THE NEW REGULATORY ERA—AN INTRODUCTION

Barak Y. Orbach*

For many decades the word "regulation" has been a bogeyman concept evoking images of unproductive and wasteful government bureaucracy. While this image has been a popular rallying cry for politicians over the years, every interest group—with the exception of libertarians—has actively supported and lobbied for regulation in certain domains of the economy and society. With the recent financial crisis, this bogeyman image of regulation has been turned on its head. This Essay explains some of the causes for the change and highlights several expected directions that the new regulatory era is likely to take.

I. THE FALL AND ITS CONSEQUENCES

The fall of 2008 brought the credit meltdown and substantial financial losses for most American households. Many individuals lost their life savings, homes, and jobs. The credit meltdown also cut short many debates over market efficacy and marked the beginning of a new regulatory era.

In late October 2008, Alan Greenspan, the former Chairman of the Federal Reserve, testifying before the House Oversight and Government Reform Committee, stated: "[T]hose of us who have looked to the self-interest of lending institutions to protect shareholders' equity (myself included) are in a state of shocked disbelief. . . . The whole intellectual edifice . . . collapsed in the summer of last year."[1] By April 2009, Judge Richard Posner published a book with the unexpected title *A Failure of Capitalism*[2] in which he argued that "the government bears the basic responsibility for causing the depression. . . . [T]he depression is

---

* Associate Professor of Law, University of Arizona James E. Rogers College of Law, www.orbach.org. I am grateful for helpful comments and excellent research support from Grace Campbell, Anne Nelson, and the editors of the *Arizona Law Review.* The outstanding research support I have received from Maureen Garmon over the years made the writing of this Essay possible. All errors and inaccuracies are mine.

1. *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. on Gov't Oversight and Reform*, 110th Cong. 17 (Oct. 23, 2008) (testimony of Alan Greenspan, Former Chairman of the Federal Reserve).

2. RICHARD A. POSNER, A FAILURE OF CAPITALISM: THE CRISIS OF '08 AND THE DESCENT INTO DEPRESSION (2009).

the result of normal business activity in a laissez-faire economic regime."[3] Like it or not, one of President Obama's campaign promises for change was "common-sense regulation." He used this promise to differentiate himself from President Bush and his predecessors since President Reagan, who continuously deregulated markets.[4] The promise for a "common-sense regulation," of course, also struck a sharp contrast between President Obama and his opponent, Senator John McCain.

The credit meltdown and the 2008 Presidential election, however, did not raise any fundamentally new questions about the role of the state in markets and society. The questions were all old and familiar: every election, political candidates raise these questions while blaming their opponents for supporting too much, too little, or socially undesirable regulations. They promise that their own regulatory agendas will make substantial improvements to the public well-being. Some approaches toward these questions vary over time with fads, fears, values, and ideologies. Other approaches improve with the accumulation of knowledge and empirical evidence. The present economic crisis convinced many that certain problems, such as imperfect information, externalities, and bounded rationality, will always exist in markets and warrant sensible regulation.

Many regulatory mavericks and advocates for new forms of regulation were active many years before the fall of 2008 and had some influence,[5] but dramatic policy changes, as opposed to theoretical ideas, began to appear only after the November 2008 election, which replaced a Republican Administration with a Democratic Administration that has Democratic control in the House and the Senate. This historical overlap does *not* suggest that the design or implementation of any of the present regulatory policies is optimal or efficient. Such evaluation is not the goal of this Essay.

This Essay explains some of the primary reasons for changes toward the concept of regulation in the United States. Obviously, it is impossible to cover in one essay all the recent developments in the perceptions and utilization of regulation; instead, this Essay highlights key factors that have been dominant in the debate over regulation. Part II focuses on the alleged inverse relations between personal responsibility and regulation. Part III briefly summarizes some known

---

3. *Id.* at 235.

4. *See* David Leonhardt, *A Free-Market-Loving, Big-Spending, Fiscally Conservative Wealth Redistributionist*, N.Y. TIMES MAG., Aug, 24, 2008, at 30 (interviewing Barack Obama during his Presidential campaign saying:

> Ronald Reagan . . . made people aware of the cost involved in government regulation. . . . Bill Clinton, to some extent, continued that pattern. . . . And George Bush took Ronald Reagan's insight and ran it over a cliff. . . .
>
> [W]hat we need to bring about is the end of the era of unresponsive and inefficient government and short-term thinking in government, so the government is laying the groundwork, the framework, the foundation for the market to operate effectively and for every single individual to be able to be connected with that market and to succeed in that market.)

5. *See, e.g.*, Mass. v. Envtl. Prot. Agency, 549 U.S. 497 (2007) (holding that the EPA could not refuse to regulate greenhouse gas emissions from motor vehicles).

fallacies related to the efficiency of the invisible hand and the reliability of human rationality. Part IV emphasizes the need for regulation when market mechanisms fail to address problems with externalities. Part V explains why concerns about slippery slopes should not undermine valid motivations for regulation. Part VI concludes.

