Decentralization, Deference, and the Administrative State

Peter J. Wallison

Modern conservatism is closely linked to decentralization. Free markets are by definition decentralized markets, and the extraordinary growth of the United States economy over the last 200 years is a testament to the creative power of individuals when they are free to respond to market demands.

Also important to modern conservatism is the decentralization of government itself, allowing decisions to be made close to the communities they affect, while also encouraging policy competition and experimentation.

Both these forms of decentralization, however, are now increasingly challenged by federal administrative agencies, which are a growing force for the suppression of diversity among individuals, businesses, and state and local governments. Although the Constitution places the federal legislative power in Congress, it is now increasingly—and alarmingly—flowing to administrative agencies that, unlike Congress, are not directly accountable to the public affected by their decisions.

Unless we can find a solution to this problem—a way to curb and cabin the discretionary power of administrative agencies—decentralization and individual self-determination will eventually be brought to an end. The diversity of our society and the innovativeness of the U.S. economy will gradually come under the pervasive control of a vast bureaucracy, and an essential element of American exceptionalism will be irrevocably lost.
In his magisterial work *Is Administrative Law Unlawful?*, Philip Hamburger observed that administrative law found a place in American government when it still could be believed that administrative regulations and adjudications would merely be exceptions within the traditional constitutional structure…. Times have changed, however, and so too has administrative law. No system of power is entirely stable, and the exception has swallowed the rule. Administrative law has by now dwarfed statutory law and has become the federal government’s pervasive mode of dealing with the public. Therefore, rather than merely a means of completing the work of Congress and the courts at the margins, administrative power has become central.

Similarly, in a comprehensive essay titled “Can the Administrative State be Tamed?,” Christopher DeMuth traced the growth of executive power through the treatment of administrative decisions in the courts. Expansion of administrative power, he notes, began in the 1970s and was assisted by the widespread judicial acceptance of deference to agencies’ interpretations of the scope of their own authority. But the growth curve turned sharply upward in 2008, with the arrival of the Obama administration. In the Obama years, DeMuth observes, the expansion of executive power essentially became lawless: “[T]he most dramatic departure in executive government in the years following 2008 was sheer unilateralism—executive agencies, and frequently President Obama personally, effecting major policy changes in defiance of reasonably clear statutory requirements, often on grounds that Congress had failed to enact them.”

The 2016 election seems destined to leave us on the same course, no matter which candidate wins. The Democratic Party’s candidate seems wedded to expanding Obama’s aggressive administrative agenda, and the Republican candidate does not appear to understand or accept constitutional, treaty, or statutory restrictions on the authority of the president.

It is the sorry state of our politics—embodied in this election but by no means initiated by it—that bears the responsibility for the growth of administrative power in the last quarter-century. The framers’
Constitution separated the government into three parts—a legislature, an executive, and a judiciary—not for the sake of pedantic tidiness, but because they saw that structure as the best way to preserve the liberties of the people. As James Madison said in Federalist No. 51: “In a single republic, all the power surrendered by the people is submitted to the administration of a single government; and the usurpations [of the government] are guarded against by the division of the government into distinct and separate departments.”

That is why the Constitution was initially submitted to the states for ratification without what would later become the first 10 amendments, the Bill of Rights. The framers believed that the tripartite structure of the federal government would be enough to prevent any one of the three branches from consolidating the power of government and becoming a danger to liberty. But with the growth of the administrative state, we may now be seeing exactly the consolidation of powers that Madison feared.

Under the framers’ theory, the departments had to remain independent of one another: “[T]he great security against a gradual concentration of the several powers in the same department,” said Madison in Federalist No. 51, “consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others.” In other words, the framers expected that each of the branches of the federal tree would treat the others as rivals, and oppose actions of the other branches that exceeded constitutional limits. If this approach had succeeded, we could rely on the natural opposition of Congress to restrain the growth of the administrative state.

PARTIES AND THE FAILURE OF CONGRESS

Madison’s hopeful view, however, was overcome in time by the development of political parties, which have undermined the personal motives or jealousies of the branches that Madison thought would prevent their consolidation into a Leviathan.

