup>174</sup>

## 2. *Rent Control Creates Housing Shortages*

The effects of rent control laws are even clearer. Economics textbooks frequently use such policies to demonstrate how price ceilings create supply shortages and poor quality goods, often distorting markets in favor of the rich or politically connected.<sup>175</sup> A 1992 survey showed 93% of economists agree that ceilings on rent reduce both the quality and quantity of housing.<sup>176</sup> The negative consequences of rent control laws have been widely acknowledged, which explains why “the economics profession has reached a rare consensus: Rent control creates more problems than it solves.”<sup>177</sup>

Although nearly a century of rent control laws has provided plenty of empirical evidence of these distortions, such conclusions are common sense to anyone who has a cursory understanding of basic economics. Like all price controls, rent controls “inevitably produce inefficiencies, reduce supply and cause [other] bad side-effects.”<sup>178</sup> Maintaining rental prices below market rates forces property owners out of the rental business by removing profit incentives. Instead of residential rentals, many choose to use their property for commercial or other non-price-controlled purposes, reducing the availability of housing. And, landlords who decide to stay in the rental business are likely to compensate for involuntarily lowered rent by reducing their maintenance expenditures, leading to lower quality housing.<sup>179</sup>

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174. *Id.* at 17.

175. *See generally* THOMAS SOWELL, *BASIC ECONOMICS: A COMMON SENSE GUIDE TO THE ECONOMY* 39–52 (4th ed. 2011) (examining the adverse economic impact of rent control policies).

176. Richard M. Alston et al., *Is There a Consensus Among Economists in the 1990's?*, 82 *AM. ECON. REV.* 203, 204 (1992).

177. Peter Navarro, *Rent Control in Cambridge, Massachusetts*, 78 *PUB. INT.* 83, 90 (1985); *see also* *The Great Manhattan Rip-Off*, *ECONOMIST* (Jun. 5, 2003), <http://www.economist.com/node/1826620/> (“It is hard to find *any* economist who supports rent restraints.” (emphasis added)).

178. *The Great Manhattan Rip-Off*, *supra* note 177.

179. *See, e.g.*, Richard A. Epstein, *The Follies of Rent Control*, *DEFINING IDEAS*, *HOOVER INST.* (Mar. 15, 2011), <http://www.hoover.org/publications/defining-ideas/article/70651> (noting that “forced frozen property arrangements encourage landlords to skimp on the maintenance of their property”).

Moreover, rent restraints create what economists call concentrated benefits and dispersed costs, meaning that a select group of tenants benefit from lower rent while the rest of the rent-controlled locality bears the costs through higher rent, lower quality housing, and fewer housing options.<sup>180</sup> The poor are rarely fortunate enough to share in these concentrated benefits, as the beneficiaries of these price restraints are unlikely to be those who are struggling the most.<sup>181</sup> Meanwhile, the burdens of housing shortages and lower quality housing tend to fall disproportionately on low-income individuals and families.

New York City's infamous Rent Stabilization Law (RSL)—a rent control law that was recently before the Supreme Court<sup>182</sup>—exemplifies such effects. As anyone who has searched for an apartment in New York can attest, housing is scarce—particularly in Manhattan<sup>183</sup>—and many apartment buildings are dilapidated because their owners are unable to

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180. See, e.g., *The Great Manhattan Rip-Off*, *supra* note 177 (“Indeed, although the press depicts the fight over price restraints as tenants versus landlords, it is more accurate to see it as tenants paying a below-market rent versus tenants who, in effect, pay the cost of this subsidy.”).

181. See, e.g., Jenkins, *supra* note 160, at 89 (“Landlords and superintendents use non-price forms of rationing. In sifting through credit reports, references, and other components of applications, they are likely to select the individuals or families that appear to struggle the least.”).

182. Although rent control laws have routinely survived constitutional challenges, the Supreme Court recently considered whether to hear a challenge to New York's RSL in *Harmon v. Kimmel*. *Harmon v. Kimmel*, No. 11-496, 2012 WL 1379682 (U.S. Feb. 20, 2011). Petitioners James and Jeanne Harmon own and live in a five-story brownstone on West 76th Street near Central Park, where they have been forced to rent to three tenants at a rate 59% below market. Anemona Hartocollis, *A Landlord's Uphill Fight to Ease Rent Restrictions*, N.Y. TIMES, Dec. 19, 2011, at A31. Under New York's law, rent-stabilized tenants also have rights of succession to these apartments and below-market rates. *Id.* The Harmons challenged the RSL on the grounds that the regulations constitute an uncompensated taking of their property in violation of the Fifth Amendment's Taking Clause and, alternatively, that they are arbitrary regulations in violation of the Fourteenth Amendment's Due Process Clause. See Brief Amicus Curiae of Pacific Legal Foundation et al. in *Harmon v. Kimmel*, *supra* note 171. Alas, on April 23, 2012, after having requested a response to the cert petition from the city and state and re-listed the petition for further consideration, the Court denied cert. *Harmon v. Kimmel*, No. 11-496, 2012 WL 1379682 (U.S. Apr. 23, 2012).