II. PERSONAL RESPONSIBILITY IN REGULATION

While the financial crisis that began in the fall of 2008 had many causes, it is widely agreed that practices of the credit industry and lax regulation were at the roots of the crisis.[6] Overly risky mortgages and related financial instruments combined to generate a chain reaction that resulted in financial devastation for most households and bankruptcy for many small and large businesses. The understanding that practices of the credit card sector had contributed to a rapid growth in consumer debt and consumer bankruptcy immediately made this sector a target for regulatory reform,[7] with the hope of avoiding a collapse of another credit market. Congress moved quickly and on May 22, 2009, President Obama signed into law the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the "Credit CARD Act").[8] The Credit CARD Act imposes new restrictions on credit card companies, banning many practices that were customary until its enactment. Examples of the statute's innovations include: (1) a requirement of a 45-day advance notice of increase in interest rate and other significant changes,[9] (2) a prohibition on retroactive increases of interest rates and fees applicable to outstanding balances,[10] (3) a ban on changing the terms governing the repayment of outstanding balances,[11] (4) a ban on double-cycle billing,[12] and (5) subjecting penalty fees to standards of reasonableness and proportionality.[13]

In his remarks upon signing the Credit CARD Act, President Obama emphasized that:

> [Credit card] costs . . . often hit *responsible* credit card users. . . .

---

6. *See, e.g.*, DEPT. OF TREASURY, FINANCIAL REGULATORY REFORM, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 2 (2009); POSNER, *supra* note 2, at 18–40. Christine Klein's Article in this *Issue* describes the contribution of the debt culture to the financial culture. Christine A. Klein, *The Environmental Deficit: Applying Lessons from the Economic Recession*, 53 ARIZ. L. REV. 651 (2009).

7. *See* S. REP. NO. 111-16 (2009); H.R. REP. NO. 111-88 (2009). *See also* Michelle J. White, *Bankruptcy Reform and Credit Cards*, 21 J. ECON. PERSP. 175 (2007) (arguing that the main reason for the dramatic growth in personal bankruptcy filings during the past three decades is the growth in credit card debt).

8. Pub. L. No. 111-24, 123 Stat. 1734 (2009).

9. *Id.* § 101(a), amended 15 U.S.C. § 1637.

10. *Id.* § 101(b), amended 15 U.S.C. § 1666.

11. *Id.*

12. *Id.* § 102(a), codified at 15 U.S.C. § 1637. Double-cycle billing occurs when a cardholder with no previous balance does not pay the entire balance of a new purchase by the payment due date, then—on the next periodic billing statement—the issuer computes interest on the original balance of the purchase. For example if the cardholder makes a $1000 purchase and pays off $950 in the first month, under double-cycle billing, she would be charged interest on the $1000 in the next month.

13. *Id.* § 102(b), codified at 15 U.S.C. § 1665(d).

> With this bill, we're putting in place some common-sense reforms designed to protect consumers . . . . [W]e're not going to give people a free pass; we expect consumers to live within their means and pay what they owe. But we also expect financial institutions to act with the same sense of *responsibility* that the American people aspire to in their own lives.[14]

President Obama's remarks highlight a perceived tension between personal responsibility and regulation. Many believe that personal responsibility diminishes the need for government regulation and that government regulation leads to dependency and irresponsibility.[15] President Obama, therefore, stressed both that common practices of credit card companies hit many responsible credit card holders and that the Credit CARD Act does not relieve consumers of their responsibility to pay debts to credit card companies in full.

The central property of the new regulatory era is the acknowledgment that bad things may happen to responsible individuals and that regulations may support and enable, rather than replace, personal responsibility.[16] The Credit CARD Act offers just one example of a regulatory regime that intends to protect responsible consumers from abusive practices of lenders. But other examples abound: the Lilly Ledbetter Fair Pay Act[17]—the first bill that President Obama signed into law—expanded the scope of protection against discrimination for employees.[18] Recent federal, state, and municipal initiatives attempt to increase awareness of calorie consumption and help individuals to address certain weight and weight problems.[19] Other initiatives seek to encourage individuals to be more

---

14. Remarks by President Barack Obama at Signing of the Credit Card Accountability, Responsibility and Disclosure Act (May 22, 2009) (emphasis added).

15. *See, e.g.*, Sonia Sotomayor, *Returning Majesty to the Law and Politics: A Modern Approach*, 30 SUFFOLK U. L. REV. 35, 40 (1996) (noting that "[s]ome would argue that reliance on regulations alone defuses the notion of personal responsibility and accountability"). One reflection of this view is the resentment of rescuing failing companies. *See, e.g.*, James Surowiecki, *Too Dumb to Fail*, NEW YORKER, Mar. 31, 2008 ("Rescuing failing companies obviously runs the risk of creating moral hazard—if we insulate people from the consequences of their irresponsibility, they're more likely to be irresponsible in the future.").

16. *See, e.g.*, RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008) (examining common human biases and offering several potential regulatory implications).

17. Pub. L. 111-2, 123 Stat. 5 (2009).

18. In *Ledbetter v. Goodyear Tire & Rubber Co.*, 550 U.S. 618 (2007), the Supreme Court held that employees are barred from filing pay discrimination claims that are based on employer's decisions made 180 days ago or more. The Lilly Ledbetter Fair Pay Act overruled the Supreme Court decision, providing that the 180-day limitation starts with the last discriminatory act.