It is well known that, for all their vision and understanding of human nature, the framers did not quite foresee the development of powerful political parties or provide for this development in the Constitution. Madison’s Federalist No. 10 is famous for its denunciation of “faction,” by which he meant the self-interested positions of non-majority groups, but it did not seem to occur to him that, if the president and a majority of
the members of the House and Senate were united in the same political party, Congress might not object to the president or his surrogates wielding the legislative-like powers that administrative agencies now employ.

For much of our country’s history, Madison’s view was not wrong or naïve, despite the growth of political parties; my own experience in government during the 1980s provided many examples of senators, in particular, who were more concerned about the institutional interests of the Senate than the interests of a president of their own party.

Nevertheless, in recent years — and particularly during the Obama administration — there have been many examples of members of the House and Senate sacrificing the institution in which they serve to partisan interests. Allowing the president to determine for himself when the Senate is in recess, abandoning the need for 60 votes to take up a presidential nomination, refusing to pass a budget for four years so as to protect vulnerable Democratic senators, and standing quietly by as a president stated he would not enforce existing immigration laws, are only some examples of partisanship overriding institutional interests. If this continues into another presidential administration, the precedents thus set will be difficult for any future Congress to overcome.

This kind of partisanship has been a major factor in the growth of the administrative state. Congressional majorities in both houses may be more willing to give substantial executive latitude to a president of the same party, and once these laws are on the books it becomes very difficult to roll them back legislatively. Private parties also take actions and make investments based on these laws, and thereafter resist reforms.

The poster child for this problem is the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, a massive law (2,300 pages in the original bill and 847 pages in its enrolled version) enacted in the wake of the financial crisis. Because the Democrats in the House correctly assessed that they might lose control of that body in the 2010 elections, the law was passed by Congress and sent to the president before lawmakers had fully investigated the causes of the crisis, and even before the Financial Crisis Inquiry Commission, established by Congress to outline the causes of the crisis, had issued its report (in which the Democratic majority on the commission simply adopted the view of the Democratic super-majority in Congress). Taking for granted the familiar but false idea that the financial crisis was caused by excessive private risk-taking and insufficient regulation of the financial
sector, Congress sought to address the underlying problems by authorizing almost 400 separate new regulations to be enforced by at least eight different agencies.

Dodd-Frank was the biggest boost to the growth of the administrative state since the New Deal, and in terms of its intrusiveness into the economy is best characterized as Obamacare for the financial system. Even today, more than six years after Dodd-Frank’s enactment, about a quarter of the regulations it authorized have not yet been adopted. In several cases, administrative agencies couldn’t produce intelligible regulations from the directions in the law. Congress in its haste had simply endorsed conflicting ideas and walked away.

One appalling example of how Congress will ignore the constitutional structure and the rule of law for ideological reasons is the Consumer Financial Protection Bureau, established by Dodd-Frank. It reveals the willingness of Congress to bypass key elements of the separation of powers established by the constitutional framework—in this case by freeing the agency from congressional appropriations, and providing that its single administrator cannot be removed from office by the president except for cause. These provisions—which are currently under constitutional challenge—hand unfettered authority to a single person engaged in an activity that the Democratic majority approved, showing that in today’s political world ideological interests can overcome constitutional arrangements and institutional interests when short-term advantages are available.

Despite the relentless growth of the administrative state, there have been a few times in the recent past when the government withdrew its control over important sectors of the economy and allowed the private economy to function without interference. Under Presidents Carter and Reagan, for example, the Civil Aeronautics Board, which once controlled airline prices, was completely eliminated between 1978 and 1985. The power of the Interstate Commerce Commission over trucking and railroad routes and rates was curbed, and the whole agency was eventually scrapped in 1995. Price controls on securities-trading commissions were eliminated in 1975. The AT&T telephone monopoly was broken up in 1984, local service was transferred to local companies, and AT&T for the first time faced price competition for its long-distance services.

Since these reforms, transportation costs have fallen drastically, billions of shares are traded daily for less than a penny a share, long-distance
telephone calls are virtually free, and the low cost of data transmission has made the internet possible. These examples suggest that if the federal government curbed its inclination to insert itself and its priorities into private activities we would all be better off economically, and the constitutional separation of powers would be easier to maintain.