183. See Nicole Gelinias, *A Man's Home is the Government's Castle*, N.Y. POST, Jan. 15, 2012, available at [http://www.nypost.com/p/news/opinion/opedcolumnists/man\\_home\\_is\\_the\\_government\\_castle\\_1AFJ8CnFxUeI212XI32t5M#ixzz1pmPhsEIZ](http://www.nypost.com/p/news/opinion/opedcolumnists/man_home_is_the_government_castle_1AFJ8CnFxUeI212XI32t5M#ixzz1pmPhsEIZ) (reporting that Manhattan's 2011 “vacancy rate was less than 1%”).

charge enough in rent to fix them.<sup>184</sup> Moreover, because costs are transferred to other non-rent-controlled apartments and non-rent mechanisms such as nonrefundable deposits, non-rent-controlled housing is more expensive than it would be absent the RSL. A 1997 *New York Times* article explained the devastating effects of rent control, particularly on new immigrant communities:

New York used to be like other cities, a place where tenants moved frequently and landlords competed to rent empty apartments to newcomers, but today the motto may as well be: No Immigrants Need Apply. While immigrants are crowded into bunks in illegal boarding houses in the slums, upper-middle-class locals pay low rents to live in good neighborhoods, often in large apartments they no longer need after their children move out. Half a century of rent regulation has created a permanent shortage of decent homes by keeping apartments off the market and encouraging landlords to neglect their buildings.<sup>185</sup>

True, New York's RSL does provide substantial benefits to some, but only to those lucky enough to be grandfathered in or know the right people.<sup>186</sup> For the rest of the city, and particularly its poor, the RSL has only led to higher-cost, lower-quality housing.<sup>187</sup>

In highlighting this disconnect between the original impetus of rent control laws and their ultimate effects, the economist Thomas Sowell noted that a policy "intended to make housing affordable for the poor has had

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184. See, e.g., Nicole Gelinas, *Is There a New York Housing Crisis?*, CITY J., Summer 2006, available at [http://www.city-journal.org/html/16\\_3\\_nyc\\_housing\\_crisis.html](http://www.city-journal.org/html/16_3_nyc_housing_crisis.html) (noting that "[r]ent regulation makes it impossible for many landlords to keep their buildings in good condition").

185. John Tierney, *At the Intersection of Supply and Demand*, N.Y. TIMES, May 4, 1997 (Magazine), available at <http://www.nytimes.com/1997/05/04/magazine/at-the-intersection-of-supply-and-demand.html?pagewanted=all&src=pm>.

186. See Richard A. Epstein, *Rent Control Hits the Supreme Court*, WALL ST. J., Jan. 4, 2012, at A13 (arguing that rent control laws are unconstitutional and describing the New York statutory right to pass on the right to occupancy in some situations); Will, *supra* note 167 (describing one landlord's inability to rid of tenants due to rent control laws); see also Gelinas, *supra* note 184 ("[A]lthough most New York renters live under rent regulation, most of the benefit goes to a comparative few who live in the richest neighborhoods and have remained in their apartments for decades.").

187. See Gelinas, *supra* note 184 (describing the low quality of the housing, the differences in cost between free market housing and controlled housing, and the cost differences between socioeconomic classes).



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the net effect of shifting resources toward the building of housing that is affordable only by the affluent or the rich, since luxury housing is often exempt from rent control, just as office buildings and other commercial properties are.”<sup>188</sup> These perverse results cannot justify such a blatant infringement of individual rights.

## VI. CONCLUSION

In summarizing the specific problems caused by rent control, Sowell recognized that such laws “illustrate[] the crucial importance of making a distinction between intentions and consequences.”<sup>189</sup> He concluded: “Economic policies need to be analyzed in terms of *the incentives they create, rather than the hopes that inspired them.*”<sup>190</sup>

That’s the fatal error underlying most of the policies discussed throughout this Article: Many well-intentioned but unconstitutional policies have led to perverse incentives and unintended consequences. They have led to a breakdown in the rule of law and greater economic uncertainty. Perhaps most troubling, they have fortified the power of political and economic elites.

In some cases, these policies were motivated out of a sincere desire to aid the least fortunate. For most of America’s poor, however, such government actions have only made their lives worse.

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188. SOWELL, *supra* note 175, at 45.

189. *Id.*

190. *Id.* (emphasis added).