19. *See, e.g.*, Menu Education and Labeling ("MEAL") Act, S. 3484, 109th Cong. (2006); Labeling Education and Nutrition ("LEAN") Act of 2008, H.R. 7187, S. 3575, 110th Cong. (2008); Labeling Education and Nutrition ("LEAN") Act of 2009, S. 558, 111th Cong. (2009); CAL. HEALTH & SAFETY CODE § 114094 (2009); N.Y. CITY HEALTH CODE § 81.50. *See also* N.Y. State Rest. Ass'n v. N.Y. City Bd. of Health, 556 F.3d 114 (2d Cir. 2009) (upholding the validity of the New York City menu labeling ordinance).

environmentally responsible by imposing a tax on disposable grocery bags.[20] The Family Smoking Prevention and Tobacco Control Act[21] grants the Food and Drug Administration (FDA) the power to regulate tobacco products,[22] reshapes the mandatory cigarette label and advertising warnings,[23] and requires tobacco companies to disclose to the FDA all delivery methods of nicotine, all ingredients of their products and changes thereof, and any research into the health, toxicological, behavioral, or physiologic effects of tobacco products.[24] The Obama Administration has also raised the cost of smoking to overcome the addiction to cigarettes or to avoid them altogether.[25]

These statutes and initiatives merely illustrate the present regulatory trend to increase protection for individuals and to create infrastructure to support and enable personal responsibility. They are not free of criticism[26] and over time some inevitably will prove ineffective and some will have unintended consequences. Regulatory measures of these kinds have always existed, but their present high density signifies a deviation from the traditional perception that responsible individuals can control their fate and improve their well-being, and that regulation defuses values of responsibility.

A prominent manifestation of the traditional approach, which considered personal responsibility and regulation to be substitutes, is the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) of 1996[27] that ended welfare as an entitlement program. PRWORA requires welfare recipients to find a job to maintain some welfare eligibility, restricts the scope of welfare eligibility, and is expressly designed to encourage two-parent families and discourage out-of-wedlock births. PRWORA is based on the premise that welfare leads to dependency and personal responsibility negates the need for welfare.[28]

---

20. *See, e.g.*, The Plastic Bag Reduction Act of 2009, H.R. 2091, 111th Cong. (2009); The District of Columbia Anacostia River Clean Up and Protection Act of 2009 (July 7, 2009).

21. Pub. L. No. 111-31, 123 Stat. 1845 (2009). A month before President Obama signed into law the Family Smoking Prevention and Tobacco Control Act, the D.C. Circuit delivered a victory to the Department of Justice in an action against the tobacco industry. United States v. Philip Morris USA, Inc., 566 F.3d 1095 (D.C. Cir. 2009). The court held the tobacco manufacturers' use of terms "light" and "low tar" to market their products was misleading and its decision had a regulatory effect on tobacco marketing.

22. Pub. L. No. 111-31, § 101.

23. *Id.* §§ 201–206.

24. *Id.* § 101.

25. 27 C.F.R. §§ 40, 41, 44, 45, 46, 71 (2008) (increased tax rates on all tobacco products).

26. Section 907 of the Family Smoking Prevention and Tobacco Control Act, for example, has been harshly criticized for exempting menthol from the artificial and natural flavors that tobacco manufacturers may add to cigarettes. Empirical evidence shows that menthol is one of the most effective flavors to promote addiction to cigarettes, especially among African Americans. *See, e.g.*, Phillip S. Gardiner, *The African Americanization of Menthol Cigarette Use in the United States*, 6 NICOTINE & TOBACCO RES. S55 (2004).

27. Pub. L. No. 104-193, 110 Stat. 2105 (1996).

28. Lawrence Mead, a scholar of poverty and welfare, coined the term "new paternalism" to describe PRWORA because it encourages individuals to become

Another example of the traditional approach to personal responsibility and regulation is the Commonsense Consumption Act Bill and its predecessors.[29] These bills, with some exceptions, prohibit new and require dismissal of pending civil actions against manufacturers, distributors, advertisers, and sellers of food for any injury related to a person's accumulated acts of consumption of food and weight gain, obesity, or any associated health condition.[30] Since 2005, the bills spell out their rationale in plain English:

> [B]ecause fostering a culture of acceptance of personal responsibility is one of the most important ways to promote a healthier society, lawsuits seeking to blame individual food and beverage providers for a person's weight gain, obesity, or a health condition associated with a person's weight gain or obesity are not only legally frivolous and economically damaging, but also harmful to a healthy America.[31]

The House passed some of the bills, but ultimately none of them became law. Their spirit, however, reflects the strong conviction that personal responsibility is a cure for many illnesses.

In 2001, two years before the introduction of the first Commonsense Consumption Bills,[32] the Surgeon General published a "Call to Action to Prevent and Decrease Overweight and Obesity."[33] In this report, the Surgeon General explained why personal responsibility may not suffice to address overweight and obesity problems and what types of public policies are needed to support and enable personal responsibility:

> Many people believe that dealing with overweight and obesity is a personal responsibility. To some degree they are right, but it is also a community responsibility. When there are no safe, accessible places for children to play or adults to walk, jog, or ride a bike, that

---

responsible for their actions and sanction those who are not responsible for their actions. Lawrence M. Mead, *The Rise of Paternalism*, *in* THE NEW PATERNALISM 1 (Lawrence M. Mead ed., 1997). This concept by definition perceives personal responsibility as a means to overcome the need for welfare.

29. The Commonsense Consumption Act of 2009, H.R. 812, 111th Cong. (2009); the Commonsense Consumption Act of 2007, H.R. 2183, S. 1323, 110th Cong. (2007); the Personal Responsibility in Food Consumption Act of 2005, H.R. 554, 109th Cong. (2005); the Personal Responsibility in Food Consumption Act, H.R. 339, 108th Cong. (2003); the Commonsense Consumption Act of 2003, S. 1428, 108th Cong. (2003).