But these rare instances of deregulation are interludes in what has otherwise been a period of relentless growth of the administrative state. Since the early years of the 20th century, Congress has spurred this growth by enacting legislation that gives increasing authority to administrative agencies, without any apparent concern for its own unique role in the constitutional framework.

Thus, what began as a trickle of regulatory activity in the first half of the 20th century has become a flood. The Code of Federal Regulations— embodying all the regulations of all federal agencies— consisted of about 18,000 pages near the close of the New Deal in 1938. By 2014, it had grown to more than 175,000 pages. And the regulations themselves have become more complex and far-reaching. A single regulation on mortgage lending by the CFPB ran to 1,099 pages, including explanatory material.

Other factors intrinsic to the legislative process are also at work. In a Congress sharply divided along partisan lines, it is difficult to achieve bipartisan action unless some of the toughest issues are either elided in favor of generalities or simply ignored. Members of Congress can then claim credit for passing needed legislation. But when ambiguous legislative language results in a broad administrative ruling that engenders opposition by the public or a significant economic group, many in Congress can complain— too late, of course— that they never intended to provide the agency with such latitude. Righteous indignation becomes a substitute for doing the arduous work of legislating at the outset.

Deference and the Failure of the Courts

The third branch of the tripartite structure envisioned by the framers— the judiciary, headed by the Supreme Court— might be a natural place to look for some response to the willful weakness of Congress and the growth of executive regulatory power. As Chief Justice John Marshall established in Marbury v. Madison in 1803, the judicial branch is supposed to be the final interpreter of the Constitution and thus the objective protector of the framework the Constitution ordains.
But unfortunately, modern courts have generally failed to perform this role; only in rare instances have they stepped in to establish guidelines, and even then they have generally withdrawn again before clear boundaries around the powers provided to administrative agencies could be defined. Indeed, the courts have been stunningly slow to understand the phenomenon of the administrative state. It wasn't until 2015 that Justice Clarence Thomas finally wrote that the courts have “overseen and sanctioned the growth of an administrative system that concentrates the power to make laws and the power to enforce them in the hands of a vast and unaccountable administrative apparatus that finds no comfortable home in our constitutional structure.”

The reticence of the judiciary is understandable up to a point. The courts are keenly aware that they are not in any sense democratically chosen or accountable, and they are reluctant to interfere with decisions of Congress and the president which at least theoretically have a foundation in the public’s will. Still, the framers envisioned the courts as a co-equal branch, and the Constitution itself as a bulwark against the growth of excessive power in the hands of the elected branches. Supreme Court justices and inferior federal court judges are presumably appointed for life for a reason. There is plenty of room in this constitutional arrangement for a judiciary that is aggressive in support of the constitutional structure.

The judiciary’s reluctance to interfere in the work of the elected branches has been formalized over time into a kind of theory of the courts’ proper role among the branches—a theory encapsulated in a concept known as judicial deference. As originally developed by the Supreme Court in the 1980s, this idea suggests that courts will not interfere with an administrative decision if it seems reasonably related to the purpose Congress appeared to have had in mind for the statute it enacted. This approach grants significant latitude to an administrative agency. A specific action or rule doesn’t actually have to be authorized by Congress; it can simply be something that the agency itself deemed to be within the scope of its jurisdiction.

Although the Supreme Court had vaguely articulated this idea for many years, judicial deference really first emerged in its now-familiar form in 1984 with the Court’s decision in *Chevron v. Natural Resources Defense Council*. (This kind of judicial deference is therefore sometimes called “Chevron deference.”) The case involved the Environmental
Protection Agency’s interpretation of the Clean Air Act. Writing for a unanimous Supreme Court (Justices Marshall, Rehnquist, and O’Connor had all recused themselves), Justice John Paul Stevens stated,

[T]he Administrator’s interpretation represents a reasonable accommodation of manifestly competing interests and is entitled to deference: the regulatory scheme is technical and complex, the agency considered the matter in a detailed and reasoned fashion, and the decision involves reconciling competing policies. Congress intended to accommodate both interests, but did not do so itself on the level of specificity presented in these cases.