30. Civil liability often has the effect of regulation, although because of its ex post nature it is not totally equivalent. *See generally* Steven Shavell, *Liability for Harm Versus Regulation of Safety*, 13 J. LEGAL STUD. 357 (1984); AM. ENTER. INST.-BROOKINGS JOINT CTR. FOR REGULATORY STUDIES, REGULATION THROUGH LITIGATION (W. Kip Viscusi ed., 2002); Donald Wittman, *Prior Regulation Versus Post Liability: The Choice Between Input and Output Monitoring*, 6 J. LEGAL STUD. 193 (1977). *See also* Mary J. Davis, *The Supreme Court and Our Culture of Irresponsibility*, 31 WAKE FOREST L. REV. 1075 (1996).

31. *See, e.g.*, The Commonsense Consumption Act of 2009, H.R. 812 § 2(a)(4).

32. *See, e.g.*, H.R. 554; the Personal Responsibility in Food Consumption Act, H.R. 339; the Commonsense Consumption Act of 2003, S. 1428.

33. THE SURGEON GENERAL'S CALL TO ACTION TO PREVENT AND DECREASE OVERWEIGHT AND OBESITY (2001).

> is a community responsibility. When school lunchrooms or office cafeterias do not provide healthy and appealing food choices, that is a community responsibility. When new or expectant mothers are not educated about the benefits of breastfeeding, that is a community responsibility. When we do not require daily physical education in our schools, that is also a community responsibility. There is much that we can and should do together.[34]

The concept of utilizing regulation to develop and support personal responsibility is therefore surely not new in theory. However, in a political landscape that until very recently considered personal responsibility and regulation as substitutes for one another, the concept is still radical for some and is likely to draw many objections from those who still believe that regulation defuses notions of personal responsibility.[35]

Christine Klein's Article argues that the financial crisis has dramatically affected responsibility and risk perceptions of individuals and institutions.[36] These changes, Klein predicts, will in turn mobilize public attitudes toward sustainable environmental regulation. At first glance, Klein's observation may support the belief in inverse relations between personal responsibility and regulation because it suggests that exogenous events influence levels of responsibility. Considering the outcome of the 2008 election and actual actions of individuals, it seems, however, that a better interpretation of this observation would be that the crisis convinced individuals that they are better off being more informed and having a government that engages in responsible regulation in many domains. Klein's conclusions seem to be consistent with this interpretation.

III. THE INVISIBLE HAND AND RATIONALITY

The belief in inverse relations between personal responsibility and regulation has strong roots in neoclassic economic thinking. Adam Smith envisioned a simple world, in which:

> [E]very individual . . . neither intends to promote the public interest, nor knows how much he is promoting it. . . . [H]e intends [to promote] only his own gain, and he is . . . led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of the society . . . .[37]

Variants of this view led many to believe that regulation is socially undesirable.

Some of greatest minds of the twentieth century explained how individuals are likely to evolve to make rational decisions of the kind that Adam Smith believed would promote social welfare. For example, Friedrich Hayek

---

34. *Id.* at XIII–XIV.

35. For contemporary criticism of this kind, see Edward L. Glaeser, *Paternalism and Psychology*, 73 U. CHI. L. REV. 133 (2006); Jonathan Klick & Gregory Mitchell, *Government Regulation of Irrationality: Moral and Cognitive Hazards*, 90 MINN. L. REV. 1620 (2006).

36. Klein, *supra* note 6.

37. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 477 (Univ. of Chi. Press 1976) (1776).

argued that the evolutionary forces of competition would necessarily spread rationality in markets:

> [C]ompetition will make it necessary for people to act rationally to maintain themselves. . . . [A] few relatively more rational individuals will make it necessary for the rest to emulate them in order to prevail. In a society in which rational behaviour confers an advantage on the individual, rational methods will progressively be developed and spread by imitation.[38]

Milton Friedman offered a softer account for human behavior: people are not perfectly rational in the sense that they may not actually solve complicated problems of utility maximization, but they act *as if* they do so.[39]

Because a rational human being maximizes his own utility, a rational person will be responsible, unless he can rely on the state (or someone else) to provide for him. Put simply, when individuals are rational or act *as if* they were rational, they would act responsibly or rely on someone else when this option lowers their own costs. Thus, the rationality assumption seems to suggest that regulation may indeed reduce personal responsibility.

In practice, the intuitive doubts about the ability of humans to consistently engage in rational conduct are substantiated by ample empirical evidence that documents patterns of behavioral biases.[40] Therefore, strong conclusions that build on the rationality premise should be taken with great caution at the very least.[41] Empirical evidence also shows that, contrary to the dependency prediction, individuals who are eligible for welfare benefits often do not take advantage of those benefits.[42]

Hayek died in 1992 and Friedman passed away in 2006. They did not have the opportunity to reevaluate their convictions in light of the pervasiveness of excessive use of credit that ultimately led to the financial crisis of the fall of 2008. Such an opportunity, however, probably would not have affected the views of these two great economists who enormously influenced common perceptions of government in the twentieth century. In the Great Crash of October 1929 that began the Great Depression, Hayek was 30 years old and Friedman was 17. In their lifetimes they observed how irrational investor conduct caused the largest

---

38. FRIEDRICH A. HAYEK, LAW, LEGISLATION, AND LIBERTY: THE POLITICAL ORDER OF A FREE PEOPLE, vol. 3, 75 (1982).

39. Milton Friedman, *The Methodology of Positive Economics*, *in* ESSAYS IN POSITIVE ECONOMICS 3 (1953).

40. *See, e.g.*, ADVANCES IN BEHAVIORAL ECONOMICS (Colin F. Camerer et al. eds., 2003); CHOICES, VALUES, AND FRAMES (Daniel Kahneman & Amos Tversky eds., 2000); RICHARD H. THALER, QUASI RATIONAL ECONOMICS (1992). *See also* Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

41. In 2006, Richard Epstein published an article in defense of the rationality assumption, expressing his conviction in the ability of market forces to correct human errors and skepticism of regulation. *See* Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111 (2006).

42. *See, e.g.*, Barak Y. Orbach, *Unwelcome Benefits: Why Welfare Beneficiaries Reject Government Aid*, 24 L. & INEQ. 107 (2006).

economic disaster in American history.[43] Both were highly educated and knew of previous bubbles that resulted in devastating financial catastrophes.[44] History and their own observations did not shake their belief that individuals at the very least act *as if* they were rational and, therefore, regulation is socially undesirable. In fact, Friedman lived long enough to observe the rapidly growing rates of obesity among American adults,[45] which was another point of reference that potentially could have suggested that many humans did not act *as if* they were rational.

One of the lessons of the fall of 2008 is that, contrary to Hayek's prediction, competitive markets can accommodate and even encourage the irrational conduct of many individuals, because the irrational conduct of one person may benefit another at least in the short term. Moreover, Hayek did not consider the possibility that the irrational conduct of many individuals may have interrelated effects that would affect the entire population, including those who acted rationally. In the fall of 2008, it became clear that the irrational investments of millions created a national problem for virtually every person who had savings or investments in real estate.

Today, nobody seriously argues that humans act rationally and the remaining political and academic debates are about whether irrationality should be regulated and if so how much.[46] The fall of 2008 stressed that, in certain domains, irrationality of individuals may have interrelated effects that may shake the entire economy. Under such circumstances, the regulation of irrational conduct may well be socially desirable. To the extent that any lessons were learned from the fall of 2008, a likely characteristic of the new regulatory era will be an attempt to isolate and address conduct patterns that can have interrelated effects.[47]

IV. EXTERNALITIES AND THE RELEVANCE OF RATIONALITY

Even if all humans were acting *as if* they were rational, we never could have assumed that some invisible hand would always—or often enough—direct them to promote social interests. Absent effective regulatory measures or concerns of legal liability, rational individuals (or firms) may harm others when such a course of action serves their interests. Alternatively, absent appropriate incentives, rational individuals (or firms) may not engage in activities that confer benefits to others if they cannot charge for those benefits. Put simply, responsibility, rationality, and the invisible hand are unlikely to resolve *all* externality problems.[48]

---

43. *See* JOHN KENNETH GALBRAITH, THE GREAT CRASH 1929 (1954).

44. *See, e.g.*, PETER M. GARBER, FAMOUS FIRST BUBBLES: THE FUNDAMENTALS OF EARLY MANIAS (2000).

45. *See* SURGEON GENERAL, *supra* note 33, at VI–VII (showing the rapid growth of obesity across the United States between 1991 and 2000).

46. *See, e.g.*, Epstein, *supra* note 41; Klick & Mitchell, *supra* note 35.

47. The annual medical costs of obesity increased from $78.5 billion in 1998 to an estimated $147 billion in 2008. Eric A. Finkelstein et al., *Annual Medical Spending Attributable to Obesity: Payer- and Service-Specific Estimates*, HEALTH AFFAIRS, Jul. 27, 2009. Considering the size of the population, this figure suggests that obesity presents significant interrelated effects.

48. *See generally* ARTHUR CECIL PIGOU, THE ECONOMICS OF WELFARE 183–203 (4th ed. 1932).

When the social norm is that people take certain vaccines, it may be rational for an individual not to submit himself and his children to the vaccines because the general population is vaccinated. This choice, however, increases certain health risks to the entire population.[49] When tobacco companies transact with smokers, the assumed rationality of the transacting parties does not extend to the interest of third parties who are affected through secondhand and thirdhand smoking. It was not the invisible hand that led smokers and tobacco companies to confine smoking in designated areas and to disclose information about nicotine levels in tobacco products. Rather, it was the visible regulatory hand of non-smokers and the drafting of Congressman Henry Waxman.[50]

The notion that externalities call for regulation is quite conventional. John Stuart Mill argued that restraints on behavior should be limited to prevention of harm to others (i.e., externalities).[51] Arthur Pigou also did not have the term "externality" at his disposal,[52] but his discussion of "divergence between social and private net product"[53] is essentially all about externalities. In his seminal book, *The Economics of Welfare*, Pigou explained the rationale for regulation in the presence of externalities:

> It is plain that divergences between private and social net product . . . cannot . . . be mitigated by a modification of the contractual relation between any two contracting parties, because the divergence arises out of a service or disservice rendered to persons other than the contracting parties. It is, however, possible for the State . . . to remove the divergence . . . by "extraordinary encouragements" or "extraordinary restraints. . . ."[54]

---

49. *See, e.g.*, Jacobson v. Mass., 197 U.S. 11 (1905) (upholding the constitutionality of a law that mandated smallpox vaccination). The 2009 outbreak of swine flu prompted the New York Department of Health to adopt a regulation that requires all health care personnel be immunized against influenza. 66-3 Health Care Personnel Influenza Vaccination Requirements (Aug. 13, 2009).