In terms of the Constitution’s separation of powers, this statement is truly astonishing. Justice Stevens describes the issue as a matter of competing interests or competing policies—the very substance of the legislative process—and notes that Congress did not resolve what was at stake. Yet, the Court allowed the EPA itself to make a major policy decision that resolved the competing interests. If an administrative agency can do this, what could the Court have imagined was the role of Congress in the constitutional scheme?

In a democracy, few would favor judicial activism—where unelected judges make policies that substitute for decisions by the legislature. The point, however, is not that the courts should substitute their policy judgments for the elected branches, but that, if they were alert to their obligation to preserve the separation of powers, the courts should strike down actions by administrative agencies where they have made the kinds of major discretionary policy choices that should be made only by Congress.

If the courts are going to say that they do not want to interfere with congressional acts, and those acts give up essential legislative authority to administrative agencies, the separation of powers embedded in the structure of the Constitution will inevitably disappear—and along with it the decentralization and diversity that has been responsible for the extraordinary success of the United States. Moreover, and this is a key point, Congress will continue to follow the path of least resistance, failing to make the tough policy decisions itself but adopting legislation that in effect allows those decisions to be made by an unelected administrative agency, not accountable to the voters.
One might argue, for a variety of reasons, that this is a satisfactory state of affairs—after all, administrative agencies are experts in the subjects committed to their care, and they ultimately report to a president who is democratically elected. But this is beside the point. The point, if it must be restated, is that the Constitution requires that Congress make the laws—not the president and certainly not an unelected bureaucracy.

**Distinguishing Legislation from Administration**

The problem here is far more complex than it might first appear. A truly difficult conceptual issue lies hidden in the constitutional structure: What is legislation? If the Constitution provides that Congress should make the laws and the president should enforce the laws, where does the legislative process end and the enforcement process begin?

Without a governing concept for deconstructing this question, it is difficult to see how a diligent court could distinguish between the respective roles of Congress and administrative agencies. But if we wish to retain the constitutional system we have, and the decentralization and diversity it allows, this question cannot be avoided.

Legislative action seems to have one fundamental characteristic: It is completely discretionary, in the sense that the legislature does not need any justification for its substantive judgments. In other words, legislation is arbitrary, a decision between contending interests—to take from one and give to another—that is made without requiring external justification. For this reason a law made by Congress cannot be attacked, or declared unconstitutional, because Congress acted arbitrarily or without evidence; the legislative branch can do whatever it wants, subject to specific constitutional restrictions on its power, such as the First Amendment.

An administrative act is entirely different, however. An administrative agency must have a foundation—rooted in authority granted by Congress—for its actions and rulings. In addition, even if authorized by Congress, to be valid under the Administrative Procedure Act, the decision or rulemaking may not be “arbitrary, capricious, [or] an abuse of discretion” and must be supported by “substantial evidence.” Of course, Congress can authorize an agency to resolve a technical issue of fact that legislators cannot resolve, but even in that case the agency’s decision must be supported by “substantial evidence”; it cannot be purely discretionary.

Thus, the way to determine where legislation ends and administration begins is to locate where the principal discretionary or arbitrary decision
was made. If it was made by Congress, that would be consistent with the Constitution’s tripartite structure; if it was made at the administrative level, it would not pass this test. Indeed, if the difference between legislative and administrative action were clearly understood by the courts, there would be no real need for the courts to resort to the Constitution in order to prevent administrative overreach; all that is necessary is a clear understanding that any policy decision that is arbitrary and discretionary in nature must be made by Congress, while no administrative decision can be valid unless it meets the requirements of the APA.

To see what happens when this principle is ignored, it is useful to return to *Chevron*. In that case, the issue was whether the Clean Air Act’s term “stationary source” of emissions applied to emissions from a single building or to an “industrial grouping” in the same location. If the stationary source is a building, and new equipment would increase the building’s total emissions, Chevron would have needed a state permit to install it. But if the broader definition were adopted, Chevron would have greater latitude for installing new equipment; it could take the whole industrial grouping into account in determining whether equipment would increase total emissions. Congress had not decided the issue, although there was legislative history showing that Congress was aware of the problem. The EPA chose the “industrial grouping” as the definition of stationary source, and the Natural Resources Defense Council sued Chevron and the EPA.