50. Congressman Henry Waxman sponsored the Family Smoking Prevention and Tobacco Control Act and championed many prior congressional campaigns against the tobacco industry. On April 14, 1994, as the Chair of the House of Representatives Health and the Environment Subcommittee, he led the famous hearing on tobacco products, in which the CEOs of the seven largest tobacco companies testified under oath that nicotine is not addictive, despite the conclusive contradicting scientific evidence that Waxman's Subcommittee presented.

51. JOHN STUART MILL, ON LIBERTY AND OTHER ESSAYS 62 (John Gray ed., Oxford Univ. Press 2008) (1859).

52. Economists started using the term "external economies" in the early 1950s. *See, e.g.*, J. E. Meade, *External Economies and Diseconomies in a Competitive Situation*, 62 ECON. J. 54 (1952); Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387 (1954); Tibor Scitovsky, *Two Concepts of External Economies*, 62 J. POL. ECON. 143 (1954). It is unknown who coined the term "externality," but by 1958 it was part of the economic jargon. *See, e.g.*, Francis M. Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351 (1958); Paul A. Samuelson, *Aspects of Public Expenditure Theories*, 40 REV. ECON. & STAT. 332 (1958).

53. PIGOU, *supra* note 48, at 172–203.

54. *Id.* at 192.

In his celebrated article, *The Problem of Social Cost*, Ronald Coase harshly criticized Pigou, presenting him as a radical government interventionist,[55] although Pigou's point is rather straightforward. Herbert Hovenkamp's Article studies Coase's criticism of Pigou and shows that, like all other giants, Coase was standing on the shoulders of his predecessors, but ungraciously Coase chose not to give a proper credit to Pigou.[56] Armed with the typical Hovenkampian arsenal of depth and knowledge, the Article points out that Pigou was not naive about or hostile toward notions of bargaining and transaction costs. Pigou acknowledged an obvious point: state intervention may be desirable in some situations where bargaining is unlikely to succeed.

The observation that externalities may warrant regulation when bargaining is unlikely to succeed does not build on any rationality assumption. Bargaining may fail irrespective of the parties' rationality for diverse reasons, such as the parties' costs of locating each other and other forms of transaction costs. We therefore cannot conclude that rationality and responsibility negate the need for regulation. In the presence of externalities, they *may* be irrelevant.

V. SLIPPERY SLOPES AND REGULATORY COMPETENCY

Mario Rizzo and Douglas Whitman's Article presents sharp and strong objections to the "new paternalism" that "claims that careful policy interventions can help people make better decisions."[57] Rizzo and Whitman focus on the slippery-slope criticism against regulation and specifically the argument that soft paternalism may lead to hard paternalism, or in their words: "moderation is not sustainable . . . slippage is most likely."[58]

While Rizzo and Whitman raise serious valid concerns about *potential* sliding on slippery slopes, they do not examine actual changes in ideological hard paternalism with the rise of soft paternalism. Ideological hard paternalism has always been around and probably will never disappear. Controversial examples include bans on sodomy,[59] restrictions on same-sex intimate relationships,[60] bans

---

55. Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

56. Herbert Hovemkamp, *The Coase Theorem and Arthur Cecil Pigou*, 53 ARIZ. L. REV. 633 (2009). For earlier criticism see A.W. Brian Simpson, Coase v. Pigou *Reexamined*, 25 J. LEGAL STUD. 53 (1996). Coase exhibited some obsession with Pigou. Significant parts of his 1988 book dismiss Pigou's ideas and harshly criticize him. RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW (1988).

57. Mario J. Rizzo & Douglas Glen Whitman, *Little Brother Is Watching You: New Paternalism on the Slippery Slopes*, 53 ARIZ. L. REV. 685, 685 (2009).

58. *Id.* at 688.

59. *See, e.g.*, ALA. CODE § 13A-6-60, 65 (defining "deviate sexual intercourse" as "[a]ny act of sexual gratification between persons not married to each other involving the sex organs of one person and the mouth or anus of another" and prohibiting such 'sexual misconduct'); GA. CODE ANN. § 16-6-2 (2009) ("A person commits the offense of sodomy when he or she performs or submits to any sexual act involving the sex organs of one person and the mouth or anus of another."). For the history of sodomy laws in the United States, see generally, WILLIAM N. ESKRIDGE, JR., DISHONORABLE PASSIONS: SODOMY LAWS IN AMERICA, 1861-2003 (2008).

60. *See, e.g.*, MICH. COMP. LAWS ANN. § 750.338 (2004) ("Any male person who, in public or in private, commits or is a party to the commission of or procures or

on abortions,[61] bans on same-sex marriage,[62] prohibitions against teaching evolution in public schools,[63] and criminalization of fornication.[64] Some of these forms of hard paternalism were already abandoned because courts held them unconstitutional.[65] Others are still in effect at least in some states. There is no conceptual link between soft paternalism that intends to improve individual decision-making and ideological hard paternalism. The governing political trend in the new regulatory era, however, seems to be hostile toward ideological hard

attempts to procure the commission by any male person of any act of gross indecency with another male person shall be guilty of a felony . . . ."); TEX. PENAL CODE ANN. § 21.06(a) (2003) ("A person commits an offense if he engages in deviate sexual intercourse with another individual of the same sex."). The Texas ban was declared unconstitutional in *Lawrence v. Texas*, 539 U.S. 558 (2003). *See generally*, ESKRIDGE, *supra* note 59, at 73–108, 299–386.