What makes Justice Stevens’s decision in *Chevron* so shocking, as noted earlier, is that he recognized the agency was deciding between “competing interests” — not simply competing evidence. Moreover, there was no indication in the *Chevron* decision that Congress intended to authorize the EPA to make the decision; it simply defaulted in defining a key point, leaving the decision to the EPA. A court could easily have insisted that this was a decision Congress itself should have made. After all, whether a stationary source is a building or a whole industrial production facility is purely a question of policy — not a question of fact — and thus for Congress to decide, not an administrative agency.

Accordingly, if the courts were to follow these rules in judging whether an administrative decision is valid, it would be possible to place some kind of judicial limit on the growth of the administrative state — not only because the courts would be attempting to return the federal government to the constitutional framework, but also because doing so would force
Congress to make the decisions it is required to make, rather than delegating these decisions, implicitly or explicitly, to administrative agencies. As long as the courts have been willing to provide deference, however, it has been easy for Congress to turn over broad legislative authority to administrative agencies while taking credit for addressing national problems. Meanwhile, as has been true for many years, the administrative state has grown more powerful and its rulings more pervasive.

**A Crucial Test**

A case currently moving through the courts could provide an opportunity to test the limits of deference and administrative power. In January 2015, MetLife, the nation’s largest life insurer, brought a suit against the Financial Stability Oversight Council, a new agency created by Article I of the Dodd-Frank Act. The voting members of the FSOC are the chairs or heads of eight federal financial regulators—including the Federal Reserve, the FDIC, and the SEC among others—and one expert in insurance who is appointed by the president and confirmed by the Senate. The FSOC’s chair is the secretary of the Treasury. The agency has one unique and important authority: It was directed by Congress to designate non-bank financial firms—insurers, finance companies, broker-dealers, mutual funds, and others—for special regulation if the FSOC determines that their “material financial distress … could pose a threat to the financial stability of the United States.”

Firms that are deemed to fall into this category are called “systemically important financial institutions,” or SIFIs, and are turned over to the Federal Reserve for what the act calls “stringent” regulation. Designation as a SIFI would be a major event for a company and for its competitors. It is essentially a statement by the government that the firm is too big to be allowed to fail—implying that in some way the government will keep it from failing. This could provide the firm with a major competitive advantage, because it is likely to make credit more easily available. Stringent regulation, however, could also make the firm less profitable and innovative. That a SIFI designation can have this effect was shown by GE’s recent decision to wind down its huge subsidiary finance company, GE Capital, after the firm was designated as a SIFI. This suggests that “stringent” regulation by the Fed, whatever it entails, may be intolerable for a company, like GE Capital, that thrives on innovation and risk-taking.
To decide whether to designate a firm as a SIFI, Congress directed the FSOC to consider a large number of specific items, such as the firm’s leverage, its interconnectedness with other firms, and the nature of its assets and activities. There are no dimensions associated with these items — no minimum size, maximum degree of leverage, or extent of interconnections — that would function as limitations on the FSOC’s discretion. Congress’s only decision was to direct the FSOC to make what is a major policy decision — and not one, as we will see, that the agency can make simply by weighing evidence.

It is not as though Congress is incapable of setting standards in this area. In the case of bank-holding companies — that is, companies that control banks — Dodd-Frank sets $50 billion in assets, a completely arbitrary number, as the dividing line between firms that would be treated as SIFIs and those that would not. This kind of arbitrary decision brands this action as clearly legislative in character. Following from this congressional decision, the Fed can pursue “stringent” regulation of banks without making any significant discretionary decision. But for non-bank financial firms, Congress left this and other issues for the FSOC to decide.

Given the open-ended language of its authority from Congress, the FSOC could designate any non-bank financial firm as a SIFI — whether an insurance company, mutual fund, broker-dealer, or hedge fund. Moreover, whether the “material distress” of a particular firm at an unknown time in the future could pose a threat to the financial stability of the United States is simply unknowable. This is true because a firm’s failure in the midst of a stable and growing market — when other firms are prospering and investors are confident about the future — is far less likely to have an adverse effect on its counterparties, or the market as a whole, than the same failure in the midst of a declining market when investors are worried about the future. It is literally impossible, then, even in principle, for the FSOC to determine now what the conditions in the market would be when and if MetLife were to fail, and thus whether that failure would cause instability in the financial system.