61. In *Roe v. Wade*, the challenged ban on abortions was a Texas statute (TEX. PENAL CODE §§ 1191–94, 1196 (1973)), but Justice Blackmun, who delivered the decision of the Supreme Court, also surveyed other state prohibitions against abortions that were valid at the time. *See* Roe v. Wade, 410 U.S. 113, 118 n.2 (1973). *See generally* LESLIE J. REAGAN, WHEN ABORTION WAS A CRIME: WOMEN, MEDICINE, AND LAW IN THE UNITED STATES, 1867–1973 (1997).

62. *See, e.g.*, ALA. CONST. art. I, § 36.03 ("Marriage is inherently a unique relationship between a man and a woman."); ALASKA CONST. art. 1, § 25 ("[A] marriage may exist only between one man and one woman."); ARIZ. CONST. art. 30, § 1 ("Only a union of one man and one woman shall be valid or recognized as a marriage in this state."); ARK. CODE ANN. § 9-11-109 (2009) ("Marriage shall be only between a man and a woman. A marriage between persons of the same sex is void."); CAL. CONST. art. 1, § 7.5 ("Only marriage between a man and a woman is valid or recognized in California.").

63. *See, e.g.*, the Tennessee Anti-Evolution Act of 1925 ("[I]t shall be unlawful for any teacher in any of the Universities, normals and all other public schools of the state which are supported in whole or in part by the public school funds of the state, to teach any theory that denies the story of the divine creation of man as taught in the Bible, and to teach instead that man has descended from a lower order of animals."). This statute was the basis for the famous "Scopes Monkey Trial" in which John Scopes was convicted for teaching the theory of evolution in Tennessee. Scopes v. State, 154 Tenn. 105 (1927). As to the trial, see THE WORLD'S MOST FAMOUS COURT TRIAL: TENNESSEE EVOLUTION CASE (1925); EDWARD J. LARSON, SUMMER FOR THE GODS: THE SCOPES TRIAL AND AMERICA'S CONTINUING DEBATE OVER SCIENCE AND RELIGION (1997).

64. *See, e.g.*, GA. CODE ANN. § 16-6-18 (2009) ("An unmarried person commits the offense of fornication when he voluntarily has sexual intercourse with another person. . . ."); MASS. GEN. LAWS ANN. ch. 272, § 18 (2000) ("Whoever commits fornication shall be punished by imprisonment for not more than three months or by a fine of not more than thirty dollars."); IDAHO CODE ANN. § 18-6603 (2009) ("Any unmarried person who shall have sexual intercourse with an unmarried person of the opposite sex shall be deemed guilty of fornication . . . ."); ILL. COMP. STAT. ANN. 720/11-8 (2009) ("Any person who has sexual intercourse with another not his spouse commits fornication if the behavior is open and notorious.").

65. *See, e.g.*, Lawrence v. Texas, 539 U.S. 558 (2003) (striking down Texas's sodomy law); Epperson v. Arkansas, 393 U.S. 97 (1968) (holding that the Arkansas anti-evolution statute was unconstitutional); *In re* J.M., 276 Ga. 88 (2003) (holding that the Georgia fornication statute was unconstitutional).

paternalism.[66] It is therefore unclear that the number of bans, mandatory requirements, and other forms of hard paternalism is likely to increase.

Furthermore, to the extent that the "soft paternalism" that defines the new regulatory era may slide to hard paternalism, such as bans on smoking or bans on use of grocery plastic bags,[67] the question remains whether this slippage is necessarily bad or wrong. Autonomy and freedom are always relative and may be restricted when their exercise entails harm or costs to others.[68] There is no controversy today that smoking and use of grocery plastic bags are socially costly, although it may be difficult to quantify these costs. Smoking serves no function other than satisfying addiction cravings and grocery plastic bags have affordable substitutes. It is therefore unclear that the bans on smoking and grocery plastic bags are necessarily socially undesirable. The same argument applies to other forms of hard paternalism. Less than a century ago, prohibitions against child labor were controversial in this country.[69] They are no longer controversial. Hard paternalism is not always evil or wrong.

History offers examples of a slippage from soft to hard paternalism. The Pure Food and Drug Act of 1906[70] introduced a mixture of regulatory innovations that included hard paternalism and soft paternalism. It banned the interstate commerce in any article of adulterated or poisonous food or drugs,[71] and the production of such items in the District of Columbia and the territories.[72] It introduced soft paternalism by criminalizing misbranding of any article of food or drugs,[73] requiring manufacturers to state "on the label of the quantity or proportion of any morphine, opium, cocaine, heroin, alpha or beta eucane, chloroform, cannabis indica, chloral hydrate, or acetanilide, or any derivative or preparation of

---

66. *See, e.g.*, Federal Benefits and Non-Discrimination, 74 Fed. Reg. 29,393 (June 22, 2009) (instructing heads of executive departments and agencies to extend certain spousal benefits to same-sex partners).