In December 2014, the FSOC designated MetLife as a SIFI, and MetLife commenced suit against the agency shortly thereafter. In its initial brief, MetLife argued that FSOC provided no substantial evidentiary support for its view that MetLife’s “material distress” could “inflict significant damage on the broader economy.” That decision, said MetLife, was essentially ipse dixit (Latin for “because I said so”) and
therefore “arbitrary and capricious.” *Ipse dixit* is also a useful way to describe a legislative act; only legislatures can make policy-level decisions where “because I said so” is a valid justification.

Congress’s delegation of authority to the FSOC was unambiguous; the agency was authorized to decide whether a particular non-bank firm should be designated as a SIFI. The FSOC, in turn, argued that its decision was entitled to deference. So the question comes down to whether what Congress clearly authorized was consistent with the Constitution and the APA.

It is important to recognize that the courts do not have to reach constitutional questions in every case where they arise. Indeed, deciding a case on constitutional grounds is always a last resort. But as noted earlier, the fundamental ideas that separate administration from legislation are contained in the APA, which authorizes courts to “hold unlawful and set aside agency action, findings, and conclusions found to be… arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” So a court can set aside an administrative action if it doesn’t meet this standard without having to decide whether Congress erred in its delegation of authority to the agency.

That appears to have been what the U.S. District Court did in the March 2016 decision of *MetLife v. FSOC*, holding that FSOC had not met the test of the APA. (The case is now on appeal to the U.S. Court of Appeals for the District of Columbia, and oral argument has been scheduled for October.) FSOC, the court said, must engage in “reasoned decisionmaking” or its action will be deemed arbitrary and capricious, but the council’s analysis of MetLife “never projected what the losses would be… or how the market would destabilize as a result.” The judge concluded that a “[p]redictive judgment must be based on reasoned predictions,” and “a summary of exposures and assets is not a prediction.”

In other words, the court found that the discretion provided to the council by Dodd-Frank violated the underlying policies of the Administrative Procedure Act, which authorizes courts to dismiss federal-agency decisions that are not based on substantial evidence. Another interpretation of this decision might say that Congress delegated too much discretion to FSOC; asking an administrative agency to predict the future, based on nothing but its supposed expertise, was outside the range of discretion that would be consistent with the constitutional structure or the APA. But instead of reaching the constitutional
issue, the court relied on the inability of FSOC to gather evidence about an unknowable future.

Could Congress have reduced the range of the FSOC’s discretion by making the ipse dixit decision itself? I think the answer is yes. Instead of asking the FSOC to predict the unknown future, Congress could have done what it did with bank-holding companies: set an arbitrary standard for designating non-bank SIFIs and allow the FSOC to collect the necessary evidence in each case. For example, Congress might have said that any non-bank financial firm shall be designated as a SIFI if it is larger than, say, $500 billion, unless FSOC finds that its failure in the current economy would not cause losses to counterparties that exceeded, say, $50 billion. That would have significantly reduced FSOC’s discretion, while leaving it with a fact-finding role appropriate for an administrative agency.

It was Congress’s unwillingness to make the necessary discretionary decision about non-bank SIFIs that expanded the discretionary authority of FSOC beyond constitutionally permissible limits and left it exposed to legal challenge.

**Restraining the Consolidation of Power**

Unfortunately, for all the reasons described above, Congress cannot be relied upon to uphold the constitutional structure. Indeed, the difficulties of the legislative process and the pressures of partisan loyalties essentially guarantee that the administrative state will continue to grow in the future. Some alternative is necessary.

America is an exceptional country in part because its constitutional framework has, until relatively recently, limited the government’s ability to centralize its control and restrain the nation’s diversity. If we are to avoid a dramatic over-centralization of power, the growth of the administrative state must be restrained.

With Congress unable or unwilling to prevent the growth and consolidation of administrative power, the judiciary is the only possible constitutional impediment to that continued growth. But for the courts to discharge their responsibility as protectors of the constitutional structure, judges must abandon judicial deference as it has taken shape; the courts must force Congress to make the tough choices that are inherent in its constitutional role as a legislature.