67. Some municipalities already banned the use of grocery plastic bags altogether. *See, e.g.*, WESTPORT, CONN., CODE § 46, art. VI (2008); Edmonds, Wash., Plastic Bag Reduction, Ordinance No. 3749 (July 28, 2009). *See also* An Act Relative to Decreasing Environmental Hazards, Toxins, and Litter, Mass. House Bill No. 798 (2009) (prohibiting retail establishment with annual gross income in excess of $500,000 to give, provide, or make available plastic carryout bags to customers).

68. *See supra* Part IV.

69. *See, e.g.*, Hammer v. Dagenhart, 247 U.S. 251 (1918) (holding that the Keating-Owen Child Labor Act of 1916 that restricted child labor was unconstitutional); The Child Labor Tax Case, 259 U.S. 20 (1922) (invalidating a federal tax imposed on goods produced with child labor). For the history of the child labor debate, see HUGH D. HINDMAN, CHILD LABOR: AN AMERICAN HISTORY (2002); KRISTE LINDENMEYER, A RIGHT TO CHILDHOOD: THE U.S. CHILDREN'S BUREAU AND CHILD WELFARE, 1912–1946 (1997).

70. Pub. L. No. 59-384, 34 Stat. 768 (1906).

71. *Id.* § 2.

72. *Id.* § 1. For earlier forms of bans on adulterated food, see Peter Barton Hutt & Peter Barton Hutt II, *A History of Government Regulation of Adulteration and Misbranding of Food*, 39 FOOD, DRUG & COSM. L.J. 2, 35–47 (1984).

73. Pub. L. No. 59-384, §§ 1–2.

any of such substances contained therein."[74] In 1914, this soft paternalism slipped a bit with the Harrison Act,[75] which imposed registration and record-keeping requirements on the production and sale of opium and cocaine. In 1938, the inevitable slippage emerged: with questionable authority, the FDA interpreted the 1938 Food, Drug, and Cosmetic Act[76] to allow it to require drug prescriptions.[77] In 1951, Congress gave its blessing to this interpretation and slippage.[78] Some believe that the prohibitions against narcotics are socially undesirable.[79] Sam Peltzman argued that the enforcement of prescription-only regulation did not significantly improve the health of drug consumers.[80] It may well be that the United States can and should improve its drug policies, but again it remains highly questionable whether all forms of hard paternalism in this domain are undesirable.

Put simply, "slippage" may represent a regulatory progress because bans and mandatory requirements, or so-called "hard paternalism," may be socially desirable. A cost-benefit comparison of available regulatory means,[81] together with the social costs of lack of regulation, is needed in order to determine whether some form of "hard paternalism" is required.

Rizzo and Whitman's concerns about slippages seem to be shaped by their general skepticism of government competency.[82] Rebecca Bratspies' Article presents the opposing position, or at least a framework for optimism.[83] Bratspies explains that the inevitable uncertainty under which regulatory agencies operate erodes public trust. She lays out principles of administration that may untangle the distrust and build credibility.

VI. THE RISE FROM THE FALL

In the fall of 2008, it became clear, even to zealous free-market advocates such as the "Maestro" Greenspan and Judge Posner, that the laissez-faire regulatory model was bankrupt and took down with it many businesses and individuals. The flaws and failures of this model were old news to many scholars

---

74. *Id.* § 8. For the historical background of the statute, see JAMES HARVEY YOUNG, PURE FOOD: SECURING THE FEDERAL FOOD AND DRUGS ACT OF 1906 (1989).

75. 38 Stat. 785 (1914).

76. Pub. L. No. 75-717, 52 Stat. 1040 (1938).

77. 3 Fed. Reg. 3168 (Dec. 28, 1938).

78. Pub. L. No. 82-215, 65 Stat. 648 (1951). For the introduction of mandatory prescriptions, see Sam Peltzman, *The Health Effects of Mandatory Prescriptions*, 30 J.L. & ECON. 207 (1987); Peter Temin, *The Origin of Compulsory Drug Prescriptions*, 22 J.L. & ECON. 91 (1979).

79. *See, e.g.*, Jeffrey A. Miron & Jeffrey Zwiebel, *The Economic Case Against Drug Prohibition*, J. ECON. PERSP., Fall 1995, at 175 (1995).

80. Peltzman, *supra* note 78.

81. For cost-benefit analysis see generally Symposium, *Cost-Benefit Analysis and Agency Decision-Making: An Analysis of Executive Order No. 12,291*, 23 ARIZ. L. REV. 1195 (1981); Symposium, *Cost-Benefit Analysis: Legal, Economic, and Philosophical Perspectives*, 29 J. LEGAL STUD. 837 (2000); CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002).

82. *See, e.g.*, Mario J. Rizzo & Douglas Glen Whitman, *The Knowledge Problem of New Paternalism*, 2009 BYU L. REV. (forthcoming).

83. Rebecca M. Bratspies, *Regulatory Trust*, 53 ARIZ. L. REV. 575 (2009).

of regulation and policymakers, but the inertia of the belief in market forces and skepticism of regulation kept the model alive.

Market forces are the engine of the economy and will always remain such. Nobody intends to replace market forces with central planning. In the new regulatory era, however, the state will be much more active in assuring the functioning of market forces, protecting consumers, and guarding individuals, firms, wildlife, and the environment from externalities. Mistakes will be made, but we have learned that the costs of inaction could be very high.

***